

**THE ROLE OF FOREIGN POLICY IN ECONOMIC DEVELOPMENT IN KENYA,  
1990-2010**

**BY  
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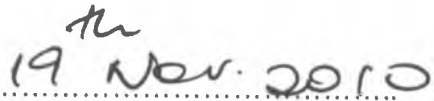


## DECLARATION

This research project is my original work and has not been submitted for a degree to any other university.

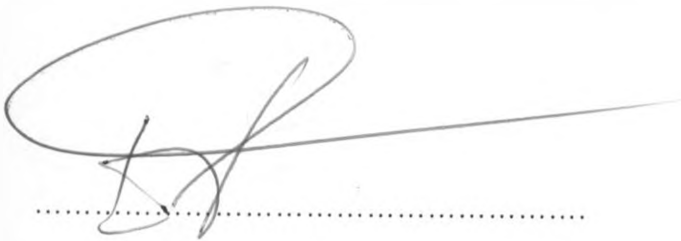


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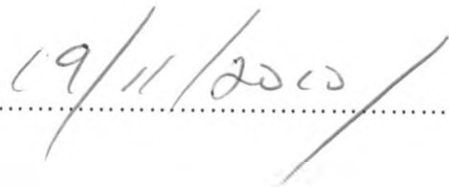


Date

This research project has been submitted for examination with my approval as a University Supervisor



Dr. Ibrahim Farah



Date

## DEDICATION

I would like to dedicate this research to my loving wife Rosy, dear parents Peter and Ruth and siblings for their precious support and belief in me.

## ACKNOWLEDGEMENT

First and foremost I would like to thank the Almighty God for his grace and faithfulness without which this study would not be possible.

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## LIST OF ABBREVIATIONS

AGOA	African Growth and Opportunity Act
APEC:	Asia Pacific Economic Commission
APEF	Asia Pacific Economic Forum
ASEAN:	Association of South East Asian Nations
BIT	Bilateral Investment Treaties
CBK:	Central Bank of Kenya
CIC:	Capital Investments Committee
COMESA	Common Market for Eastern and Southern African
DFCK:	Development Finance Company of Kenya
DRC:	Democratic Republic of Congo
DTT	Double Taxation Treaties
EAC:	East Africa Community
EC:	Economic Commission
EDB	Economic Development Board
EPZ:	Export Processing Zones
EPZA:	Export Processing Zones Authority
EU	European Union
FDI:	Foreign Direct Investment
FIPA	Foreign Investment Protection Act
GCF	Gross Capital Formation
GDP	Gross Domestic Product
IBEAC:	Imperial British East Africa Company
ICSID	International Center for Settlement of Investment
ICT	Information Communication and Technology
IDB:	Industrial Development Bank
IGAD:	Inter Governmental Authority on Development
IMF:	International Monetary Fund
IORARC:	Indian Ocean Rim Association on Regional Cooperation
IPC	Investments Promotion Center
ISPC	Industrial Survey and Promotion Center
JEC:	Joint Economic Council

KANU:	Kenya African National Union
KEBS:	Kenya Bureau of Standards
KIA	Kenya Investment Authority
KIE:	Kenya Industrial Estates
KIRDI:	Kenya Industrial Research and Development Institute
MFA	Ministry of Foreign Affairs
MIGA	Multilateral Investment Guaranteed Agency
MNC:	Multinational Corporations
NAM	Non Alignment Movement
NARC	National Rainbow Coalition
NPC:	New Projects Committee
NSE:	Nairobi Stock Exchange
NSTB:	National Science and Technical Board
OAU	Organization of African Unity
OAU:	Organization of African Unity
PTA:	Preferential Trade Area
SADC:	Southern Africa Development Community
TNC	Trans-National Corporation
UK:	United Kingdom
UNCTAD	United Nations Council on Trade and Development
US:	United States
USSR	Union of Soviet Socialist Republics
WB:	World Bank
WIPO	World Intellectual Property Organization
WTO:	World Trade Organization

## ABSTRACT

One of the central goals of the foreign policy of a country is to foster its economic development. This is especially so in the post-cold war period where economic diplomacy has gained currency replacing the predominant political and security preoccupations of the cold war era. The 1990s were crucial to states as they had to do undertake some adjusting to conform to the new world order which was inspired by liberal ideals that advocated free market economy, including free trade and other forms of economic exchanges to spread economic prosperity. Among the many ways through which states sought to promote their economic development is the pursuit of Foreign Direct Investment (FDI). Many states embarked on economic and political reforms with a view to attracting the same. Others had a negative view of FDI terming it a new form of neocolonialism. Yet others still grapple with to find the right formula to attract and exploit the benefits that FDI brings. This study examined the foreign policy of Kenya in the post cold war era and its contribution to economic development through inward FDI mobilization. It concluded that the former has been ineffective in mobilizing FDI despite embracing albeit begrudgingly, liberal economic ideals. However the little FDI that was realized during the period under review made significantly contributions to economic development especially in Information Communications and Technology (ICT). A review of the economic diplomacy of South East Asian countries also revealed that FDI has been at the very core of their development. It is thus the contention of this study that more needs to be done to bolster the economic diplomacy of Kenya to attract significant levels of FDI to promote economic development.

## CHAPTER ONE

### THE ROLE OF FOREIGN POLICY IN ECONOMIC DEVELOPMENT IN KENYA (1990-2010): INTRODUCTION TO THE STUDY

#### 1.1 Introduction

The end of the Cold war marked the end of the preeminence of military power in international relations.<sup>1</sup> States relegated political and military issues and took deliberate efforts to pursue foreign policies which would spur their economic growth and development.<sup>2</sup> This period also saw the rapid growth in the interdependence of states in a globalized world which underlined economic issues with economic diplomacy standing out as the most efficient instrument of foreign policy.<sup>3</sup> Earlier, states had taken cognizance of the value of the economic component of foreign policy. The United States (US) and United Kingdom (UK) have since the 1960s witnessed a progressive increase in economic diplomacy in their foreign policies.<sup>4</sup>

In the increasingly competitive international system, the value of economic diplomacy cannot be gainsaid. States are perpetually competing for economic gains and at the same time seeking to engage with likeminded partners so as to attract Foreign Direct Investments (FDI) and gain market access for their goods and services. Economic policy has evolved from “low politics” to “high politics” thus shifting focus on foreign policy from the political to the

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<sup>1</sup> J. W. Spanier and E. M. Uslander, *American Foreign Policy Making and the Democratic Dilemmas* (NY: Macmillan 1994), p.4.

<sup>2</sup> A. C. Alves, “Emerging Post-Colonial Solidarities: China’s New Economic Solidarity Towards Sub-Saharan Africa,” paper was presented to the 16th Biennial Conference of the Asian Studies Association of Australia in Wollongong 26 June - 29 June 2006.

<sup>3</sup> R. Saner, and L. Yiu, “Economic Diplomacy, Mutations in Post-modern Times,” Paper presented at the 2001 Annual Directors of Diplomatic Academies in Vienna Austria.

<sup>4</sup> J. Bandyopadhyaya, *The Making of India’s Foreign Policy*, (New Delhi: Allied Publishers PVT Ltd, 2003), p.183.

economic arena.<sup>5</sup> States have therefore, irrespective of whether they are economically developed or less developed, seen the importance of assigning a major role to economic diplomacy in their foreign policies.<sup>6</sup>

This study thus sought to examine the role of foreign policy on economic development in developing countries. The study focused on the relationship between the two variables using the Kenyan experience from 1990 up to including the month May 2010. The period under review witnessed a foreign policy priority shift from political to economic issues which coincided with varying levels economic growth. The motivation behind this study is to establish whether foreign policy really contributed to the economic development of Kenya during this period and if so to what extent.

## 1.2 Background

Foreign policy forms an integral part of a state's strategy in its interactions with other states and of late non-state actors, in the international system. In such a system states act in their own national interests though the liberal school of thought may want to add that states also act with common interests in mind.<sup>7</sup> Foreign policy must, either way, have the purpose of obtaining benefits for the state on behalf of which it is prosecuted.<sup>8</sup> This is especially so due to the anarchical environment in which the state operates and from which it seeks to guarantee its own

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<sup>5</sup> S. Wright, "The Changing Context of African Foreign Policies" Wright S. (ed), in *African Foreign Policies*, (Boulder: Westview Press 1999), pp.1-22:17.

<sup>6</sup> J. Bandyopadhyaya, *The Making of India's Foreign Policy*, op.cit. p.183.

<sup>7</sup> N. Bayne and S. Woolcock, "Theoretical Analysis of Economic Diplomacy," in N. Bayne and S. Woolcock, (eds), *The New Economic Diplomacy* (Hampshire: Ashgate 2007), pp.21-42:25.

<sup>8</sup> Okoth, P. G., "Crisis and Diplomacy in the Great Lakes Region of East and Central Africa: The Roles of Regional Actors, the United States and the United Nations" Paper Presented at the 6<sup>th</sup> Regional Conference on American Studies in Eastern Africa. The Future of US-African Relations July 8-12 1997 at Egerton University Kenya, p.33.

security.<sup>9</sup> The crucial goal of foreign policy is thus maximization of wealth through supplying among other things, markets, capital and technical skills to the extent that these are deficient in that state.<sup>10</sup> This is built on the fact that no one state is self sufficient as to survive on its own. The interdependence of nations more so in the economic realm is a contemporary reality hence a country must formulate the necessary policies to guide its economic relations with its partners.<sup>11</sup>

Economic diplomacy can be traced to the Cold War era. Up to the Second World War, scholars and statesmen tended to equate diplomacy with the political aspect of foreign relations.<sup>12</sup> However the bipolar world experienced developments in many fields which gave rise to a multifaceted approach to foreign policy including economic diplomacy. The Marshal Plan that was designed to bail out Europe out of the destructive nature of World War 2 and the rise of the International Monetary Fund (IMF) and the World Bank (WB) ushered in an era of economic diplomacy.<sup>13</sup>

Developing countries also engaged in economic diplomacy. The advent of independence to former colonies and the modernization drive in Asia, Africa and Latin America added a global economic dimension to international relations. Economic diplomacy was central in the realization of the economic development of these countries through securing foreign aid, capital and technology and for the promotion of exports.<sup>14</sup>

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<sup>9</sup> J. W. Spanier and E. M. Uslaner, *American Foreign Policy Making and the Democratic Dilemmas*, op. cit. pp 5-6.

<sup>10</sup> P. A. Reynolds. *An Introduction to International Relations*, (London: Longman, 1994), pp. 54-55: 54.

<sup>11</sup> D. K. Orwa, "Independent Kenya's External Economic Relations" in W. R. Ochieng, and R. M. Maxon, *An Economic History of Kenya* (Nairobi: EAEP, 1992), pp.389-404:389; see also K. S. Rana, "Economic Diplomacy: The Experience of Developing Countries", in N. Bayne and S. Woolcock, *The New Economic Diplomacy*, (Hampshire: Ashgate, 2007), pp. 201-220:201.

<sup>12</sup> J. Bandyopadhaya. *The Making of India's Foreign Policy*, op.cit. p.23

<sup>13</sup> Ibid pp.23-24.

<sup>14</sup> Ibid p.24.

Economic diplomacy however saw its profile raised in the post Cold War era. Economic robustness and strengths rapidly became the leading priorities of foreign policies as opposed to power being associated with military might.<sup>15</sup> The pre-eminence of economic issues in foreign policy during the decade after the collapse of the Soviet Union led to a tremendous growth in world trade and foreign direct investment (FDI) which was stimulated by new technologies that shrank distances, sped up transactions and accelerated the pace of change. This enhanced the place of economic diplomacy as a tool of promoting and protecting national interests within foreign policy strategies.<sup>16</sup>

Regionally, states engaged priority shifts in their foreign policies to economic issues as well. In 1987, Tanzania for instance shifted her foreign policy emphasis to economic development as opposed to the hitherto political predominance. The country embarked on policies that were geared towards promoting national investments to strengthen the national economy.<sup>17</sup> This was a departure from the *Arusha Declaration* of 1967 where the country deemphasized the role of foreign capital in its economic development.<sup>18</sup> Tanzania obviously took this policy direction under the assumption that foreign policy indeed promotes economic growth and development.

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<sup>15</sup> J. W. Spanier, and E. M. Uslaner, *American Foreign Policy Making and the Democratic Dilemmas* Op. Cit. p.5.

<sup>16</sup> Ibid p.6

<sup>17</sup> M. Nzomo, "The Foreign Policy of Tanzania: From Cold War to Post Cold War," in S Wright.(ed), *African Foreign Policies*, (Boulder: Westview Press 1999) pp182-198:188: see also G. Kabelwa, "Potential Impacts of FDI on Economic Development in East Africa," A Paper Prepared for a Policy Dialogue for Accelerating Growth and Poverty Reduction in Tanzania, held at the Conference Hall, ESRF, on May 25th, 2006

<sup>18</sup> K.G. Adar, and M. Ngunyi, "The Politics of Integration in East Africa" in, W.O. Oyugi, *Politics and Administration in East Africa* (Nairobi: EAEP, 1994), pp. 395-425:411.

Locally, Kenya's foreign policy had to shift from the traditional political to the economic pillar after the end of the Cold War.<sup>19</sup> This was necessary owing to the fact that the hitherto cordial relations that the country enjoyed with the West came to a halt. Kenya lost her strategic position to the West and issues of human rights, governance and management of public finances became of fundamental concern to the West. Relations with key bilateral and multilateral donors deteriorated leading to a freeze in aid. Kenya's economy was seriously affected until a new regime came to power in late 2002. The new administration was greeted with optimism among Kenyans and the multilateral and bilateral development partners alike. Kenya aggressively pursued economic diplomacy as a strategy to address its ailing economy.<sup>20</sup> Coincidentally, by 2007 the economy was growing at a rate of 7.1 percent. The trend was interrupted by violence as a result of disputed elections in 2007, which considerably slowed down the economy.<sup>21</sup>

States are therefore alive to the fact that economic diplomacy is a salient feature of the foreign policies and its intention is to spur economic development and stability.<sup>22</sup> Thus the general assumption among states and which has led them into economic diplomacy is that economic diplomacy contributes a great deal towards promoting economic development. It is against this background therefore that this study will examine the extent to which economic diplomacy policy actually contributes to economic development in developing states with a specific emphasis on Kenya.

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<sup>19</sup> D. Odipo, "Four Decades of Live and Let Live," *Diplomat East Africa*, January-February 2010, Vol. 001, pp: 32-33:33.

<sup>20</sup> P.A. Nyong'o, "The State of the Nation's Economy," Lecture given at the Institute of Economic Affairs Annual Lecture Series, Norfolk Hotel, Nairobi 29th January 2003

<sup>21</sup> Republic of Kenya, *Economic Survey 2009* (Nairobi: KNBS, 2009) p.1

<sup>22</sup> J. B. Taylor, "The Economic Component of Foreign Policy," Remarks to the Hoover Institution Board Of Overseers Willard Hotel Washington, D.C. February 25, 2002. See also, S.M. Krishna, "High Economic Growth, Key Goal of Foreign Policy," in [www.thaindian.com](http://www.thaindian.com) posted on 2<sup>nd</sup> September 2009 accessed on 1<sup>st</sup> September 2010



### 1.3 Problem Statement

Economic diplomacy has been a key pillar of the foreign policy of Kenya since independence. The newly independent government of Kenya set out to establish foreign economic relations with any state regardless of its ideological orientation. The main aim was to diversify markets for her exports and access imports of goods, capital or manpower as well as attract FDI. Though on paper Kenya subscribed to the Non Aligned Movement (NAM), her economic policies were in practice aligned to her Western partners especially the UK and US which espoused capitalism.<sup>23</sup> Kenya continued to enjoy good relations with the Western states and the International Financial Institutions including the World Bank (WB) and the International Monetary Fund (IMF). This led to massive investments into the Kenyan economy at both bilateral and multilateral levels.

The end of the cold war era and the subsequent diminishing of Africa's strategic value to the West saw a shift in the foreign policies of African states including Kenya to respond to the new phenomenon. Kenya had to compete with other states particularly eastern European states for FDI, foreign assistance and trading opportunities. This had to be done within a hostile environment with relations with economic partners especially the West deteriorating. Kenya strategically began engaging closely with new friends in Asia, Middle East, Latin America, Caribbean and Eastern European states while maintaining ties with her traditional partners in Western Europe and North America.<sup>24</sup>

This study thus sought to examine the relationship between the shift in foreign policy priority in the two decades of the Post Cold War era in Kenya and economic development of the

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<sup>23</sup> J.D. Barkan, "Divergence and Convergence in Kenya and Tanzania: Pressures for Reform," op. cit. pp.1-45:1.

<sup>24</sup> E.Kabaji, "Why Kenya has New Foreign Policy Framework," *Diplomat*, January-February 2010, Vol. 001 pp: 30-31:31.

country during this period. The study sought to examine the policies that Kenya has put into place to attract FDI, determine how adequate the policies were in attracting the FDI and assess the extent to which the FDI contributed to Kenya's economic development during the period under study.

#### 1.4 Objectives

1. To determine the role of foreign economic policy in economic development in Kenya.
2. To review independent Kenya's foreign economic policy
3. To establish the FDI inward trends into Kenya between 1990 and 2010.
4. To explore the extent to which FDI inflows contributed to Kenya's economic development during the period under review.

#### 1.5 Justification of the Study

The major concern for Kenya's economic diplomacy as it is for any other country is to promote economic growth and development. Since independence, Kenya has embarked on foreign economic policies that were geared towards the achievement of rapid economic and social development. This was explicitly stated in the famous 1965 Sessional Paper No. 10 of 1965<sup>25</sup> and the Kanu Manifesto.<sup>26</sup> Kenya set out to establish economic relations with any state regardless of its ideological orientation and pursue a foreign economic policy that that would diversify markets for its exports and sources of imports whether of goods, capital or manpower.

Foreign economic policy is thus supposed to be one of the avenues through which states pursue policies aimed at promoting economic advancement. The period between 1990 and

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<sup>25</sup> Government of Kenya. Sessional Paper No. 10 of 1965 on *African Socialism and its Application to Economic Planning* (Nairobi: Government Printer, 1965).

<sup>26</sup> KANU Manifesto, 1963 p.17 and pp 23-24.

2010 marks the first two decades of the Post Cold War era where states have intensified their economic diplomacy efforts in a bid to promote their economies in an increasingly competitive world. During this period, Kenya has witnessed varied economic growth with the first twelve years witnessing a declining or stagnant economy. The change in leadership in late 2002 saw an aggressive shift in emphasis from political to economic diplomacy. This is the period when Kenya witnessed impressive growth before being interrupted by domestic political turmoil in 2008.

Scarce attention seems to have been paid to the study of Kenya foreign policy in general and its economic component in particular. Some scholars have written on the foreign policy of Kenya in general since independence. A keen study of the works reveals that the actual contribution of foreign policy to the growth of the economy of the country has not been given due consideration. The literature that attempts to address the issue is inadequate. This study thus takes up the challenge of filling the dimly addressed link in terms of the extent of the relationship between the foreign policy of economic diplomacy and economic development. It will form a basis upon which further research can be undertaken in the area of economic diplomacy particularly in our core environment the East African Community (EAC) to determine how much the strategy has contributed to economic development.

The findings of this study will also be crucial to policy makers as well since they will spur a foreign economic policy audit to determine the effectiveness of the much talked about economic diplomacy in the promotion of Kenya's economic development. The recommendations may also lead to the strengthening of the current economic diplomatic strategy or discarding it altogether depending on our findings.

## 1.6 Literature Review

There have been relatively few studies thus scanty literature on African foreign policies, Kenya included.<sup>27</sup> This section nevertheless reviewed literature on the concept of foreign economic diplomacy, as well as the foreign economic policies of some countries such as Singapore which is deemed as a model of how economic diplomacy can lead to economic development, South Africa and Kenya.

### 1.6.1 Economic Diplomacy in Developing States

Economic diplomacy is defined as:

*the process through which countries tackle the outside world to maximize their national gain in all the fields of activity including trade, investment and other forms of economically beneficial exchanges where they enjoy comparative advantage. It has bilateral and multilateral regional dimensions.*<sup>28</sup>

The definition identifies the main aim of economic diplomacy which is to ensure that the state obtains economic benefits in all fields of the economy in its dealings with other states. Three stages of economic diplomacy in developing states are also distinguished. On the one hand are developing states which view globalization as a positive opportunity thus pursue international business partnerships, tourism, offshore banking etc and are active participants in an interdependent world both at bilateral and multilaterals level such as World Trade organization or the World Economic Forum. On the other hand there are those who view globalization suspiciously. Their economies are punctuated by an acute shortage of resources, are torn by internal conflict, poor governance and are woefully dependent on foreign aid. These states are

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<sup>27</sup> S. Wright, "The Changing Context of African Foreign Policies" in S. Wright (ed), *African Foreign Policies*, (Boulder: Westview Press 1999), pp 1-22:1. See also M. Mwagiru, "Foreign Policy and the Diplomacy of Conflict Management in Kenya: A Review and Assessment," *African Review of Foreign Policy*, Vol.1 No. 1 March 1999, pp. 44-62:44.

<sup>28</sup> K. S. Rana, "Economic Diplomacy, The Experience of Developing Countries" in Bayne N. and Woolcock, S., (eds), *The New Economic Diplomacy*, op.cit. pp 201-220:201.

extremely vulnerable to the seemingly ruthless world order. In between the two extremes are the majority of states, which are still learning the ropes, scrambling for the right mixture of structure, policy and method to take proactive advantage of the external environment.<sup>29</sup> Kenya falls in the latter category.

Prior to the end of the Cold War, economic diplomacy in many countries was dominated by government officials of a few countries and was shaped by the constraints of the War. The Post Cold War era and the advent of globalization saw the entry of non state players who play an active role in shaping government policies and as independent players in their own right.<sup>30</sup> Such collaboration is more effective in helping the state attain its economic diplomacy goals.<sup>31</sup>

There are several key ingredients for a successful economic diplomacy. These include: the involvement of other players apart from the classical ministries of foreign affairs, trade and industry; the integration and harmonization of the structures of foreign affairs and external economic management, mobilization of export promotion and inward foreign investment; providing a conducive regulatory framework for trade and investment; distinction of economic diplomacy as it operates at home from the way it operates abroad and providing the necessary resources in terms of adequate staffing and motivation.<sup>32</sup> It is also necessary to include good and focused leadership as among the prerequisites of a successful economic diplomacy.

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<sup>29</sup> Ibid p.202.

<sup>30</sup> N. Bayne and S. Woolcock, "What is Economic Diplomacy," in N. Bayne and S. Woolcock, (eds) , *The New Economic Diplomacy* (Hampshire: Ashgate 2007) pp.1-19:3.

<sup>31</sup> K. S. Rana, "Economic Diplomacy, The Experience of Developing Countries" op.cit pp.201-220: 202

<sup>32</sup> Ibid p.203-205:see also M. Mwangi, "Foreign Policy, Economic Diplomacy and Multilateral Relations; Framing the Issues in Kenya's Emerging Asia Pacific Policy" *African Review of Foreign Policy*, Vol 4 No.1 May 2006, pp. 45-58:49.

### 1.6.2 *Successful Economic Diplomacy: The Case of Singapore:*

Singapore is touted as one of the most successful models of economic diplomacy. The country has combined innovativeness, strong institutional framework, adequate policy response to internal and external economic problems and good leadership to scale to great heights of economic development. The country has also engaged in both bilateral and multilateral diplomacy to attain her economic aims.

Singapore has always had strong institutions since her independence to coordinate and promote her economic diplomacy goals. The country has throughout its history established strong institutions including the Economic Development Board (EDB) in the late 1950s, Economic Commission (1985) and the National Science and Technology Board (NSTB)<sup>33</sup> to coordinate various emerging issues that have a bearing on her economy.

Singapore has also embarked on appropriate and timely policy responses to address challenges in her economy. In 1967 Singapore adopted a pro-business, pro-foreign investment, export-oriented economic policy framework to address a lack of physical resources and a small domestic market which the earlier import substitution strategy had failed to adequately deal with.<sup>34</sup> As a result, Singapore became a regional center for offshore assembly for American and European semiconductor industries and electrical and electronic goods. The total stock of inward FDI also rose from \$303million in 1967 to 2659\$ million in 1973. Over the same period, GDP grew at an average 13 percent. The country shifted its industrial strategy to higher value added

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<sup>33</sup> C. Dent, *The Foreign Economic Policies of Singapore, South Korea and Taiwan* (Cheltenham: Edward Elgar, 2002) p.65

<sup>34</sup> CIA Fact Book, "Singapore Country Profile," US Department of State [www.state.gov](http://www.state.gov)

activities with greater emphasis on the skill, quality and technological content of her production activities.<sup>35</sup>

Faced with the 1970s oil crises, Singapore changed its policy to focus more on less energy intensive industries such as telecommunications, computer components and peripherals and financial services. The country also shifted the more labour intensive production offshore and embarked on compensatory enhancement in skill and productivity levels to attract higher technology FDI. The strategy led to a substantial increase in wage levels<sup>36</sup> In the early 1980s the government promoted Singapore as the regional headquarters for foreign Multinational Corporations (MNC). By 1984, its stock of manufacturing inward FDI had risen to 12.2b\$.<sup>37</sup>

Singapore's innovativeness can be seen in the country's decision to establish institutes of technology in collaboration with the French, Japanese and German governments for technology transfer in electronic and engineering fields. The strategy led to higher value FDI flowing into Singapore with labour intensive production shifting offshore especially in the borderland areas in the emerging Indonesia- Malaysia- Singapore- Growth Triangle.<sup>38</sup> The country's innovativeness was also to be witnessed in the late 1990s when, faced with the Asian financial crisis, it chose to negotiate through the National Wage Council, a wage cut of between 4 percent and 8 percent to address the problem instead of devaluing its currency. The government also fast-tracked infrastructural projects, increased spending on education and training and made investments geared towards promoting Singapore as a center for e-commerce and research and development.

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<sup>35</sup> C. Dent, *The Foreign Economic Policies of Singapore, South Korea and Taiwan*, op.cit.p.65.

<sup>36</sup> Ibid

<sup>37</sup> Ibid

<sup>38</sup> Ibid

These measures were successful and the economy recovered to grow at 9.9% in 2000 as opposed to 0.4% in 1998.<sup>39</sup>

Singapore also strongly supports multilateral economic regimes such as the World Trade Organization and World Bank owing to its export oriented inward FDI based economy. It is also an active participant in the Association of South East Asian Nations (ASEAN) and the Asia Pacific Economic Forum (APEF)

In a nutshell, Singapore, over the long term is one of the 20<sup>th</sup> Century's economic success stories having transformed itself from a third world port city to a highly developed city-state economy. In 2000 it was the second richest state in Asia after Japan and the fourth richest in the world<sup>40</sup> Singapore's hallmark has been: an inclusive approach that mobilizes all stakeholders on a "team Singapore formula; long-term vision and thinking outside the box: astute regional and trans-regional diplomacy: and an exploration of best practices in diplomacy and human resource development.<sup>41</sup>

There are both similarities and differences between the Kenyan and the Singapore experiences. Kenya and Singapore adopted the import substitution industrial development strategy but while Singapore was quick to adopt a new export oriented strategy, Kenya was reluctant until the 1980s when she reluctantly adopted the strategy. In the Singapore experience, there was political stability which has all along made the country conducive to investment. Kenya on the other hand has experienced political turmoil several times (1992, 1997 and 2007) in its independence hence driving away investors. While Kenya was content with economic aid

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<sup>39</sup> Ibid

<sup>40</sup> Ibid p.66

<sup>41</sup> K.S. Rana, "Singapore's Diplomacy: Vulnerability into Strength," *The Hague Journal of Diplomacy* Vol.1, No.1 pp. 81-106:106.



from her donors, Singapore was alive to the risks involved and instead pursued trade and technology transfer which has made it a technological hub of Asia. Singapore also developed an institutional framework, using the all inclusive EDB and NSTB to further her economic goals while Kenya's policies appeared to be driven by personal rule. The tripartite relations between the government, employers and employees saw the country successfully negotiate wage cuts when faced by an economic crisis while Kenya devalued her currency with serious economic consequences. While Singapore has since transformed itself to an industrialized country, Kenya still grapples with her predicament.

### *1.6.3 Economic Diplomacy in Africa: The Case of South Africa*

A keen study of the South African foreign economic undertakings reveals that the country has actively engaged in both multilateral and bilateral economic diplomacy after the end of apartheid. This has resulted in increases in annual increases in total trade and strong investment inflow and outward investment from South Africa hence boosting her economy.<sup>42</sup>

South Africa's economic diplomacy has been two pronged. Her bilateral involvement in Africa has particularly been very successful with the balance of trade with her African trading partners being skewed in her favour. By 2008, the balance of trade within the Southern African Development Community (SADC) was R 11.4billion in favour of South Africa.<sup>43</sup> South Africa has also been very actively involved in multilateral economic diplomacy especially within the World Trade Organization (WTO). The country has placed considerable faith in the benefits of

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<sup>42</sup> C. Ajulu, "South Africa's Economic Diplomacy: Trade and Investment Promotion," Report prepared for The Presidency's Fifteen Year Review Institute for Global Dialogue, March 2008.

<sup>43</sup> M. Qobo, "The Political Economy of Regional Integration in Southern Africa," in P. Draper (ed.), *Reorienting South Africa's African Trade Strategies*. (Johannesburg: South African Institute of International Affairs (SAIIA), 2005.) pp.13-14:12.

rules-based trade multilateralism, as a prerequisite for growth and development in an increasingly interdependent world.<sup>44</sup>

One of the strategies that South Africa has used in pursuit of her economic aims is the diplomacy of conflict management. Beneath the veneer of altruistic perceptions on the part of South Africa is the intention of preparing markets for her corporate entities. South Africa's involvement in Angola and the Democratic Republic of Congo particularly offer bright prospects for South African businesses.<sup>45</sup> This could only be intended to expand South Africa's influence in the continent and make it a regional hegemon.

#### *1.6.4 Economic Diplomacy in Kenya*

Kenya has had mixed fortunes with its foreign economic policy since independence as far as economic development is concerned. During the early years of Kenya's independence, foreign economic policy emphasized a mixed economy that encouraged foreign investments and close ties with Western nations.<sup>46</sup> The country had to adopt this policy due to lack of capital and expertise hence the need for foreign investment and technological know-how from abroad.<sup>47</sup> To make it more attractive to foreign investors, Kenya passed the Foreign Investment Protection Act of 1964.<sup>48</sup> This had the effect of attracting foreign investors such that between 1967 and 1970, the average annual inflow of foreign capital was £41.3 million.<sup>49</sup> Kenya's policy of economic non-alignment also saw her reap some benefits from both sides of the Cold War divide during this period. Kenya's Vice President Jaramogi Oginga Odinga was a good friend of the Soviet

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<sup>44</sup> Ibid.

<sup>45</sup> Ibid, p.13

<sup>46</sup> J. Rono, "Kenyan Foreign Policy" op.cit. pp 100-117: 104.

<sup>47</sup> M. Mudavadi, *Rethinking Development in Africa: The Case Study of Kenya*, op.cit. p.2

<sup>48</sup> J. Rono, "Kenyan Foreign Policy" op.cit. pp 100-117: 101

<sup>49</sup> Ibid

Union from where he obtained aid to build a hospital, radio station, sugar factory, paper mill, irrigation project, fish cannery and a food processing facility as well as three hundred scholarships.<sup>50</sup>

Kenya also engaged in regional multilateral economic relations during this period. The East African Community (EAC) presented Kenya with an attractive market for her goods and services, being the most advanced economy in the region. The EAC also provided a route for Kenya's goods to reach other countries such as Zambia, Zimbabwe, Malawi, Rwanda, Burundi and Eastern Zaire (now Democratic Republic of Congo)<sup>51</sup>

It is thus evident that between 1963 and 1978, Kenya's foreign economic policies played an important role in the impressive growth of virtually all sectors of the Kenyan economy especially agriculture and manufacturing thus enhancing the economic development of the country.<sup>52</sup> The Gross Domestic Product (GDP) also grew at an impressive rate of 5.8 percent between 1965 and 1973 and 5.3 percent between 1974 and 1980.<sup>53</sup>

From the 1980s to the millennium Kenya's economy performed dismally to the extent that by 2002 the economy had shrunk to 0.7 percent. This was as a result of many factors both systemic and domestic. Kenya's dependence on foreign aid, deteriorated relations with the West and reluctance to carry out economic and political reforms led to capital flight suspension of foreign aid hence undermining economic development.<sup>54</sup> The end of the Cold War also meant that Kenya lost her geostrategic value to the West hence had to devise other survival strategies.

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<sup>50</sup> Ibid p.110

<sup>51</sup> S. M. Makinda, "From Quiet Diplomacy to Cold War Politics: Kenya's Foreign Policy" *Third World Quarterly*, Vol. 5, No. 2, *Africa: Tensions and Contentions* (Apr., 1983), pp. 300-319:301.

<sup>52</sup> M. Mudavadi, *Rethinking Development in Africa: The Case Study of Kenya*, op.cit. p.2.

<sup>53</sup> Ibid p.3

<sup>54</sup> Ibid p.11.

To address the situation, Kenya embarked on the “look east” policy and began to rekindle her engagement with the Orient.

In 2002 a new regime ascended to power and aggressively pursued the engagement with the East as a result of belligerent policies from the West towards Kenya’s domestic affairs.<sup>55</sup> This has resulted in several infrastructure development projects and oil exploration ventures with China maintaining a visible presence in Kenya. By 2007 the economy of Kenya was growing at an impressive 7.1 percent only to be interrupted by violence following the disputed 2007 elections.

Kenya has also employed a foreign policy of conflict resolution as a means towards achieving her foreign economic policy aims. Kenya engaged in the diplomacy of conflict management within the East African region from the 1980s and into the millennium because of her vital economic and trade interests in the region.<sup>56</sup>

One of the outstanding issues in Kenya’s foreign economic policy since independence is heavy influence from the West.<sup>57</sup> Kenya did little by way of changing the economic infrastructure that existed at the time hence the domination of the Kenyan economy by multinational corporations and foreign capital. Thus the indigenous bourgeoisie rules in collaboration with and at the behest of the international bourgeoisie.<sup>58</sup> A contrary view however holds that Kenya’s ruling elite was alive to Kenya’s interests other than those of their foreign

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<sup>55</sup> K. Wanjohi, “Kenya: Look East My Son.” *New African*, Jul 2006

<sup>56</sup> M. Mwangi, “Foreign Policy and the Diplomacy of Conflict Management in Kenya: A Review and Assessment.” *op.cit.*

<sup>57</sup> T. Shaw, “International Stratification,” cited in P. G. Okoth, *A Historiography of Kenya’s Foreign Policy*, *African Review of Foreign Policy*, Vol. 1 No. 1 March 1999.

<sup>58</sup> W.R. Ochieng, “Structural and Political Changes” in W.R. Ochieng, and B. Ogot (eds), *Decolonization and Independence in Kenya*, (London: James Currey Ltd. 1995), pp 83-109:91.

associates.<sup>59</sup> This is reinforced by Kenya's policy goal of achieving rapid economic development through economic non alignment and the inherent right to decide on her own economic policies. The policy assumed that Kenya would develop in partnership with industrialized capitalist countries without becoming a dependency of any country or group of countries. However, Kenya lacked the capacity to carry out independent economic decisions owing to her limited domestic savings and tax revenue base hence she had to rely on external economic assistance.<sup>60</sup> While this may have been the aim, in practice Kenya's economy was almost entirely owned by foreigners hence reinforcing the dependency argument.

From the literature reviewed, several issues emerge. First, the post-Cold War era presented developing states with serious economic challenges that necessitated a shift in foreign policy priority to economic diplomacy. Secondly, economic diplomacy has had mixed results in the developing states with some countries succeeding while others are still grappling with issues. Success in economic diplomacy depends on stable leadership, adequate policy response to external and internal shocks, proper consultation and involvement of all sectors of the society in economic diplomacy ventures, strong institutional framework and innovativeness. Successful economic diplomacy also combines bilateral and multilateral diplomacy. Third, Kenya has had mixed experiences of its economic diplomacy since independence owing to a mixture of domestic and systemic issues.

### **1.7 Theoretical Framework**

Some of the competing theories that seek to explain the foreign economic policy of states include realism, liberalism and the Marxism. According to realism, relative power influences

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<sup>59</sup> D.K. Orwa, "Continuity and Change: Kenya's Foreign Policy from Kenyatta to Moi," in W.O. Oyugi, *Politics and Administration in East Africa* (Nairobi:EAEP, 1994), pp: 297-330:302

<sup>60</sup> *Ibid* p. 302.

policy outcomes including those in economic diplomacy. Realism explains state behaviour and hence foreign policy through power politics. Realists see the desire to maximize the power of one's state compared to that of others as a central explanatory variable in international politics.<sup>61</sup> However realism is inadequate in explaining the foreign economic relations of states in an increasingly globalized world where states are interdependent and where challenges are cross cutting. The theory also ignores the role of domestic factors and international institutions (which check the raw abuse of raw economic power). After all, economic diplomacy is about the interaction of international and domestic interests.

Marxism also attempts to explain the foreign economic policy through the dependency theory. The theory states that the South will remain undeveloped because the rich core which includes former colonial powers will gain more from a liberal trading order. This is reinforced by the fact that some developing countries have not been able to industrialize despite pushing for the New International Economic Order (NIEO). However, dependency does not explain why some developing countries have been able to develop while others have not.<sup>62</sup>

Based on our problem statement and the literature reviewed, our study will adopt economic liberalism as the appropriate theoretical framework. This theory is an offshoot of the liberal school of thought and is associated with terms such as capitalism, laissez-faire, economic internationalism and free trade. This theory holds that international economic relations should be conducted cooperatively since the international economy is a non-zero sum game in which

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<sup>61</sup> N. Bayne and S. Woolcock, "Theoretical Analysis of Economic Diplomacy," in N. Bayne and S. Woolcock (eds), *The New Economic Diplomacy* (Hampshire: Ashgate 2007), pp.20-42:23.

<sup>62</sup> Ibid p.25

prosperity is available to all. To spread prosperity, economic liberalists favour free trade and other forms of economic interchanges.<sup>63</sup>

Economic liberalism acknowledges that the state is still the primary economic policy maker but it argues for its eventual elimination from the scene. The theory further holds that politics should only be used to promote domestic free markets and international free economic interchange. It also views the current economic relations as involving national competition but cooperation is increasing. It emphasizes the pursuit through foreign policy of general economic benefits to the nation including a favourable balance of trade, strong economic growth and a healthy macro economy.<sup>64</sup> On development of the least developed states, economic liberalists argue that this can be achieved through aid, loans, investment, trade and any other assistance within the current system.<sup>65</sup>

From the literature reviewed it is discernible that Kenya has over the years generally adopted a foreign economic policy that is intended to promote rapid economic and social development through cooperation. Kenya has since independence rejected *autarkism* and embraced capitalist ideals hence fully participating in the international economic system with the aim of diversifying markets for its exports and sources of imports whether of goods, capital or manpower.<sup>66</sup> Kenya's policies also appear to have been inspired by the liberalist tenet that least developed states can be achieve development through aid, loans and investment This study thus adopts economic liberalism as our theoretical framework.

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<sup>63</sup> Ibid p.8

<sup>64</sup> B.W. Jentleson, *American Foreign Policy, the Dynamics of Choice in the 21<sup>st</sup> Century*(Duke University: W. W. Norton &Co., 2004), p.18.

<sup>65</sup> Ibid p.19.

<sup>66</sup> D K.Orwa, "Independent Kenya's External Economic Relations," op.cit. pp.389-404:390.

## 1.8 Hypotheses

1. Post-Cold War Foreign policy of Kenya contributed significantly to economic development.
2. Kenya's foreign economic policy led to an increase in FDI volumes between 1990 and 2010
3. Inward FDI into Kenya made a significant contribution to economic development between 1990 and 2010

## 1.9 Research Methodology

Owing to the complexities of relating the two variables that is foreign policy and economic development this study adopted qualitative research methodology. The study relied on secondary data collected from government publications including Economic Surveys and Statistical Abstracts of Kenya. Data analysis was qualitative. We employed inferences made on the findings subjected to critical analysis.

### 1.9.1 Scope and Limitations

The study of economic diplomacy is a wide subject which calls for extensive research. Our study restricted itself to Kenya's economic diplomacy during the period between 1990 and 2010. The study also only concentrated on inward FDI inflows resulting from the policies.

## 1.10 Chapter Outline

Chapter One introduces the topic of this study by setting out the broad context of the research, the statement of the problem, justification, theoretical framework, literature review, hypotheses and the methodology of the study.

Chapter Two: Foreign Policy and Economic Development: An Overview of the Kenyan



## Situation

Chapter Three: Foreign Policy and Economic Development: A Case Study of Kenya

Chapter Four: Foreign Policy and Economic Development: Critical Analysis

Chapter Five: Conclusions

## CHAPTER TWO

### FOREIGN POLICY AND ECONOMIC DEVELOPMENT: AN OVERVIEW OF THE KENYAN SITUATION IN THE COLD WAR PERIOD

#### 2.1. Introduction

The previous chapter dealt with the introduction and background to this study. It stated the problem the objectives of the study and justification to the problem. The chapter also reviewed literature on what has been written on foreign policy and economic development in developing states from a general view before narrowing down to the Kenyan situation. The Chapter also introduced a theoretical framework within which the problem will be analyzed and stated the probable answers to our research problem. The methodology to be used as well as the limitations to the study were also discussed in Chapter one.

This chapter presents an overview of the Kenyan situation within the context of the relationship between foreign policy and economic development. The Chapter looks at the pre-independent Kenya's foreign economic policy as well as independent Kenya's foreign economic relations up to the end of the Cold war period. The latter is divided into two distinct time frames each corresponding with reigns of Presidents Kenyatta and Moi. It also analyzes the Kenyan macro-economic scenario in independent Kenya, trade and investment policies and traces the foreign direct investment trends into the country before summarizing the main arguments.

#### 2.2 Pre Independent Kenya's Foreign Economic Policy

Pre independent Kenya's foreign economic relations can be analyzed within two time frames: pre colonial Kenya and Colonial Kenya .The pre-colonial Kenya represents the period up to 1895 when the colonial government was established in Kenya after the disbandment of the Imperial British East Africa Company (IBEAC). Colonial Kenya on the other hand represents the period between 1895 and 1963 when Kenya attained independence from Britain. During the pre-

colonial period, the different autonomous communities that inhabited the land that is now Kenya engaged in foreign economic relations amongst each other. The *Luo* nation for instance engaged in cattle trade with the *Abagusii* nation as well as the *Basoga* and the *Baganda* via Lake Victoria.<sup>67</sup> East Africa as a whole also engaged in trading relations with India, Egypt and other countries along the Indian Ocean.<sup>68</sup>

The entry of the colonial government had a profound effect on foreign economic relations that were existent at the time. The colonialists altered Kenya's pre-colonial trade and reoriented it away from the Indian Ocean towards Britain and other industrial countries to providing primary agricultural produce and a market for manufacturers. This was aimed at achieving the short term goals which included making the colony self sustaining through exports, getting the best returns on capital invested, producing exports to ease Britain's reliance on foreign sources and transforming the pre-colonial economy into a market for Britain's manufactured goods.<sup>69</sup> The foreign economic policy of colonial Kenya was therefore conducted by the British colonialists in Kenya and their British counterparts in Britain with the main aim of furthering British interests. There was also co-operation with other British administrations across Africa and this saw the establishment of a Joint Economic Council (JEC) to promote economic cooperation with Nyasaland, Northern Rhodesia, Tanganyika, Uganda and Zanzibar<sup>70</sup>

Colonial Kenya's foreign economic relations were modeled along Western capitalist tenets. The imposition of colonial rule in Kenya entailed the process of Westernization and

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<sup>67</sup> W. R. Ochieng', *A History of Kenya* (Nairobi: Macmillan 1980), p.44.

<sup>68</sup> W. R. Ochieng', "The Post Colonial State and Kenya's Economic Inheritance" in W. R. Ochieng. and R. M. Maxon, *An Economic History of Kenya* (Nairobi: EAEP 1992), pp. 259-272:261.

<sup>69</sup> Ibid p.261.

<sup>70</sup> P.G. Okoth. "A Historiography of Kenya's Foreign Policy," in *African Review of Foreign Policy*, Vol1 No.1 1999 pp. 63-88:71

capitalist penetration of African economies.<sup>71</sup> During the colonial period, Kenya's economy was dominated by foreign capital, dominance of agriculture, limited development of industry and heavy reliance on export of primary goods and imports of capital and manufactured goods.<sup>72</sup> Colonial Kenya created public agencies that controlled and subsidized selected economic activities including wheat, maize, tea, coffee and pyrethrum. The government also adopted import substitution as a strategy for industrial development as opposed to export promotion. This was due to the highly competitive international market.<sup>73</sup>

Kenya's engagement in international trade during the colonial period had the effect of expanding the range and extent of commercial intercourse with the rest of the world. It also led to the internal transformation of Kenya's economy through among other ways establishment of the necessary infrastructure for foreign trade including the establishment of a monetary unit and railway network.<sup>74</sup> External trade grew in response to the expansion of international trade within an increasingly integrated international economy.<sup>75</sup>

The external economic policy of Kenya during the colonial period also attracted the participation of multinational corporations. By 1945 about 15 multinational corporations were already operating in Kenya in different fields including agricultural estates and export producing, trading, manufacturing and mineral extraction. Majority of them were involved in processing.<sup>76</sup> After 1945 there was an exponential increase in the number of multinational corporations

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<sup>71</sup> W.R. Ochieng, and E.S. Atieno-Odhiambo, "On Decolonization," in W.R. Ochieng' and B.A. Ogot (eds) *Decolonization and Independence in Kenya 1940-1993* (London: James Currey 1995), pp. xi-xviii :xi

<sup>72</sup> Ibid

<sup>73</sup> M. Mudavadi *Rethinking Development in Africa: The Case Study of Kenya*, op.cit. p.2

<sup>74</sup> P.N. Odhiambo, "Kenya's Foreign Trade 1895-1963" in W.R. Ochieng' and R.M. Maxon, *An Economic History of Kenya*. (Nairobi:EAEP, 1994), pp.223-258:228

<sup>75</sup> Ibid

<sup>76</sup> N. Swainson, *The Development of Corporate Capitalism in Kenya* (London: Heineman), p.64.

existing in Kenya especially in the manufacturing sector.<sup>77</sup> This had the effect of positioning Kenya as the regional economic hub with a much better developed economy than her immediate neighbours.

### 2.3 Independent Kenya's Foreign Economic Relations

This Section deals with the foreign policy of Kenya since independence and its impact on economic development. The section will review the foreign policy issues as a whole but specifically their effects on the economic development of the country under the following three distinct time frames which coincide with three different administrations: 1963-1978; 1978-2002; and 2003-2010

#### 2.3.1 1963-1978

Kenya gained independence from Britain in 1963 with Jomo Kenyatta assuming the Prime Minister's position and later the Presidency when Kenya converted to a republic in 1964.<sup>78</sup> Immediately after independence the great task facing the Kenya government was economic development to address the needs of the people. There were challenges including land, scarcity of capital resources and skilled manpower. Immediate measures had to be taken to expand the economy through industrialization, improved methods of farming and intensive training of local manpower. The economy was heavily in the eyes of expatriates who owned large companies, banks and hotels.<sup>79</sup> As will be seen later in this section, Kenya's foreign economic policy has been quite consistent in its open door approach in encouraging foreign investments.<sup>80</sup>

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<sup>77</sup> M. Nzomo, "External Influence on the Political Economy of Kenya: The Case of MNCs" in W. Oyugi, *Politics and Administration in East Africa*, op.cit. pp.429-468:435.

<sup>78</sup> J. Rono, "Kenyan Foreign Policy," in S. Wright (ed), *African Foreign Policies*, op. cit p.103

<sup>79</sup> W. R. Ochieng', "Structural and Political Changes," in B. Ogot and W. R. Ochieng (eds) *Decolonization and Independence in Kenya 1940 – 1993* (London: James Currey 1995) pp. 83-110:106.

<sup>80</sup> M. Nzomo, "External Influence on the Political Economy of Kenya" in Oyugi, W.O., *Politics and Administration in East Africa* op.cit. pp.429-468:449.

Like many African and other developing states, foreign policy formulation and conduct was (and still is) mainly carried out by the President assisted by foreign affairs ministries.<sup>81</sup> Lack of proper institutions facilitated the emergence of personal rule.<sup>82</sup> Consequently, foreign policy of these states was chiefly affected or influenced by the personal idiosyncracies of these leaders. Kenyatta, who was credited with the fight for independence in Kenya, was a cautious and conservative individual. His formal education in London had exposed him to the Western world hence he sought to embrace a departure from radical aggressiveness which he knew Kenya had no chance of defending.<sup>83</sup> He recognized that for a poor nation, economic and social modernizations were the prime objectives of foreign policy hence chose to concentrate on that. This was reflected in the foreign policy of Kenya during the first decade and a half of Kenya's foreign policy.<sup>84</sup>

Between 1963 and 1978, Kenya pursued a foreign policy that emphasized cooperation with neighboring countries, support of continental liberation movements and mixed economy that strongly encouraged foreign investment and hence close ties with the Western states<sup>85</sup> Kenya's foreign policy was thus premised on free enterprise tied to the West. This was informed by the fact that the new state lacked capital and expertise hence the need for foreign investment and technological know-how from abroad.<sup>86</sup> Kenya moved fast to assure British settlers and potential foreign investors that the government would not deprive them of their property or right

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<sup>81</sup> J. Rono, "Kenyan Foreign Policy," in S. Wright(ed), *African Foreign Policies*, op.cit. p.101.

<sup>82</sup> R. Jackson and C.G. Rosberg, *Personal Rule in Africa: Prince, Autocrat, Prophet, Tyrant* (Berkeley: University of California Press, 1982), p.1

<sup>83</sup> J. Okumu, "Kenya's Foreign Policy," in O. Aluko(ed), *The Foreign Policy of African States* (London: Hodder and Stoughton, 197) p.136

<sup>84</sup> J. Rono, "Kenyan Foreign Policy," in S. Wright (ed), *African Foreign Policies*, op.cit. p.105

<sup>85</sup> Ibid p.101

<sup>86</sup> M. Mudavadi, *Rethinking Development in Africa: The Case Study of Kenya*, op.cit. p.2. See also S. Langdon, "The Multinational Corporation in the Kenyan Political Economy," in R. Kaplinsky(ed), *Readings on the Multinational Corporations in Kenya* (Nairobi: OUP, 1978), p.62

to ownership. In 1964, Kenya passed the Foreign Investment Protection Act (FIPA) which was geared towards attracting foreign investment. The Act guaranteed foreign investors the right to repatriate their profits, loans, interests on their loans and the approved proportion of the net proceeds of sales or any other part of the approved enterprise. MNCs were also guaranteed protection from nationalization. This was aimed at encouraging investors to invest in Kenya and do their business peacefully so as to bring prosperity to Kenya.<sup>87</sup>

In 1965, Kenya published the Sessional Paper No. 10 on *African Socialism and its Application to Planning in Kenya*<sup>88</sup>. Together with the 1963 KANU Manifesto,<sup>89</sup> the documents were instrumental in setting the broad framework within which Kenya would carry out its foreign economic relations.<sup>90</sup> The two documents identified the overall goal of the Kenyan foreign economic policy as the achievement of rapid economic and social development. To achieve this, Kenya was to establish economic relations with any state regardless of its ideological orientation. Foreign economic policy would be a strategic tool for diversifying markets for Kenya's exports as well as sourcing of imports whether of goods, capital or manpower.<sup>91</sup>

During this era, the government also came up with an institutional framework to deal with foreign investment. The New Projects Committee in 1968 which was the main state bargaining forum on all investments with foreign companies. The ad-hoc inter-ministerial Committee was charged with the reviewing of applications by foreign companies to invest in

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<sup>87</sup> Ibid p.102

<sup>88</sup> Government of Kenya, Sessional Paper No. 10 on *African Socialism and its Application to Planning in Kenya* Government Printer:1963

<sup>89</sup> KANU, Election Manifesto, 1963.

<sup>90</sup> D.K. Orwa, "Kenya's Foreign External Economic Relations," in W.R. Ochieng and R. M. Maxon, *An Economic History of Kenya* op.cit p.390.

<sup>91</sup> Ibid p.390

Kenya. It negotiated with incoming companies issues such as protection, duty exemptions, government share holding, Africanization, levels of management and technical fees among others.<sup>92</sup> Though a noble idea to ensure that the foreign investments favoured Kenya through technology transfer and fair profit sharing, the committee lacked the legal mandate necessary to act effectively.<sup>93</sup>

In 1970, the government established the Industrial Survey and Promotion Center (ISPC). The body had a better technical manpower than the NPC. However the manpower was still inadequate and inexperienced to deal with MNCs complex business and investment processes and lacked the necessary financial resources to evaluate many project proposals in detail.<sup>94</sup>

In 1971, the Capital Issues Committee (CIC) was established. Its role was to vet all issues of capital stock with a view of cutting down on capital outflow from Kenya. The body was also to play the role of encouraging MNC subsidiaries in Kenya to issue a proportion of their shares capital on the Nairobi Stock Exchange (NSE) so as to promote higher level of local ownership of MNC dominated industrial sector. The success of CIC has however been limited due to interference from politicians<sup>95</sup>

Other institutions established during this time to spur industrial and economic development in the country were Industrial and Commercial Development Corporation (ICDC), Kenya Industrial Estates (KIE), Industrial Development Bank (IDB), Development Finance Company of Kenya (DFCK), Kenya Bureau of Standards (KBS), Kenya Industrial Development and Research Institute (KIRDI) and the Central Bank of Kenya (CBK). These organizations

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<sup>92</sup> R. T. Ogonda, "Kenya's Industrial Performance up to 1980" in W.R. Ochieng and R. M. Maxon, *An Economic History of Kenya*, op.cit.298

<sup>93</sup> M. Nzomo, "External Influence on the Political Economy of Kenya" in W.O. Oyugi, *Politics and Administration in East Africa* op.cit p. 449

<sup>94</sup> Ibid p.450.

<sup>95</sup> Ibid p.391



however witnessed poor performance owing to various factors ranging from poor coordination among government bodies dealing with related issues and poor if any implementation.<sup>96</sup>

As a result of the foreign economic policies employed during Kenyatta's reign, Kenya's economy became heavily contingent on private ownership and market forces. Foreign investors and multinational corporations found their way into the Kenyan economy and their influence increased. Between 1967 and 1970, the average annual inflow of foreign capital was £41.3 million.<sup>97</sup> The willingness with which Kenyan leaders embraced foreign capital confined them to practicing what some authors describe as quiet diplomacy.<sup>98</sup> Other scholars prefer to use the term dependency as opposed to quiet diplomacy.<sup>99</sup> The former appears to be more convincing since Kenya could not afford to pursue an independent and adventurous foreign policy at the risk of offending the foreigners who almost wholly owned her economy.

It is thus quite evident that between 1963 and 1978, Kenya's foreign economic policy was instrumental in the impressive economic growth and development that the country witnessed by way of attracting economic aid and massive foreign investment. During this time, virtually all sectors of the economy especially agriculture and manufacturing expanded hence making the country a regional economic hub.<sup>100</sup> The peace that Kenya enjoyed during this time contributed immensely to the economic success witnessed.<sup>101</sup>

### 2.3.2 1978-2002

Jomo Kenyatta's death in 1978 ushered in a new era in the domestic and foreign policy environment. When Daniel Arap Moi ascended to power there was uncertainty and the new

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<sup>96</sup> Ibid

<sup>97</sup> Ibid

<sup>98</sup> J. Okumu, "Kenya's Foreign Policy," in O. Aluko, *The Foreign Policy of African States*, op.cit. p.136

<sup>99</sup> S. M. Makinda, "From Quiet Diplomacy to Cold War Politics: Kenya's Foreign Policy," op.cit p.301

<sup>100</sup> M. Mudavadi, *Rethinking Development in Africa: The Case Study of Kenya*, op. cit p.2

<sup>101</sup> Ibid p.5.

leadership had to move with speed to allay fears of possible radical shifts in policies pursued by Kenyatta. Though Kenya set out to follow in Kenyatta's policies, Moi's style of leadership was radically different from that of Kenyatta. He was much more aggressive and sometimes controversial.<sup>102</sup> Indeed some authors describe the initial years of Kenya's foreign policy under Moi as a departure from quiet diplomacy to open identification with one of the superpowers.<sup>103</sup> It is during Moi's early years in power that Kenya granted the US naval facilities in exchange for economic and military aid.<sup>104</sup> The dependency on foreign aid drew Kenya into the Cold War politics and as part of America's defence network.<sup>105</sup>

Relations with the West during Moi's tenure were cordial during the first decade after Moi's ascendancy to power before turning hostile towards the end of the Cold War.<sup>106</sup> The strategic value that the US held Kenya with in the early 1980s necessitated the friendly relations that the two countries enjoyed during the period. However towards the end of the 1980s the relations took a turn for the worse after the Cold War with the US demanding more transparency, accountability and good governance from her allies.<sup>107</sup> Relations between the two countries were on and off until Moi's exit.

Kenya's foreign policy under Moi was marked by a desire to enhance good neighbourliness through conflict resolution efforts in the region and beyond.<sup>108</sup> Kenya brokered peace in Uganda, Sudan and Somalia with mixed results.<sup>109</sup> Kenya was also involved in peace

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<sup>102</sup> J. Rono, "Kenyan Foreign Policy," in S. Wright(ed), *African Foreign Policies*, op.cit. p.103.

<sup>103</sup> S. M. Makinda, "From Quiet Diplomacy to Cold War Politics: Kenya's Foreign Policy" op.cit p.301

<sup>104</sup> Ibid p.312.

<sup>105</sup> Ibid p.312.

<sup>106</sup> M. Macharia, "Conflict and Collaboration in US-Kenya Relations 1985-1996", in P.G. Okoth (ed), *Africa at the Beginning of the 21<sup>st</sup> Century* (Nairobi: Nairobi University Press, 2000). pp. 157-192:157.

<sup>107</sup> Ibid p.158.

<sup>108</sup> J. Rono, "Kenyan Foreign Policy," in S. Wright, *African Foreign Policies*, op.cit p.103.

<sup>109</sup> Ibid p.104

keeping within the region and beyond. This earned Kenya respect in addition to the economic benefits that the peacekeepers accrued from their missions abroad and which was ploughed to the Kenyan economy.

Under Moi, Kenya employed personal diplomacy to a great extent. The president visited many countries in his attempt to establish useful links to Kenya. In 1980, Moi visited China where economic and cultural agreements were signed. Between then and the early 1990s, Kenya received in excess of Ksh. 300 million mainly in the area of construction of sporting facilities including the Moi International Sports Center and the Moi Referral Hospital in Eldoret.<sup>110</sup> Other countries that Kenya engaged with include Japan which financed development projects such as the construction of the Jomo Kenyatta University of Agriculture and Technology, Moi Airport-Mombasa and Kilifi Bridge among others. Kenya's dependence on oil also saw her engage closely with the Middle East countries such as Iran, Saudi Arabia and the United Arab Emirates.<sup>111</sup> The president made numerous foreign visits here he signed bilateral agreements with the host countries and which contributed to the economic and cultural needs of the country.

One prominent characteristic that marked the period between 1978 and 2002 was the end to an era in which there were a number of actors in policy-making to one where the head of state became the main actor both in the making and execution of policies. By and large major policy announcements of the government were directly and indirectly influenced by the president.<sup>112</sup> The emergence of a strong executive meant that other would-be actors in policy

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<sup>110</sup> D.K. Orwa, "Continuity and Change: Kenya's Foreign Policy from Kenyatta to Moi," in W.O. Oyugi, *Politics and Administration in East Africa* op.cit. p.318. See also Rono, J., "Kenyan Foreign Policy," in S. Wright, *African Foreign Policies*, op.cit. p.104

<sup>111</sup> J. Rono, "Kenyan Foreign Policy," in Stephen Wright (ed), *African Foreign Policies*, op.cit. pp 100-117:111.

<sup>112</sup> D.K. Orwa, "Continuity and Change: Kenya's Foreign Policy from Kenyatta to Moi," in W.O. Oyugi, *Politics and Administration in East Africa*, op.cit. pp: 297-330:318.

formulation and implementation process including political parties were effectively shut out. Other government organs, including parliament and the judiciary, were seriously emasculated to a point where they played only a minor role in the determination of the country's broad socio-economic and political development policies and strategies. The private sector was also largely ignored and was hardly consulted in virtually all policy areas, including strategic trade and industrial policies.<sup>113</sup>

The period also witnessed the emergence of multilateral and bilateral donor institutions as crucial actors in the country's economic policy formulation especially in the 1980s and 1990s. These changes started in 1980 when the country joined a group of other African countries implementing the World Bank-IMF SAPs. By the close of the 1990s, the role of the donor community had become perhaps the most important force in Kenya's policy formulation process. The participation of donors was particularly enhanced by the economic crisis which gripped the country in the second half of the 1990s making the country heavily dependent on external donor resources.<sup>114</sup>

The period between 1978 and 1990 was generally characterised by poor performance of the economy. While a number of external factors like commodity and oil shocks and the unfavourable international environment are partly responsible for the performance, a number of domestic factors such as mismanagement, corruption, poor infrastructure and insecurity have been more important.

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<sup>113</sup> M. Nzomo, "External Influence on the Political Economy of Kenya" in W.O. Oyugi, *Politics and Administration in East Africa*, op.cit p.392

<sup>114</sup> G.K. Ikiara et al "Kenya: Formulation and Implementation of Strategic Trade and Industrial Policies" in C. Seludo et al (eds) *The Politics of Trade and Industrial Policy in Africa: Forced Consensus?* (New Jersey: IDRC/World Press, 2004) pp.205-224:209

## 2.4 Domestic and Systemic Influences

Domestic and International politics played a major role in Kenya's foreign policy during the reign of Jomo Kenyatta. Immediately after independence the United States identified the geo-strategic value of Kenya and embarked on a mission to win over the latter through providing development aid and investment.<sup>115</sup> The US needed Kenya to preempt the possibility of the Union of Soviet Socialist Republics (USSR) making inroads into the East African and Great Lakes regions. Kenya's colonial past with Britain was also critical since the latter espoused capitalism, whose structures Kenya inherited and maintained. Kenya welcomed the move since it was in dire need of aid especially food which the US had in plenty.

In the first decade after independence the Cold War politics prevailing in the international system played Kenyan leaders against each other. In 1966, Kenya's first Vice President Jaramogi Oginga Odinga parted ways with Kenyatta.<sup>116</sup> Odinga was perceived as a communist who went against Kenya's thinly veiled capitalist orientation. He was fiercely anti-capitalist and anti Western.<sup>117</sup> Odinga's communist leanings saw him visit the Soviet Union in 1964 where he obtained aid which included putting up of a 200 bed hospital in Kisumu, a radio station, a sugar factory, a paper mill, an irrigation project, a fish cannery and food processing factory. Kenya was also offered 300 scholarships.<sup>118</sup>

Cold War politics and the effects on Kenya's foreign and domestic policy environment continued into Daniel Arap Moi's era. Though Kenya espoused positive non alignment on paper,

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<sup>115</sup> J. Rono, "Kenyan Foreign Policy," in Stephen Wright (ed), *African Foreign Policies*, op.cit. pp. 100-117:114.

<sup>116</sup> W.R. Ochieng, "Structural and Political Changes," in W.R. Ochieng' and B.A. Ogot, (eds) *Decolonization and Independence in Kenya 1940-1993* (London: James Currey. 1995), pp 83-108:98.

<sup>117</sup> S. M. Makinda, "From Quiet Diplomacy to Cold War Politics: Kenya's Foreign Policy" op.cit p.303.

<sup>118</sup> Ibid.

the country favoured one of the superpowers.<sup>119</sup> During this period, Kenya enjoyed cordial relations with the West owing to many reasons including a stable political situation, healthy economy and favourable conditions for Western Multinational Corporations.<sup>120</sup> Kenya received massive economic assistance from the West to the tune of 40% of her development spending in water, food, education, transport and energy sectors. The West funded policies such as Sessional Paper No. 1 of 1982 on District Focus for Rural Development and Sessional Paper No. 1 of 1986. Moi and Thatcher had a close personal relationship leading to the construction of the Margaret Thatcher Library at the Moi University.<sup>121</sup>

The changing international political environment in the early 1990s however had an effect on the domestic scene. The pro democracy movement took root in one party states in Africa. Moi resisted the clamour for political pluralism, much to the chagrin of the West who were questioning human rights records, corruption and economic mismanagement and insisted that aid would hitherto be tied to good governance and respect for human rights.<sup>122</sup> Throughout the 1990s Kenya faced major problems including political instability and economic and social decline throughout the 1990s. Corruption was a thorny issue in Moi's government and international development aid was frozen.<sup>123</sup> Political upheavals were a common feature during Moi's time with clashes in the Rift Valley in 1992 and at the Coast in 1997 impacting negatively on the economy.

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<sup>119</sup> Ibid

<sup>120</sup> W. Tordoff, *Government and Politics in Africa* (NY:Palgrave, 2002), p.106.

<sup>121</sup> J. Rono, "The Foreign Policy of Kenya" in S. Wright, *African Foreign Policies*, op.cit p.107.

<sup>122</sup> W. Tordoff, *Government and Politics in Africa*, op.cit. p197-198

<sup>123</sup> G.K. Ikiara et al "Kenya: Formulation and Implementation of Strategic Trade and Industrial Policies" in Charles Seludo et al (eds) *The Politics of Trade and Industrial Policy in Africa: Forced Consensus?* Op.cit. pp.205-224:208-209.

## 2.5 Other Interests

This Section analyzes two areas of interest in Kenya's foreign policy and which have a direct bearing on the economic development of the country. These include conflict resolution and economic interests as well as regional integration and Kenya's economic development.

### 2.5.1 *Conflict Resolution and Economic Interests in Kenya's Foreign Policy*

Conflict management is a useful tool of the foreign policy of weak states.<sup>124</sup> Kenya's foreign policy under Kenyatta was punctuated by the desire for good neighbourliness and protection of Kenya's territorial integrity.<sup>125</sup> Kenya was frequently consulted on continental matters with Kenyatta chairing the Organization of African Unity (OAU) Congo Conciliation Committee in 1964.<sup>126</sup> Kenya was also involved in conflict resolution efforts during the reign of Daniel Arap Moi. The Ugandan peace efforts in 1985 as well as the Somali and Sudanese mediation efforts were dear to Kenya due to many reasons but principally economic and trade interests. Uganda is a crucial conduit for Kenyan goods to the Great Lakes region while Sudan offers an attractive market.<sup>127</sup> Following the 1972 Addis Ababa Peace agreement that stopped the Sudanese war, Kenyan businessmen thrived during the reconstruction. The country also served as the operational base for multilateral and other agencies involved in the reconstruction programme.<sup>128</sup> The risk of losing out economically thus has motivated Kenya to involve herself

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<sup>124</sup> M. Mwangi, "Foreign Policy and the Diplomacy of Conflict Management in Kenya" in *African Review of Foreign Policy*, op.cit. pp 44-62:58.

<sup>125</sup> S. M. Makinda, "From Quiet Diplomacy to Cold War Politics: Kenya's Foreign Policy" op.cit p.300

<sup>126</sup> M. Mwangi, "Foreign Policy and the Diplomacy of Conflict Management in Kenya" in *African Review of Foreign Policy*, op.cit. pp 44-62:58.

<sup>127</sup> Ibid p.50.

<sup>128</sup> Ibid.

in conflict resolution efforts in the neighbouring states. The policy was dictated by Kenya's economic and industrial infrastructure.<sup>129</sup>

Foreign policy under Mwai Kibaki has taken a low profile after seeing the Sudanese peace process succeed and the Somali one collapse. Throughout Kibaki's term Kenya has manifested disinterest in conflict resolution efforts in the region.

### 2.5.2 *Regional Cooperation and Kenya's Economic Development*

While Kenya's economy benefited immensely from Western capital, it was imperative that the country found an outlet for her manufactured goods so as to continually attract the investment.<sup>130</sup> In 1967, Kenya signed the East African Cooperation (EAC) treaty with Uganda and Tanzania.<sup>131</sup> The East African Common market became an asset to Kenya which, being the most economically advanced state in the region, was increasingly being viewed as the center of the periphery. Kenya indeed controlled 48.7 percent of the intra-EAC trade between 1969 and 1978. During the same period, exports alone accounted for 79 percent of her total intra-EAC trade.<sup>132</sup> Thus the foreign relations with the East African region were primarily driven by economic considerations. Kenya had to pursue a policy of vigorous economic development at home and economic cooperation with the region.<sup>133</sup>

With time however, Kenya's dominance of the East African market at the expense of her neighbours Tanzania and Uganda attracted feelings of discontent among the East African states.

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<sup>129</sup> S. M. Makinda, "From Quiet Diplomacy to Cold War Politics: Kenya's Foreign Policy" op.cit. pp. 300-319: 301.

<sup>130</sup> Ibid p.304.

<sup>131</sup> A. Legovini, "Kenya: Macro Economic Evolution Since Independence" (NY:UNDP) November 2002

<sup>132</sup> K.G. Adar, and M. Ngunyi, "The Politics of Integration in East Africa" in W.O. Oyugi, *Politics and Administration in East Africa*, op.cit. pp. 395-425:405.

<sup>133</sup> J. Okumu, "Kenya's Foreign Policy," in O. Aluko, *The Foreign Policy of African States*, op.cit. p.138



Uganda and Tanzania felt that Western states were dominating their markets through Kenya, a situation that deteriorated leading to the collapse of the union in 1977.<sup>134</sup>

The dependency on the East African market saw the economy of Kenya exposed several times. Uganda expelled unskilled workers who had originally come from Kenya. Owing to the sensitive nature of the dependency, Kenya had to live with Uganda's decision. The same happened when Tanzania's announced the socialist *Arusha Declaration* which was ideologically different from Kenya's open capitalist orientation.<sup>135</sup>

The collapse of the EAC in 1977 and the subsequent closure of the Kenya-Tanzania border necessitated Kenya's shift in her foreign policy. Kenya had to look for market for her goods to replace lost markets in Tanzania, Zambia and Malawi. The last two were accessible to Kenya via Tanzania.<sup>136</sup> Kenya was forced to look for alternative markets in other parts of Africa and Middle East. The country began engaging with the Arab world by encouraging diplomatic and trade relations. Sudan, Ethiopia, Rwanda, Burundi and Congo were also wooed<sup>137</sup> As a strategy to contain the losses that accrued from the collapse of the EAC, Kenya actively engaged in the formation of the Preferential Trade Area (PTA) to boost her economy. The main aim was to capture the Tanzanian, Malawi, Mozambique, Zimbabwe and Zambia through the multilateral organization.<sup>138</sup>

The value of the East African market to Kenya's economic interests cannot be gainsaid and it is due to this fact that Kenya never gave up on its desire to see the market operational. Even in the face of suspicions and mistrust, Kenya relentlessly pursued the revival of the East

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<sup>134</sup> S. M. Makinda, "From Quiet Diplomacy to Cold War Politics: Kenya's Foreign Policy" op.cit. pp.300-319: 305

<sup>135</sup> Ibid p.306.

<sup>136</sup> Ibid p.301.

<sup>137</sup> Ibid p.310.

<sup>138</sup> Ibid p.310

African Community and this led to the signing of the East African Cooperation Treaty in 1996.<sup>139</sup> The regional body has since grown rapidly and will usher in a Common Market from July 2010, a move that will facilitate free movement of labour and capital within the region and promote intraregional trade. A Monetary Union is also expected in 2013.<sup>140</sup>

Other regional bodies that Kenya has actively been involved in their formation and operation include the Common Market for Eastern and Southern African States (COMESA), the Inter Governmental Authority on Development (IGAD) and the Indian Ocean Rim Association for Regional Cooperation (IORARC).<sup>141</sup> All these regional bodies contribute significantly to Kenya's economic development.

## 2.6 Independent Kenya's Economic Performance

### 2.6.1 Kenya's Macro-Economic Scene

Kenya has witnessed a mixed macroeconomic experience since independence. The first decade of independence witnessed real GDP growth of an average 6.6 percent per year between 1964 –1973.<sup>142</sup> This can be attributed to consistency in economic policy which promoted smallholder agricultural farming, high domestic demand, and expansion of market for domestic output within the East African region. The policy environment also favoured investment and capital imports. In industry, the government employed an industrial strategy based on import-substitution which delivered high growth rates for the sector in the first years of implementation.<sup>143</sup>

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<sup>139</sup> J. Rono, "Kenyan Foreign Policy," in Stephen Wright (ed), *African Foreign Policies*, op.cit. pp. 100-117:105.

<sup>140</sup> B. Wekesa, 'The EAC Reloaded,' in *Diplomat*, January-February 2010, Vol. 001 pp:9-13:9.

<sup>141</sup> J. Rono, "Kenyan Foreign Policy," in Stephen Wright (ed), *African Foreign Policies*, op.cit. pp 100-117:114

<sup>142</sup> D. M'Amanja and O. Morrissey, "Fiscal Policy and Economic Growth in Kenya," Centre for Research in Economic Development and International Trade (CREDIT) Research Paper, (University of Nottingham June 2005).

<sup>143</sup> A. Legovini, "Kenya: Macro Economic Evolution Since Independence", UNDP November 2002. p.13

During 1970s, several factors worked against the Kenyan economy: the two oil crises; government involvement in the economy leading to market distortions and stifling of the private sector; poor monetary and fiscal management and poor policy response to these problems led to an average real GDP decline to 5.2 percent average over the period.<sup>144</sup>

The third decade saw the effects of expansionary fiscal policy of the previous decade that led to the establishment of highly protected but grossly inefficient private industries and state corporations begin to cause serious strain on the economy. The economy performed poorly with average real GDP falling further to 4.2 percent over the period.<sup>145</sup> Kenya responded with fiscal and monetary policy reforms in that pleased international donors. Aid inflows more than doubled during the 1980s leading to a macroeconomic stability.<sup>146</sup> However the stabilization was short-lived. From the second half of the decade, fiscal expenditures rose and hence external debt kept rising.<sup>147</sup>

The trend persisted into the fourth decade of independence, the result being an even more severe downward spiral to an average low of 2.2% GDP growth between 1990 and 2002 owing to a combination of poor fiscal and monetary policy regime, external and internal shocks as well as political events. By 1992, the economy was in a recession and the first multiparty elections were coming up in December. There was need for a shift in policy to arrest the recession. The government relaxed controls of foreign exchange transactions and adopted a floating exchange rate. In 1993 the Kenyan Shilling was devalued to the tune of 81 percent hence increasing the foreign debt and inflation rate. The economic growth continued deteriorating. High real interest

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<sup>144</sup> D. M' Amanja and O. Morrissey, "Fiscal Policy and Economic Growth in Kenya," Centre for Research in Economic Development and International Trade (CREDIT) Research Paper, (University of Nottingham June 2005)

<sup>145</sup> Ibid

<sup>146</sup> A. Legovini, "Kenya: Macro Economic Evolution Since Independence" op.cit. p.13

<sup>147</sup> Ibid

rates, high transaction and business costs combined to create uncertainty resulted and low employment and slow output growth. The poor economic performance can be attributed to weak macroeconomic management, slow progress in structural reforms and failure to address governance issues. The 1992 and 1997 political upheavals further affected Kenya's credibility in the international community, thereby resulting in severe cuts in international aid.<sup>148</sup>

### 2.6.2 *Trade Policy*

Post independence Kenya adopted the import substitution as its strategy for industrial growth. This policy was in place by the time Kenya gained independence having been adopted in the 1940s and 1950s to protect local manufacturers. In the late 1960s protection was ensured through the creation of the customs union with Uganda and Tanzania by way of a system of import quotas which provided barriers to entry and was also a source of revenue. The system was maintained even after the collapse of the regional customs union during which Kenya's export markets were hard hit.<sup>149</sup>

The import substitution strategy seemed not to be working hence the fourth development plan for 1979-84 took called for the elimination of quantitative restrictions, and lowering and simplification of tariffs. Between 1980 and 1985 there was categorization of items into restricted and unrestricted categories. This had the effect of doubling the share of imports without quantitative restrictions and reduction of the average tariff by 8 percent. The reforms, however, stalled early on and revenues from import duties rose rather than decline in the period. During the foreign exchange crisis of 1982-84, tariffs further increased by 10 percent<sup>150</sup>

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<sup>148</sup> Ibid

<sup>149</sup> Ibid

<sup>150</sup> S. Gurushi "Kenya: Structural Adjustment in the 1980s" Policy Research Working Paper, World Bank, 1994.

In 1987, a second stage of trade liberalization began. The reform measures were aimed at instituting automatic licensing for a large number of import items, and reducing tariffs. By 1991, significant progress had been made and only 5 percent of imports were subject to quantitative restrictions.<sup>151</sup>

Further reforms were carried out in 1993-94 with the government removing import licensing and foreign exchange controls and implementing customs management reforms. The latter reforms were responsible for increasing revenues by at least one third more than can be explained by changes in trade, exemptions, and tariff rates. The elimination of import licensing was important to reduce rent-seeking activity. The liberalization was supported by a real exchange rate depreciation of 10 percent between 1987 and 1990 that reflected a 9 percent fall in the terms of trade.<sup>152</sup>

A new wave of trade reforms was triggered by Kenya co-founding and joining of the Common Market for Eastern and Southern Africa (COMESA). In 2001, the government formulated a comprehensive tariff reform to improve Kenya's external position, simplify duties and facilitate collection in view of joining the common external tariff of COMESA in 2004.

In 2009, Kenya embarked on formulation of a new trade policy that was aimed at maximizing on the emerging business trends in the world.<sup>153</sup> This is aimed at consolidating the various trade policies to create a coherent one.

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<sup>151</sup> A. Legovini, , "Kenya: Macro Economic Evolution Since Independence" op.cit

<sup>152</sup> Ibid

<sup>153</sup> M, Kapchanga, "Kenya Formulating New Trade Policy" in *The East African* posted on 26<sup>th</sup> April 2009 accessed on 14<sup>th</sup> August 2010.

### 2.6.3 *Inward Foreign Direct Investment (FDI) Trends in Independent Kenya*

States engage in foreign economic relations with the aim of attracting inward FDI so as to supplement available resources in economic development. FDI is assumed to have the potential of bringing not only more stable capital inflows but also greater technological know-how, higher-paying jobs, entrepreneurial and workplace skills, and new export opportunities.<sup>154</sup> There are several requisite conditions for a steady flow of FDI in any country. These include economic openness, political stability and a legal structure that protects property rights.<sup>155</sup>

Developing countries specifically African countries have had a long history of engagement with FDI. After independence, many developing countries engaged their policy makers in a bid to formulate investor friendly policies so as to attract FDI so as to provide the much needed impetus for industrialization.<sup>156</sup> The 1980s also saw the advent of structural adjustment which vouched for FDI combined with as key to sustained economic recovery.<sup>157</sup>

In the first two decades after independence, Kenya was a prime choice for foreign investors seeking to establish a presence in Eastern and Southern Africa. This was possible owing to Kenya's fairly open economy, the relatively high level of development, good infrastructure, market size, growth and receptiveness to FDI. These factors influenced Trans-National Corporations (TNCs) into choosing Kenya as their regional hub. FDI started at a low of around \$10 million a year in the early 1970s before peaking at \$80 million in 1979-1980<sup>158</sup>

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<sup>154</sup> E. Prasad et al., "Effects of financial globalization on developing countries: Some empirical evidence" IMF Occasional Paper 220, (Washington DC: 2003).

<sup>155</sup> C. W. Hill, *International Business: Competing in the Global Marketplace* (Irwin: McGraw-Hill 2001) p143.

<sup>156</sup> T. Mkandawire, "Thinking about Development States in Africa." *Cambridge Journal of Economics* 25 (3) p.306.

<sup>157</sup> World Bank, "Global Economic Prospects and the Developing Countries." (Washington, DC: World Bank 1997) p.51.

<sup>158</sup> UNCTAD, *Investment Policy Review: Kenya* (Geneva: 2005) p.13.

The 1980s however witnessed the deterioration of the economy and this, coupled with corruption, poor governance, half-hearted approach towards structural and economic policy reforms and the deterioration of public services and infrastructure led to a lull in inward FDI that started which persisted into the new millennium. Between 1981 and 1999 FDI averaged only \$22 million a year. Although the sale of mobile phone licenses to Kenyan-foreign joint ventures pushed FDI to over \$100 million in 2000, inflows fell again to around their average of the 1980s and 1990s, before rising again in 2003 on the back of textile investments in export processing zones (EPZs). A United Nations Council on Trade and Development (UNCTAD) report ranked Kenya as 129<sup>th</sup> (out of 140 countries) on UNCTAD's FDI performance index in 2001-03. The report further states that the country has never ranked better than 111<sup>th</sup> at any time since 1990 in FDI flow. Throughout the 1990s Kenya missed out on the global surge in FDI that affected most of the world in the 1990s. While its average annual level of FDI inflows doubled between 1981-1985 and 1996-2003, the average inflow into African countries was multiplied by six, and average inflows into developing countries as a whole almost increased tenfold. The poor performance is attributed to lack of significant progress and half hearted nature of economic reforms over the past decades, corruption, mediocre growth performance, deterioration in the quality of infrastructure and the rising cost of services.<sup>159</sup>

The year 2003 saw the ascendancy to power of a new regime which inherited a country that had experienced a long period of poor economic and industrial policies in which rampant corruption contributed to a weak investment climate. The new administration embarked on a process of drastically improving policies and providing a favourable setting for private investment to generate wealth and reduce poverty.

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<sup>159</sup> Ibid p.13.

The Economic Recovery Strategy for Wealth and Employment Creation adopted in 2003 was aimed at ensuring that the public sector played its regulatory and facilitator role for private investment. The Strategy revolved around seven key areas including the macro-economic framework, governance, security and the rule of law, public sector reforms, infrastructure, sectoral policies in agriculture, tourism, trade and industry; social policies and cross-cutting issues such as the financial sector, land or research and development policies. These reforms were aimed at attracting foreign investment and in the process contributing significantly towards Kenya's economic development.

## **2.7 Conclusions**

The chapter has presented an overview of the Kenya's foreign economic relations and the trends in economic growth and development since independence. It was argued that the foreign economic policy of Kenya has over the years been shaped by both systemic and domestic factors. The colonial legacy that Kenya inherited from the British played a crucial role in deciding the direction that Kenya was to take in its quest for economic development. Kenya followed in the footsteps of its colonial masters by espousing capitalism. This made her the regional economic powerhouse and a preferred destination for foreign investors. The 1960s and 70s were thus to experience impressive economic development. This was compounded by relative political stability. However external and domestic factors combined to set in motion a process that would see the Kenyan economy decline in the 1980s and 1990s and also into the millennium. Another factor that stood out was the kind of leadership. The period between 1963 and 1978 saw the foreign policy of Kenya being formulated through a consultative process though tightly controlled by the state. Only government actors were involved. Between 1978 and 2002 the power was consolidated around the presidency where the foreign policy was effectively



controlled by the president. This coincides with the period of economic decline. Between 2003 and 2010 the country has adopted a more consultative process of formulating and executing foreign policy.

## **CHAPTER THREE**

### **FOREIGN POLICY AND ECONOMIC DEVELOPMENT: A CASE STUDY OF KENYA, 1990-2010.**

#### **3.1 Introduction**

The previous chapter presented an overview of the Kenyan situation under the framework of the relationship between foreign policy and economic development. The chapter reviewed the foreign and domestic economic policies that Kenya has pursued since independence with a view towards furthering her economic development goals. The Chapter established that Kenya's foreign economic policies up to the end of the Cold War period were shaped by various factors including colonial legacy, personal idiosyncracies of leaders, domestic politics and more importantly cold war politics. It was also established that the policies led to mixed economic growth owing to an interplay of these factors.

This Chapter looks closely at the relationship between foreign policy and economic development in Kenya during the Post Cold War period. The Chapter will first examine the foreign economic policy measures and institutions that the country embraced in a bid to promote its economic development. The Chapter will narrow down to FDI also compare the FDI inflows into the country under two periods (1990-2002) and (2002-2010) and with other countries within the region as well. Finally, the Chapter will analyze the nature of FDI into the country and its impact on the economic development of Kenya before drawing conclusions in line with the hypotheses of the study.

#### **3.2 Policy and Institutions for Attracting FDI (1990-2010) into Kenya**

This section looks at the policy and institutions that Kenya has put in place as part of its economic diplomacy in to attract FDI into the country.

### 3.2.1 Policy Framework for Attracting FDI

Kenya has over the years embarked on policy reform that is geared towards attracting FDI into the country. The 1990s were crucial due to the increased competition for inward FDI from countries in Eastern Europe. Kenya on its part implemented a comprehensive reform programme intended towards bailing out its ailing economy. The reform process marked the shift of the economy towards a market system with the government liberalizing interest rates and exchange rates as well as removing price controls. Import controls were also removed and capital controls relaxed hence opening up the economy.<sup>160</sup> The free foreign exchange regime was intended to facilitate repatriation of profits by foreign investors. To further motivate foreign investors, the government removed barriers to foreign commercial private. Kenya also established the Export Processing Zones with attendant incentives including unrestricted foreign ownership, employment of expatriates and control over foreign exchange earnings as well as other tax, procedural and infrastructure incentives.<sup>161</sup>

Other policy reform measures that the government implemented include the liberalization of major sectors of the economy as well as privatization of state corporations. In 1994 the government launched the Parastatal Reform Project which identified 207 public enterprises in non-strategic commercially-oriented enterprises for privatization.<sup>162</sup> Kenya has also implemented liberalization of some sectors including transport and communication among others.

In the mid 2000s Kenya enacted the Investments Promotions Act 2004 which aimed at facilitating foreign investments into the country. The Bill provided for all foreign investors to

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<sup>160</sup> F. Mweya, and R. Ngugi, "Foreign Direct Investment in Kenya" in S. I. Ajayi (ed) *Foreign Direct Investments in Sub Sahara Africa: Origins, Targets, Impact and Potential* (Nairobi: AERC, 2006), pp:119-143:124

<sup>161</sup> Ibid

<sup>162</sup> UNCTAD, "Investment Policy Review: Kenya 2005," op.cit. p.51.

obtain certification from the Kenya Investments Authority before operating in Kenya. The certificates were to ascertain the resultant benefits of the FDI in Kenya through job creation, skills and technology transfer and contribution to tax and other government revenues. They were also required to invest at least US\$500,000. <sup>163</sup>

Kenya is also a member of multilateral organizations that partly or wholly influence the investment scene. These include the World Trade Organization, International Center for Settlement of Investment Disputes (ICSID), Multilateral Investment Guaranteed Agency (MIGA), and World Intellectual Property Organization (WIPO) among others<sup>164</sup>

The government also promotes Kenya as a destination of FDI through diplomatic means with negotiations and conclusion of Bilateral Investment Treaties (BIT) and Double Taxation Treaties (DTT) which serve to improve the investment relations among states that are parties to the same. <sup>165</sup>

### ***3.2.2 Institutional Framework for Attracting FDI***

#### ***3.2.2.1 Export Processing Zones Authority (EPZA)***

In a bid to attract FDI into the country, Kenya created the Export Processing Zones (EPZ) program in 1990 with the enactment of the EPZ Act, CAP 517 of the Laws of Kenya. The Export Processing Zones Authority (EPZA) was established as the attendant regulatory body. The EPZA is a State Corporation, under the Ministry of Trade and its mandate is to promote and facilitate export oriented investments and to develop an enabling environment for such

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<sup>163</sup> Ibid. p.23

<sup>164</sup> Ibid. p.26

<sup>165</sup> Ibid. 29

investments. The body does this through fiscal, infrastructural and procedural incentives designed to attract FDI into Kenya.<sup>166</sup>

### 3.2.2.2 *Investments Promotion Center/Kenya investments Authority*

The Investments Promotion Center (IPC) was established in 1986 through an Act of Parliament with the aim of attracting private investments into Kenya. Its mandate was to facilitate investments through approval and licensing as well as promotions through exhibitions both locally and abroad. In 2004 Parliament enacted legislation that created a new body the Kenya Investment Authority (KIA) to succeed the IPC.<sup>167</sup> KIA'S mandate is to promote and facilitate investments into Kenya and it does this through organizing investment promotion activities both locally and internationally, providing information to ease the implementation of new investment projects, providing after care services for existing investments and investor tracking.<sup>168</sup> The organization is also involved in policy advocacy through reviewing the investment environment and making recommendations to the Government and others actors with respect to changes that would promote and facilitate investment.<sup>169</sup>

### 3.2.2.3 *National Investments Council*

The Investments Promotion Act 2004 also established the National Investment Council consisting of the President, ministers of finance, trade and industry; agriculture; lands; local authorities; planning; tourism and information; and environment, natural resources and wildlife; the Governor of the Central Bank of Kenya; the chairman of the board of the Kenya Investments Authority; and twelve persons appointed by the President to represent the private sector, each of

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<sup>166</sup> Export Processing Zones Authority, *Doing Business in Kenya 2005*, (Nairobi: EPZA, 2005) pp.28-29

<sup>167</sup> Government of Kenya, *Investment Promotion Act 2004*, (Nairobi: Government Printer, 2004) p.7.

<sup>168</sup> [www.investmentkenya.com](http://www.investmentkenya.com) accessed on 12<sup>th</sup> May 2010.

<sup>169</sup> Government of Kenya, *Investment Promotion Act 2004*, (Nairobi: Government Printer, 2004) p.8.

whom has distinguished himself in the field of law, economics, commerce, industry or management. The Council was charged with advising the Government and government agencies on ways to increase investment and economic growth in Kenya; and to promote co-operation between the public and private sectors in the formulation and implementation of government policies relating to the economy and investment.<sup>170</sup>

#### 3.2.2.4 Ministry of Foreign Affairs (MFA)

The MFA is a key institution as far as economic diplomacy is concerned. It was established immediately after Kenya became independent to articulate Kenya's foreign policy.<sup>171</sup> The MFA develops and implements Kenya's Foreign Policy which seeks to pursue the interests and values of Kenya and those of Africa, through diplomatic engagement with other states.<sup>172</sup> The ministry has gone through various phases in its structure and strategy. From 1963-1978 the balance between the structure and strategy leaned more to the strategy with the formulation and conduct of the foreign policy being entrusted to the bureaucrats at the MFA. The balance tilted from 1978 to 2002 when the structure preeminence. The presidency increasingly consolidated power around it and foreign policy became a preserve of the Head of State. From 2003 the new regime delegated the formulation and conduct of foreign policy back to the bureaucracy at the ministry.

Since 2003 the MFA has moved to articulate Kenya's foreign policy more clearly. The draft MFA Foreign Policy Framework 2009 hinges Kenya's foreign policy around five main pillars with economic diplomacy taking a central role. The other four include Diaspora

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<sup>170</sup> Ibid p.9-10.

<sup>171</sup> [www.mfa.go.ke](http://www.mfa.go.ke) accessed on 12<sup>th</sup> May 2010.

<sup>172</sup> Ministry of Foreign Affairs Kenya, *Draft Foreign Policy Framework 2009*.

diplomacy, cultural diplomacy, environmental diplomacy and regional integration.<sup>173</sup> The Draft also acknowledges Kenya's foreign policy a tool to advance the country's aspirations of being a middle income country by 2030. Among the specific objectives is to foster increased capital inflows into Kenya and promote the country as a favoured FDI destination.<sup>174</sup>

In carrying out its economic diplomacy mandate the MFA cooperates with various institutions including the Executive; legislature; office of retired head of state; former ambassadors and senior diplomats; ambassadors at large and goodwill ambassadors; and immigration policies and instruments among others.<sup>175</sup>

#### 3.2.2.2.1 Structure of MFA

The MFA is headed by a minister and deputized by an assistant minister both appointed by the president. The implementation of policy and other technical aspects of the ministry are left to the permanent also appointed by the president. The former is assisted by the Diplomatic Secretary, Chief of Protocol and directors of Administration and Foreign Service Institute. There are also 21 divisions including the economics division, most of them headed by former ambassadors. Kenya has a diplomatic coverage of over 100 stations with 51 fully fledged missions abroad, some with multiple accreditations. The country is also represented in 8 multilateral organizations, 4 of which are accredited to the UN and its agencies in New York, Geneva, Vienna and Nairobi.<sup>176</sup>

Since independence, Kenya has had no less than 18 different people heading the MFA and 19 Permanent Secretaries overseeing the technical aspects of the ministry. The longest

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<sup>173</sup> Ministry of Foreign Affairs Kenya, *Draft Foreign Policy Framework 2009* p.16.

<sup>174</sup> *Ibid* p.17

<sup>175</sup> *Ibid* p.18

<sup>176</sup> [www.mfa.go.ke](http://www.mfa.go.ke) accessed on 12<sup>th</sup> May 2010.

serving minister lasted 5 years while the PS who served the longest did 6 years.<sup>177</sup> This shows the lack of continuity and stability at the ministry.

### 3.3 Trends and Nature of FDI inflows into Kenya (1990-2010)

This subsection traces the evolution of FDI into Kenya within two time frames (1990 and 2002) and (2003-2010). The two periods coincide with two different regimes that of Daniel Arap Moi and Mwai Kibaki. The two leaders had different leadership styles which may have had an impact on Kenya's relations with her economic partners. This section will establish whether this had an impact on the FDI inflows into the country.

#### 3.3.1 FDI inflow Trends into Kenya (1990-2002)

The 1960s and 70s are widely considered as the golden years of Kenya in terms of FDI inflows with the country becoming one of the most important destinations of Multinational Corporation(MNC) investments in Africa.<sup>178</sup> The 1980s in contrast witnessed the beginning of a downturn in the FDI volumes into Kenya.<sup>179</sup> This has been attributed to deterioration of economic performance coupled with growing problems of corruption and poor governance, poor economic policies, hesitance in implementation of structural reforms and the deterioration of public services and infrastructure.<sup>180</sup>

Between 1990 and 1999, Kenya FDI inflows into Kenya averaged 22 million US\$ a year. (See Table 1) The early 1990s saw the volumes of FDI fall significantly from a high of US\$57.1million in 1990 to a low of US\$1.6 million in 1993. The period between 1992 and 1994

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<sup>177</sup> Ibid

<sup>178</sup> M. Nzomo, "External Influence on the Political Economy of Kenya" in W.O. Oyugi (ed) *Politics and Administration in East Africa* (Nairobi: EAEP, 1994) pp.429-468:435; UNCTAD, *Investment Policy Review:Kenya* (New York: United Nations, 2005)p.4

<sup>179</sup> F. Mwega and R. Ngugi, "Foreign Direct Investment in Kenya" in S. I. Ajayi,(ed), *Foreign Direct Investments in Sub Sahara Africa: Origins, Targets, Impact and Potential*, op.cit. pp.119-143:121

<sup>180</sup> G.K. Ikiara et al "Kenya: Formulation and Implementation of Strategic Trade and Industrial Policies" in Charles Seludo et al (eds) *The Politics of Trade and Industrial Policy in Africa: Forced Consensus?* Op.cit. pp.205-224:220



was particularly dismal averaging US\$3.9 million.<sup>181</sup> This is the time when the world was adjusting to unipolarity and the new wave of democratization sweeping across the world. The period witnessed hostilities between the government and its potential donors in the West. The year 2000 however saw the levels rise to over \$110.9 million giving a false impression that the country had change in fortunes as far as FDI inflows was concerned. The sharp rise can however be attributed to the sale of mobile phone licenses to Kenyan-foreign joint ventures as well as accelerated offshore borrowing by private companies to finance electricity generation. It is instructive to note that the FDI inflow levels quickly fell again to around their pre millennium.<sup>182</sup>

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<sup>181</sup> World Bank, "World Development Indicators, 2003": UNCTAD, World Investment Report, 2002

<sup>182</sup> UNCTAD, "Investment Policy Review: Kenya 2005," op.cit. p.5

*Table 1: FDI Inflows into Kenya 1990-2002*

Year	Net inflows US\$ million	Gross inflows (% of GDP)	Net inflows (% GDP)	Net inflows (% of Gross Capital Formation)	Net FDI Stock US\$ million
1990	57.1	0.67	0.67	3.4	569
1991	18.8	0.23	0.23	1.17	
1992	6.4	0.08	0.08	0.58	
1993	1.6	0.03	0.03	0.18	
1994	3.7	0.05	0.05	0.32	
1995	32.5	0.36	0.36	2.05	614
1996	12.7	1.14	0.14	0.82	
1997	19.7	0.21	0.19	1.21	
1998	11.4	0.10	0.10	0.65	
1999	13.8	0.13	0.13	0.90	
2000	110.9	1.06	1.06	7.76	764
2001	5.3		0.05	0.36	737

Adopted from Mwega and Ngugi<sup>183</sup>

*Table 2: Analysis of Comparative FDI Inflows for Selected Countries/Region*

Country/Region	Inflows (US\$ million)						
	1990-95	1996	1997	1998	1999	2000	2001
World	224,295	384,960	481,911	686,028	1,079,083	1,392,957	823,825
Kenya	20	13	40	42	42	127	50
Uganda	44	121	175	210	222	254	229
Tanzania	39	149	158	172	183	193	224

Adopted from Mwega and Ngugi<sup>184</sup>

<sup>183</sup> F. Mwega and R. Ngugi., "Foreign Direct Investment in Kenya" in S. I. Ajayi (ed) *Foreign Direct Investments in Sub Sahara Africa: Origins, Targets, Impact and Potential*, op.cit p.135

<sup>184</sup> Ibid p.136

Comparatively, Kenya's fared poorly in the region in FDI inflows. Between 1990 and 1995, the total global FDI inflow was US\$224,295 million (see table 2). Kenya could only manage to attract US\$ 20 million against Tanzania and Uganda which attracted US\$39 million and US\$44 million over the same period. Worse still, by 2001 Kenya could only attract a paltry US\$50 million as compared to Uganda's US\$229 million and Tanzania's US\$224 million. (See Table 2). In 1995, Angola attracted US\$ 2629 million with Tanzania raking in US\$309 million.(Table 3). Kenya could only manage US\$ 38 million. Further, FDI contributed 1.6 percent of Kenya's Gross Capital Formation (GCF) compared to Angola's 148.1 percent and Tanzania's 15.4 percent (see table 4). Over the same period the FDI stock for Kenya was US\$732 million compared to US\$2922 and US\$ 620 million for Tanzania (see Table 5). FDI accounted for 6.3 percent of the Gross Domestic Product (GDP) of Kenya and 10.2 percent and 58.4 percent for Tanzania and Angola respectively. (See table 6).

It is thus clear that while Kenya's bid to attract FDI was falling that of her neighbours was rising steadily. Kenya's regional leadership in attracting FDI suffered setbacks from the early 1990s. This was attributed to the reform measures employed by Tanzania and Uganda. The two countries introduced a raft of economic measures which included opening their economies to foreign investors. During this time Kenya was experiencing economic stagnation. The entry of South Africa into the international community in the early 1990s also increased competition for the attraction of large TNCs seeking a single production or headquarters centre in English-speaking Africa.<sup>185</sup>

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<sup>185</sup> UNCTAD, *Investment Policy Review, Kenya, 2005*, op.cit p.4

By the turn of the millennium, Kenya's long held tradition as the lead FDI destination had long diminished. Throughout the 1990s into the 2000s Kenya had gradually lost its appeal as the preferred destination of FDI in the region. This state of affairs was blamed on a chain of self-inflicted political and economic blunders, mostly between 1978 and 1991. Investor confidence slowly eroded due to a raft of factors including political instability, insecurity, corruption, poor infrastructure, high utility costs, high real interest rates and limited legal recourse.<sup>186</sup> Other factors include reluctant implementation of economic reforms and mediocre growth performance as well as reform initiatives in neighbouring states which served to deflect FDI from Kenya.

**Table 3: Comparative Analysis of FDI Inflows into Kenya and other Selected Countries**

Country/Region	FDI Inflows (US\$ billions)				
	1995-2005	2006	2007	2008	2009
Kenya	38	51	729	96	141
Angola	2627	9064	9796	16581	13101
Tanzania	309	597	647	679	645
East Africa	978	2643	4030	3814	2938

Source: UNCTAD World Investment Report 2010

<sup>186</sup> Federation of Kenyan Employers, "Kenya loses FDI to Neighbours" in *Africa Business* 1<sup>st</sup> July 2002: See also F. Mwea and R. Ngugi "Foreign Direct Investment in Kenya" in S. I. (Ajayi ed) *Foreign Direct Investments in Sub Sahara Africa: Origins, Targets, Impact and Potential*, op.cit. p.121.

*Table 4: FDI as a Percentage (%) of GFCF of Selected Countries*

Country/Region	1995	2007	2008	2009
Kenya	1.6	13.9	1.9	3.0
Angola	148.1	118.1	123.2	109.0
Tanzania	15.4	12.9	10.3	10.5
East Africa	9.7	17.2	13.9	10.5

Source: UNCTAD World Investment Report 2010

*Table 5: Analysis of FDI Stock (US\$ million)*

Country	1995	2000	2007	2008	2009
Kenya	732	931	1893	1989	2129
Angola	2922	7978	11202	12880	16515
Tanzania	620	2778	5942	6621	7622

Source: UNCTAD World Investment Report 2010

*Table 6: Analysis of FDI as a Percentage (%) of GDP*

Country	1995	2007	2008	2009
Kenya	6.3	7.0	6.5	6.5
Angola	58.5	21.4	15.2	24.0
Tanzania	10.2	34.3	31.0	31.5

Source: UNCTAD World Investment Report 2010

The 1990s were characterized by FDI flight from Kenya. During this period, good number of companies including multinationals moved away from Kenya. Proctor and Gamble moved its detergent production line to Egypt in 1999 with Johnson and Johnson moving production to Zimbabwe in 2000. Colgate Palmolive gradually phased out production in Kenya

while preserving support services for the region in Nairobi).<sup>187</sup> One of the major reasons that led to this state of affairs was poor infrastructure. The manufacturing sector was particularly hard hit owing to neglected infrastructure.

### 3.3.2 *Trends of FDI Inflow into Kenya (2003-2010)*

The year 2002 marked an important era in Kenya's history. The country was preparing itself for a transition of power from one sitting head of state to another through elections. Elections were held in late 2002 and the then opposition leader Mwai Kibaki was elected to power. The new government was elected on a platform of economic and other sectoral reforms that were geared towards salvaging the dwindling fortunes of the economy. The Economic Recovery Strategy for Wealth Creation and Employment Creation was prepared to guide economic recovery.<sup>188</sup> The reform measures instituted by the government were partly aimed at overturning the declining trends of FDI into the country.

The new confidence and optimism that greeted the new government had a effect on the levels of FDI into the country. By 2006 the FDI inflows into Kenya had hit US\$ 51 million compared to the annual average of US\$ 38 Million between 1995 and 2005. This was still low compared to Tanzania's US\$ 597 million and Angola's US\$9064 million. The upward trend however continued and by 2007 Kenya had managed to upstage Tanzania to record US\$ 729 million. The latter received US\$647 million during the period (Table 3). The trend was however interrupted in 2008 dropping to US\$96 million only to rise again to US\$141 million. The drop to the FDI inflows in 2008 can be attributed to the prevailing hostile domestic political environment

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<sup>187</sup> UNCTAD, "Investment Policy Review: Kenya, 2004"op.cit.7

<sup>188</sup> Government of Kenya, *Economic Recovery Strategy for Wealth and Employment Creation*, (Nairobi: Government Printer, 2003) xiii

following the disputed 2007 Presidential elections which escalated to violence and undermined investor confidence.

During the same period, FDI accounted for 13.6 percent of the Gross Fixed Capital Formation (GFCF) in 2007 from a low of 1.6 percent in 1995. Tanzania on the other hand had 12.9 percent in 2007 which was a decline from 15.4 percent in 1995. The trend for Kenya was once more interrupted in 2008 falling to 1.9 percent (Table 4).

An analysis of FDI inflows into Kenya as a percentage of the GDP shows an upward trend during the period under review. In 2007 for instance, FDI contributed 7.0 percent of GDP a rise from 6.3 percent in 1995. In 2008 and 2009, FDI accounted for 6.5 percent of the GDP apiece. This represented a slight drop from the 2007 figures. The slight drop coincided with the post-election violence witnessed in Kenya at the time. Over the same period, FDI into Tanzania accounted for 34.5 percent in 2007 before dropping to 31.5 in 2009. (Table 6)

The FDI stock for Kenya increased to US\$ 2129 million in 2009 from US\$ 931 million in 2000. Though this compares badly with Angola's and Tanzania's over the same period, it represented a rise in FDI stocks over the mid and late 2000s.

Statistics processed by the KIA show an increase in the number of foreign projects during the period under review. In 2007 for instance 73 foreign projects were processed as compared to a high of 37 between 1990 and 2002. In fact between 2003 and 2009 annual number of projects for any given year exceeded those processed for any the period between 1990 and 2002 (Table 7 and 8). The tables also show the rise of China and India as major sources for Kenya. The main sectors however remain Agriculture, Tourism, Service and Manufacturing with construction featuring prominently in the late 2000s.

### 3.3.3 *Nature of FDI Inflows 1990-2010*

Kenya does not keep comprehensive data on the value of actual foreign direct investment by sector and industry since not all investors are required to liaise with the KIA.<sup>189</sup> However data processed by the Investment Promotions Centre (IPC)- now KIA between 1995 and 2002 indicated that foreign participation in the economy has been diversified. The main sectors that dominated the projects were service, manufacturing, tourism and agriculture. (See table 7). These included mainly the horticulture, floriculture, textile and tourism.

Investments in the first two were due to favourable local conditions linked to climate and a fairly developed transport infrastructure. The textile sector on the other hand was spurred by the US initiated preferential access to its market under the African Growth and Opportunity Act (AGOA).<sup>190</sup>

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<sup>189</sup> UNCTAD, "Investment Policy Review Kenya, 2004"op.cit p.7

<sup>190</sup> Ibid



**Table 7: Major FDI Projects, Countries of Origin and Main Sectors**

Year	No. of Projects	Major Source Countries	Main Sectors
1995	31	UK=12%,China=12%,USA10%,France =10%,Pakistan=10%,Rwanda=10%,Other=36%	
1996	25	UK=20%, China=20%, Canada=16%, Rwanda=10%,Other= 24%	Service, Manufacturing, Tourism, Agriculture
1997	25	UK=16%, China=12%, South Africa=12%, Italy=12%,Other= 48%	Service, Manufacturing, Tourism, Agriculture
1998	27	China=26%, UK=11%, Pakistan=11%, Germany =10%,Other=42%	Service, Manufacturing, Tourism, Agriculture
1999	37	China=27% UK=10%, India=10%, Italy=8%,Other=45%	Service, Manufacturing, Tourism, Agriculture
2000	28	China=31%, India=18%, UK=11% ,Other=40%	Service, Manufacturing, Tourism
2001	25	China=48%, UK=12%, Germany=10%, North Korea=10%, Other=20%	Manufacturing, Service, Tourism
2002	31	China =20%,SA=16%, India=16%, Uk= 10%, Others= 36%	Manufacturing, Services and Tourism

Source Investment Promotion Centre/Kenya Investment Authority

**Table 8: FDI Projects Major Countries of Origin and Main Sectors (1995-2002)**

Year	No. of projects	Major Source Countries	Main Sectors
2003	56	China= 17%, UK = 15%, USA= 7%, India =4% ,Others =57%	Service,Manufacturing,Tourism
2004	64	UK=14%, China =11%, German= 10%, USA= 8% , India = 5 % , SA = 5% ,Others= 47%	Service, Manufacturing, Tourism, Agriculture
2005	52	China= 22%, UK =22%, India =10%, SA= 6%, USA=13% Others=27%	Service, Manufacturing, Tourism, Agriculture
2006	70	UK,India,China,Germany,SA USA	Service, Manufacturing, tourism, Agriculture
2007	73	UK, China,Canada, India, Italy,Pakistan	Service, Manufacturing, Tourism
2008	49	Italy, South Africa USA,India, Netherlands,UK	Manufacturing,Construction,Servi ce,Tourism
2009	64	UK, India,Canada,China,South Africa	Construction,Agriculture,Tourism Energy, Manufacturing,ICT
May 2010	21	South Africa, UK,Turkey,Canada,India	Construction,Service, Manufacturing, Agriculture

Source: Kenya Investment Authority

### 3.4 Impact of Investment Policies on Economic Development

In the 1990s the government embarked on economic reforms owing to the difficult domestic and international environments. Privatization of unprofitable state enterprises was one of the reform measures. The process led to the sale of 207 small and medium size companies, 97 per cent of which were bought by Kenyans. The Kenya Airways was however an exception with

the Dutch Company KLM buying 26 per cent of the 77 percent shares on offer in 1996. The Government received \$76 million from the sale of the shares.<sup>191</sup>

As stated earlier, one of the major policy decisions that the government came up with in the 1990s was privatization. Though implemented in a haphazard and reluctant manner, this policy had some significant contribution to the economic development of Kenya. The privatization of Kenya Airways for instance was hailed as one of the most successful privatization ventures in sub-Saharan Africa.<sup>192</sup> Kenya Airways has seen tremendous improvement in reliability and performance making it one of the market leaders in the region.<sup>193</sup> It is also one of the few profitable airlines in Africa and one of the market leaders in flights between Europe and Africa and within Africa. In 2003, Kenya Airways made a net profit of \$16 million which was three times that of 2002 with passenger hitting \$322 million.<sup>194</sup>

Liberalization of the telecommunications sector was one of the economic reform policies that Kenya embarked on. The move was instrumental in pushing the FDI inflows into Kenya to more than US\$110 million in 2000 from a low US\$ 13.8 million in 1999 through purchase of their shareholding.<sup>195</sup> Between 1999 and 2000, British firm Vodafone purchased a 40 percent shareholding in Safaricom. During the same period, French firm Vivendi was licensed to operate another mobile phone company Kencel (which has since changed hands to Celtel then Zain and is in the process of rebranding to Bharti Airtel.) The purchase of the licences by Vodafone and Vivendi fetched \$55 million apiece. In 2003, a third national mobile phone operator, Econet of

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<sup>191</sup> IFC, *A New Look at African Privatization* (Washington; World Bank, 2004).

<sup>192</sup> UNCTAD, *Investment Policy Review, Kenya 2004*, op.cit. p.9

<sup>193</sup> Ibid p.11

<sup>194</sup> Government of Kenya, *Economic Recovery Strategy for Wealth and Employment Creation*, op.cit. xiii

<sup>195</sup> UNCTAD, *Investment Policy Review, Kenya 2004* op.cit p.9

South Africa, was awarded a licence and is currently in consortium with Essar of India.<sup>196</sup> In late 2007, France Telecom through its brand Orange purchased a 49 percent share in Telkom Kenya and is now operating in mobile telephony and fixed wireless lines. The privatization of the communications sector has revolutionized communication by easing communication through efficient service as well as reduced costs. New technologies have also been introduced with services such as payment of utility bills, money transfer (such as MPesa and Zap) and internet.

Perhaps one of the major areas where FDI has had a major impact is the floriculture and horticulture industry. In the early 1990s the industry was dominated by small scale holders who produced vegetables for export. By the end of the decade they had been superseded by large commercial farms and exporters' own farms. Foreign investors currently dominate almost 90 per cent of flower production thus contributing significantly to the success of the sector.<sup>197</sup> Horticulture and floriculture industries are the single most important contributors to the GDP of Kenya. The industry also employs tens of thousands of workers. The success of the flower industry also served to motivate small scale growth of flowers and vegetables for the export market.<sup>198</sup>

FDI has also had a considerable impact in the textile and apparel sector. The advent of AGOA in 2001 rejuvenated the EPZ. Most FDI in manufacturing since 2001 has been in the EPZs, with the majority (60 per cent of total EPZ investment by 2003) in AGOA-related textiles. In 2003, There were 55 foreign or joint-venture enterprises (as well as 11 fully local companies) operating in EPZs in 2003. 7 EPZs have expanded from their initial textiles focus to also produce

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<sup>196</sup> "Econet Kenya Changes Name to Ward off Suitors" *Balancing Act* Issue No. 449 10<sup>th</sup> April 2009

<sup>197</sup> UNCTAD, *Investment Policy Review, Kenya 2004*, op.cit. p.7

<sup>198</sup> *Ibid* p.9

a number of other goods, although the domination of garments remains strong. The largest single investment is the De La Rue currency printing operation with a value of \$48 million.<sup>199</sup>

As seen from the analysis elsewhere in this Chapter, level of FDI into Kenya has since 1990 been low by all benchmarks. FDI which is supposed to provide extra sources of capital and investment and help close the savings gap has done little to achieve this end. Between 1995 and 2009 FDI inflows represented ranged between 1.6 and 3.0 percent (hitting a high of 13.9 in 2007 per cent) of (GFCF), compared with a high of 15.4 per cent for Tanzania and 148.4 per cent for Angola. (See table 4) This has been attributed to slow progress in opening up the infrastructure sector to private investment.<sup>200</sup> Some of the major contributions of FDI to capital and investment have nevertheless occurred from the privatization of the telecommunications sector especially through the rapid build-up of infrastructure. The competition introduced in mobile telephony has been instrumental in generating a sharp increase in the availability and quality of telecommunication services, with the number of users exceeding 20 million in 2003 (out of a population of 38 million people).

The opening of the power generation sector to private investment in the late 1990s also allowed the rapid increase in power supply that was needed at the time through the involvement of foreign Independent Power Producers. By the early 2000s the four IPPs time operating at the time accounted for about 20 per cent of total capacity.<sup>201</sup> The government also privatized other infrastructure projects such as water, railways and roads (through concessioning) with mixed results. However others such as ports, airports and electricity distribution remain under the control of the state.

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<sup>199</sup> Ibid

<sup>200</sup> Ibid

<sup>201</sup> Ibid

Technological transfers have taken place mostly through transfers of managerial skills and processes, and not so much through embodied technology. Formal research and development is very low and is confined to a few large enterprises.<sup>202</sup> The operations of foreign enterprises in manufacturing are largely in the production of low-end consumer and agro-processed goods for the local and regional market and garments for export to the United States. However some companies have employed the use of complex technology and advanced processes in manufacturing. These include General Motors and Tetrapak. General Motors has endeavoured to constantly upgrade automation in order to improve productivity. Tetrapak on the other hand has applied World Class Manufacturing techniques to its Kenyan operations since 2001 as part of a global programme.<sup>203</sup>

FDI has also played an important role in technology transfer in horticulture and floriculture in Kenya thus enabling the sector to become a leading exporter of quality products to their consumers. The companies in the horticulture industry have set up large state of the art greenhouses as well as employed modern technology in land preparation, irrigation systems, greenhouses, refrigerated storage, communication and staff welfare facilities. Dutch-owned Oserian has for instance installed one of the world's biggest geothermal heated greenhouses to reduce disease pressure and increase rose yield through more uniform temperatures. Homegrown on the other hand uses sophisticated communication systems to ensure speedy transportation of produce to customers within the shortest time possible. The company employs wireless data

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<sup>202</sup> Ibid p.14.

<sup>203</sup> Ibid

communication linking their production, cooling and packing facilities in Kenya with order information from their customers in Europe.<sup>204</sup>

FDI has also played a central role in the transfer of skills to local workers in Kenya. The relatively high level of general education in Kenya has facilitated the transfer of skills. Kenya requires that companies undertake an understudy programme for each expatriate employee recruited by foreign investors, with the aim of replacing the expatriate with a Kenyan employee in the medium term.<sup>205</sup> Many foreign firms have complied and provided training to their employees on a wider basis. They have also given a high level of responsibility to local staff by providing ongoing training programmes in order to allow them to occupy top management positions.<sup>206</sup>

FDI has, since the 1990s, been an important source of employment for Kenyans. The EPZ for instance employs tens of thousands of people, with around 12,000 additional jobs created indirectly as a result of sub-contracting.<sup>207</sup> Employment rose 32 per cent in 2003 from a year earlier and accounted for around 17 per cent of total formal manufacturing employment in the same year representing a rise of 14 percent from 1999.<sup>208</sup> Horticulture which is labour intensive has also significantly contributed to the growth of employment. There were about 135,000 people employed in the sector as of 2003.

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<sup>204</sup> Ibid

<sup>205</sup> Ibid

<sup>206</sup> Ibid

<sup>207</sup> [www.epzakenva.com](http://www.epzakenva.com). Accessed on 9<sup>th</sup> September 2010.

<sup>208</sup> UNCTAD, *Investment Policy Review, Kenya 2004*, op.cit. p.16

### 3.5 Conclusions

This Chapter has discussed the role of foreign economic policy on economic development with a special emphasis on Kenya between 1990 and 2010. The gave an overview of the policy framework that Kenya has put in place at both domestic and international levels to attract inward FDI volumes which would then facilitate faster economic growth and development. Despite the fact that post-cold war foreign policy calls for an all inclusive approach to further foreign policy goals, the formulation and implementation of foreign policy still largely remains the responsibility of the state and state organs including the presidency, ministries and parastatals. The Chapter established that despite implementing various policy reforms during the post cold war era, Kenya has largely failed in its bid to attract FDI. The volumes of inward FDI into the country have continued to steadily fall from the 1980s with Kenya losing out to her neighbours in attraction of FDI. Therefore, to the extent that FDI is assumed to lead to economic development it can be concluded that Kenya's post-cold war foreign policy has made negligible contributions to its economic development.

The second hypothesis stated that the foreign policy of Kenya contributed to increased volumes of FDI into the country. This was through the data that is available, negated. The study established that the volumes of FDI have steadily declined since the late 1990s owing to a poor foreign and domestic framework towards attraction of the same. Blaming it on foreign economic policy alone however is simplistic since other factors including an unstable sociopolitical and economic environment played a critical role in affecting the volumes of FDI into the country.

The third hypothesis stated that inward FDI into Kenya contributed to economic development. This Chapter has demonstrated that though the FDI volumes into Kenya were minimal compared to those in the region and elsewhere, the FDI nevertheless has given an notable contribution to



economic development. The ICT, horticulture and floriculture as well as textile sectors have contributed to economic development through job creation and technology and skills transfer as well as spillover effect. The ICT sector has done very well with innovative products coming from the mobile telephony market. Mobile money transfer has particularly had a huge effect on the way Kenyans transact their businesses including payment of utility bills, banking and other services.

Chapter 4 will look at the issues raised in this chapter and elsewhere through a more incisive critical analysis.

## CHAPTER FOUR

### FOREIGN POLICY AND ECONOMIC DEVELOPMENT: A CRITICAL ANALYSIS

#### 4.1 Introduction

The previous Chapter examined the role of foreign policy in economic development using Kenya as a case study. Available data showed that despite Kenya embracing various economic policy measures aimed at attracting FDI the inflows into the country have, by all standards been persistently low since 1990. Compared to her regional peers, Kenya has in the Post-Cold War period performed dismally. The country has never risen above position 110 in FDI ranking which brings. Despite all this, the little FDI that the country has been able to attract has contributed significantly to the economic development of the country especially in the horticulture and telecommunications industry.

This chapter critically analyzes the role that foreign policy plays in the economic development of developing countries. A number of issues on the Kenyan situation have emerged from this study namely: the changing nature of foreign policy in the post-Cold War era; the role of FDI in economic development of developing states; and the imperatives of a successful economic diplomacy. In addition, the chapter will include a comparative analysis of Kenya and two South East Asian countries: Singapore and Malaysia within the context of foreign policy and economic development.

#### 4.2 Changing Nature of Post Cold War Foreign Policy of Developing States

As discussed earlier in Chapter 1 the end of the Cold War marked an important epoch in the evolution of foreign policies of developing states. Superpower politics were radically altered and the involvement of the sole standing superpower as well as the European Union in

developing countries especially Africa redefined.<sup>209</sup> During the cold war period developing states held some leverage over the powers and played them with the full knowledge that the latter could not afford to nudge them into the opposite camp and in the process lose geo-strategic advantages.<sup>210</sup> In this way the developing states obtained concessions in the form of military and economic aid with loyalty to the powers being the only condition. However, with the end of the Cold War, developing states could no longer seek concessions from the superpowers. In fact the Western states began disinvesting from regions they perceived to be less strategic to their interests.<sup>211</sup>

Faced with the unfolding scenario, the states had either to adapt to the new realities or perish. Globalization posed certain urgent problems in the formulation of foreign policies, requiring developing states to conform to the realities of the complex interdependence in whose grip the international system has found itself.<sup>212</sup> The liberal economic wave that swept across the world was unstoppable and states had to bow down to pressures for economic reform as well as democratization. The pressures came from both within and without with the International Finance Institutions (IFIs) and Western powers employing the newly acquired leverage to force states to reform their economic policies to conform the market economy. The clamour for democratization saw domestic pressure groups exert extreme pressure on their governments to

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<sup>209</sup> S,Wright, "The Changing Context of African Foreign Policies," op. cit p.2

<sup>210</sup> Ibid p.7: see also A. K. J. Hey "Introducing Small State Foreign Policy," in A.K.J.Hey (ed) *Small States in World Politics: Explaining Foreign Policy Behaviour*, op.cit. pp.1-11:1.

<sup>211</sup> T. Shaw and J. Nyang'oro, "African Foreign Policies and the Next Millennium: Alternative Perspectives, Practices and Possibilities, in S. Wright (ed) *African Foreign Policies*, op.cit. pp.237-248: 237-238

<sup>212</sup> M. Mwagiru, "Re-inventing the Future: Linkages between Human Rights, Foreign Policy and Regional Integration" *Thought and Practice: A Journal of the Philosophical Association of Kenya (PAK)New Series*, Vol.1 No.2, December 2009, pp.73-86.

introduce pluralism, transparency and accountability in politics.<sup>213</sup> Liberalization thus tended to be one of the parameters that shaped foreign policy with liberal tenets including economic liberalism dominating international relations.

With liberalism dominating the world politics, foreign policies of developing states shifted in terms of actors (from states and presidents to multiple players especially economic ones), issues (from diplomatic and strategic to economic) and levels (from national to regional then global). Thus instead of focusing on classic external relations of national security and high politics it now concentrates on two issues economic diplomacy and peace keeping/peace making.

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Decision making in foreign policy also changed with more players seeking to be consulted in both foreign and domestic policy making. Parliaments, pressure groups, civil society groups and non-governmental organizations (NGOs) have become factors in the foreign policy equation attempting to shift decision making from a centralized command post (office of the president).<sup>215</sup>

One of the outstanding issues of the post-cold war international system was the decline of official development assistance.<sup>216</sup> This was attributed to the fact that the geostrategic importance of some developing states diminished hence the superpower had no obligation to assist them financially. Consequently the interest for FDI as an alternative source of capital was

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<sup>213</sup> A.J. K. Hey, "Introducing Small State Foreign Policy," in A.J.K.Hey (ed) *Small States in World Politics: Explaining Foreign Policy Behaviour*, op.cit. pp.1-11:1.

<sup>214</sup> T. Shaw and J. Nyang'oro, "African Foreign Policies and the Next Millennium: Alternative Perspectives, Practices and Possibilities, op. cit p.238

<sup>215</sup> S. Wright, "The Changing Context of African Foreign Policies," op. cit p.8.

<sup>216</sup> B.K.Kinuthia, "Determinants of Foreign Direct Investment in Kenya: New Evidence," A Paper submitted for the Annual African International Business and Management (AIBUMA) Conference in Nairobi in August 2010.

renewed.<sup>217</sup> Thus the countries moved to reform their economies and domestic political situations to attract FDI. The countries took measures designed to promote macroeconomic stability and other measures thought to be investment friendly. African countries in particular have taken steps to liberalize the environment for FDI, gradually allowing foreign investors to operate in virtually all sectors with very few of them restricted. Other policy measures include tax holidays, easing of import and customs controls, investment in infrastructure and labor law reform as well as establishment of investment promotion agencies to promote investment<sup>218</sup>. Countries that were slow or unwilling to implement the same experienced difficulties in attracting foreign investments hence affecting their economic progress.

#### ***4.2.1 Post Cold War Foreign Policy and FDI: The Kenyan Situation***

Chapter two discussed the foreign policy of Kenya from the pre-independence period through the end of the cold war. The foreign policy during this period was influenced by various factors including the colonial legacy left behind by the British, the prevailing international political order which involved superpower relations and the regional political dynamics. One of the major shapers of the foreign policy of Kenya at the time was the need for economic development hence the adoption of liberal economic policies aimed at attracting FDI as well as fostering external trade. The liberal policies were in line with the ideals of Kenya's preferred Western economic partners and this led to economic and military assistance from the latter.

The end of the cold war however brought new dynamics that affected developing and particularly African states. The new order of world politics that the time brought with it was not enthusiastically welcomed among in many African states. Kenya in particular experienced

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<sup>217</sup> Ibid

<sup>218</sup> T. J. Moss et al, "Is Africa's Skepticism of Foreign Capital Justified? Evidence from East African Firm Survey Data." Working Paper No. 41, June 2004, Center for Global Development, (i)

problems in the implementation of political and economic reforms. By the early 1990s Kenya's relations with the hitherto friendly West had changed to the extent that some of them began disinvesting from the country. The West was pushing Kenya for good governance, pluralism in politics, increased democratic space, respect for human rights, free and fair elections, transparency and accountability in management of public resources, privatization and liberalization of the economy.<sup>219</sup> Development aid and any other form of economic cooperation were tied to fulfillment of the conditions stated above. It is imperative to note that relations with donors were one of the key parameters that foreign investors held dearly. Poor relations with the latter meant little confidence in the business environment hence investments dwindle. On the other hand, cordial relations with donors meant that they had confidence in the institutions and policies of the host country which in turn translates to a conducive business environment and more foreign investments.

Kenya's less than enthusiastic reaction to the prevailing post cold war international politics inevitably led to the loss in fortunes that the country suffered in the inward flow of FDI. As seen in Chapter 3, FDI inflows suffered a sharp decline from the 1990s with the country losing its prime position as the preferred FDI destination in the East African region. The situation was further worsened by the politically instigated clashes in 1992 and 1997 which brought serious instability thus serving to further alienate investors.<sup>220</sup>

Another factor that undermined Kenya's efforts to attract FDI into the country is corruption.<sup>221</sup> Kenya's traditional economic partners had during the cold war era turned a blind eye to the corruption related activities that were taking place in the country. This was as

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<sup>219</sup> J. Rono, "Kenyan Foreign Policy," op.cit p. 107

<sup>220</sup> Ibid p.108

<sup>221</sup> B.K. Kinuthia, "Determinants of Foreign Direct Investment in Kenya: New Evidence," op.cit.p.107

mentioned earlier due to the fact that these countries were reluctant to annoy their strategic ally that was a gateway for establishing a sphere of influence in the greater Eastern Africa region. With the end of the cold war and clamour for greater accountability, corruption became a key issue to the Western states. In Kenya, the early 1990s for instance witnessed the revelations of the Goldenberg scandal where the country lost Ksh.14.8 billion.<sup>222</sup> The corruption scandal damaged relations with the IFIs and other bilateral donors and by extension foreign investors hence undermining economic development. Corruption activities extended into the early years of the millennium despite the change in leadership in late 2002. Government ministers were implicated in corrupt deals with Kenya reportedly losing billions of shillings in the *Anglo Leasing* scandal.<sup>223</sup>

The first hypothesis of this study was that foreign policy contributes significantly to economic development. In testing the hypothesis, this study proceeded from the assumption that the line between foreign and domestic policy is blurred so that whatever may be ordinarily termed domestic policy by some is indeed a critical part of foreign policy. Measures put in place for instance to attract FDI and promote external trade are as foreign policy as they are domestic policy. The analysis also assumed as will be demonstrated later that FDI contributes to economic development. To this extent, if it is to be assumed that the more FDI the greater the economic development, then Kenya's foreign policy has not succeeded in fostering economic development. This is due to the declining inward flow of FDI into the country during the period under review. However it would be simplistic to look at the issue in this manner. Comparing Kenya with her neighbours Uganda and Tanzania, the latter have continued to attract far more FDI than Kenya.

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<sup>222</sup> Ibid p. 108

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However, Kenya continues to be the dominant economy in the region despite this. More critically, it would be appropriate to consider not the volumes of FDI but the quality of the FDI and what it has been able to achieve in terms of economic development in the countries where it is hosted.

### **4.3 FDI and Economic Development: The Big Debate**

The role that FDI plays in the economic development of states is an issue that continues to elicit different opinions amongst scholars thus giving birth to three schools of thought in the debate. The first school argues that FDI is crucial to the economic development of states while the second one takes the opposite view. The third one, while agreeing with the first one advocates for empowerment of the local entrepreneurs terming it a more sustainable model.

#### **4.3.1 Pro-FDI View**

The pro-FDI authors proceed from the assumption that host countries have low productivity levels, low wages, low levels of savings and low investment levels which perpetuate low levels of production.<sup>224</sup> FDI is therefore crucial in that it helps address these issues through supplying more effective management, marketing and technology to improve productivity. FDI also provides employment opportunities and capital for domestic investments hence stimulating domestic investment and in the process promoting economic growth.<sup>225</sup>

A survey carried out in East African firms by the Center for Global Development revealed tangible positive effects of FDI for both the host economies and workers in the foreign

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<sup>224</sup> T.H. Moran, *FDI and Development, the New Agenda for Developing Countries and Economies in Transition*, (Washington: Institute for International Economics, 1999), p.15.

<sup>225</sup> G. Kabelwa, "Potential Impacts of FDI on Economic Development in East Africa," A paper prepared for a Policy Dialogue for Accelerating Growth and Poverty Reduction in Tanzania, held at the Conference Hall, ESRF, on May 25th, 2006. See also Kinuthia, B.K., "Determinants of Foreign Direct Investment in Kenya: New Evidence," A Paper submitted for the annual African International Business and Management (AIBUMA) Conference in Nairobi in August 2010



based firms. These benefits include more productivity, better management skills, heavy investment in infrastructure as well as in the training and health of their workers. The firms were also found to be more connected to global markets than domestic firms. The survey also established that foreign firms do not appear to succeed by grabbing market share and crowding out local industry. The study concludes that many of the common objections to foreign investment are exaggerated or false. Africa, by not attracting more FDI, is therefore failing to fully benefit from the potential of foreign capital to contribute to economic development and integration with the global economy.<sup>226</sup>

China is the world's fastest growing state with FDI playing a crucial role in its economic development. FDI does this through improved the liquidity in the Chinese economy thus facilitating other investments, creating employment, increased earnings and thus taxation revenue for the central and regional governments. The revenues thus accrued have been ploughed into the economy to boost the living standards of the population further boosting the economy and in the process bringing prosperity for over two decades.<sup>227</sup>

#### 4.3.2 *Anti-FDI View*

The second school of thought states that FDI is not beneficial to developing states more so African countries. Those who hold this view argue that rather than transfer technology to the host countries FDI transfers obsolete and inappropriate technology to developing countries at inflated prices. Foreign investment, especially by MNCs, holds monopolistic tendencies with some exercising great political and economic power within their host countries. These companies

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<sup>226</sup> T. J. Moss, et al, "Is Africa's Skepticism of Foreign Capital Justified? Evidence from East African Firm Survey Data," Op. Cit

<sup>227</sup> S. Ali, and W.Guo, "Determinants of FDI in China" in *Journal of Global Business and Technology*, Volume 1, Number 2, Fall 2005, pp.21.

also discourage domestic investments due to the fact that local companies cannot compete with superior technology and well established political and economic networks. Foreign investors have also been accused of evading taxes through transfer pricing between their subsidiaries, a practice that denies the host countries the much needed revenues.<sup>228</sup>

This argument has indeed percolated into some foreign economic policies of African states hence affecting the inward FDI volumes into the continent. Moss et al identify several factors including historical, ideological and post independence politics as some of the issues eliciting a negative view of FDI among African states.<sup>229</sup> One of the major factors affecting African policies towards FDI is early experiences with foreign companies. FDI's initial contact with African companies is widely perceived to be a precursor to colonialism which had a traumatic effect on Africans. Foreign capital is believed to have disorganized the socioeconomic and political institutions that governed pre-colonial African communities. Foreign companies are thus seen as imperialism and exploitation.<sup>230</sup> Many African leaders also have a Marxist ideological background owing to the fact that most anti-colonial movements were sponsored by the USSR. Thus even though finance ministers may seek to embrace open economies, they are constrained by policy making organs that are dominated by Marxist leaning leaders. Political elites also do not want to be constrained by foreigners who might control key strategic sectors of the economy or their access to foreign exchange and may also influence policy or even support opposition political groups.<sup>231</sup> Other anti-FDI sentiments and which have continued to affect policy include arguments that the former edges out local firms that cannot compete owing to

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<sup>228</sup> C.H. Joon and I. Gabel, *Reclaiming Development*, (London: AED Books, 2004) p.138.

<sup>229</sup> T. J. Moss, et al, "Is Africa's Skepticism of Foreign Capital Justified? Evidence from East African Firm Survey Data," op.cit. p.2

<sup>230</sup> Ibid

<sup>231</sup> Ibid p.3

size, financing, market power or some other advantages. Others argue that foreign firms merely exploit local labor and make no contribution to the wider economy, either through creating jobs, training workers, or in using local suppliers; FDI can be a drain on foreign exchange and that foreign firms remit profits.<sup>232</sup>

#### 4.3.3 *Eclectic View*

Yet other scholars, while agreeing with the first position that FDI is by and large beneficial to host states, argues that it is not the only path to faster economic development. They instead call for a system that promotes home grown entrepreneurs which prove to be more sustainable to economic development than FDI in the long-term.<sup>233</sup> They argue that home grown entrepreneurs may prove to be more sustainable to economic development than FDI in the long-term. This position builds on a comparative study between the Indian and Chinese growth models. The comparison reveals that China's growth model is largely due to policies are geared towards attraction of FDI but which have stifled the growth of domestic private enterprise. Thus Chinese export led manufacturing is largely a creation of FDI which has served as a substitute for local entrepreneurship.<sup>234</sup> India on the other hand adopted a comparatively less favourable attitude towards foreign investors hence attracting lesser FDI. In addition, while China has always had a willingness to warmly receive investments from its large and wealthy Diaspora, the Indian Diaspora has been treated with resentment hence it has been unwilling to invest back home. India has instead concentrated on providing a more conducive environment to domestic

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<sup>232</sup> Ibid p.8

<sup>233</sup> Y. Huang, and T. Khanna. "Can India Overtake China?" *Foreign Policy* July/August 2003, pp. 74-81: 74.

<sup>234</sup> Ibid

entrepreneurs thus developing a comparatively stronger infrastructure to support private enterprise<sup>235</sup>

Owing to the two different models pursued, India has managed to develop home grown corporates that have been able to challenge the best in the world market. In 2002 for instance, Forbes 200, an annual ranking of the world's best small companies, included 13 Indian firms as compared to China's four.<sup>236</sup> Companies such as Infosys and Wipro in ICT, Ranbaxy and Dr Reddys Lab in pharmaceutical and biotechnology are examples of world class Indian corporates.<sup>237</sup> Thus the Indian strategy, coupled with comparatively greater efficiency and transparency in the Indian market and a more advanced legal system, make the Indian model more sustainable compared to the Chinese where foreign investors and state owned enterprises are preferred to local private entrepreneurship.

From the arguments presented above, it can safely be argued that FDI is by and large essential in the economic development of states, both developing and developed. The negative sentiments associated with FDI especially in African states are unfounded. This is demonstrated by the resounding success that the South East Asian countries such as Singapore and Malaysia as well as China and India have been able to experience rapid economic growth owing to their ability to attract and manage FDI. The problem therefore lies not in the negative effects that FDI brings but in the ability to attract and innovatively exploit FDI by ensuring technology and skills transfer, job creation and capital accumulation for economic development. The Indian model of promoting local entrepreneurs appears more attractive though.

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<sup>235</sup> Ibid

<sup>236</sup> Ibid

<sup>237</sup> Ibid

#### 4.4 Imperatives of a Successful Foreign Economic Policy

Rana identifies four main ingredients that are necessary for the success of the foreign economic policy goals of a developing country, which include the attraction of FDI. These include the active involvement of non-state actors; integration or harmonization of foreign affairs and external economic management; Aggressive Promotion of promotion and mobilization of external trade and inward FDI; and empowerment of the ministry of foreign affairs<sup>238</sup>

This subsection analyzes the economic diplomacy efforts of different developing and newly developed countries using the key parameters that Rana has identified above.

##### 4.4.1 Role of Non-State Actors in Economic Diplomacy

The demands of the interdependent and globalized international system have blurred the distinctions between what is domestic and international policy. Economic diplomacy has thus become more complex and has to go deep into domestic decision making and in the process introducing more issues and actors. New economic diplomacy goes deeper than foreign ministries or any closed circle of bureaucrats in the government.<sup>239</sup> A great variety of non state actors also engage in economic diplomacy both by shaping government policies and as independent players in their own right. NGOS, civil society have assumed center stage. International organizations are also a vital forum through which governments pursue their policies and integrate them into their decision making processes.<sup>240</sup>

Successful economic diplomacy therefore must involve more than the state agencies so as to deliver the aims of foreign economic policy. This means the involvement of more than the

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<sup>238</sup> K. Rana. "Economic Diplomacy: The Experiences of Developing Countries" in N. Bayne and S. Woolcock , *The New Economic Diplomacy*, op.cit. pp. 204-205

<sup>239</sup> N. Bayne, and S. Woolcock. "What is Economic Diplomacy" in N. Bayne and S. Woolcock (eds) *The New Economic Diplomacy*, op cit pp 1-20:3.

<sup>240</sup> Ibid p.4.

ministries of foreign affairs, commerce and industry and tourism among others. For a state to achieve its foreign economic policy aims, it must involve business units of the country, associations of commerce and industry, financial sectors, business schools and think tanks. Countries that have proactively reached out to the key stakeholders and co-opted them for the advancement of the countries' economic interests abroad through formal and informal mechanisms have experienced much better results than those that have been reluctant to do so.<sup>241</sup>

To involve more non-state actors in their economic diplomacy, state agencies need to take initiatives to create viable, innovative public-private partnerships<sup>242</sup> Examples of possible such engagements include advisory groups constituting of businessmen to guide external economic outreach and FDI mobilization, official bilateral joint commissions that are actually driven by associations of business and industry, joint eminent persons groups and CEO panels to brainstorm on new opportunities, think tanks and scholars working with business leaders to advise on free trade negotiations.<sup>243</sup> Countries that pursue inclusive home partnerships tend to work well with non state actors in foreign countries.

Singapore has perhaps been one of the most successful developing country in economic diplomacy. The country has been able to use economic diplomacy as a powerful transformational tool that has enabled it to achieve its economic development goals with ease. Singapore used the EDB in the 1960s as a powerful FDI mobilization tool. The EDB is part of Singapore's all inclusive approach that mobilized all stakeholders hence creating synergies that

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<sup>241</sup> K. Rana, "Economic Diplomacy: The Experience of Developing Countries" in N. Bayne and S. Woolcock (eds), *The New Economic Diplomacy*, op.cit. p.202.

<sup>242</sup> Ibid.

<sup>243</sup> Ibid p.202

helped the country innovatively achieve high economic development levels.<sup>244</sup> On the other hand African countries including Kenya still maintained the centrality of the state in foreign economic policy hence lagging behind in attraction of FDI particularly in the 1980s and 1990s. The Ministry of Foreign Affairs and other government departments still maintain a strong grip in the formulation and conduct of foreign economic policy hence denying it the crucial input of the private sector. The country is yet to harness the opportunities that institutions such as Kenyans in Diaspora, sportsmen, former ambassadors, retired heads of states, non governmental organizations (including business executives clubs and associations) among others can offer in formulation and implementation of foreign economic policy.

#### 4.4.2 *Integration/Harmonization of Foreign Affairs and External Economic Management*

A successful economic diplomacy strategy has to either integrate or harmonize foreign affairs and economic management.<sup>245</sup> Different countries employ different ways to achieve this. Some countries have combined foreign affairs with external trade and investment. These include the Caribbean countries-Barbados, Dominica, Grenada, St Lucia, Scandinavia-Finland, Denmark, Iceland, Norway, Sweden, South Pacific, Fiji, Marshal Islands, Samoa, Solomon Islands, Vanuatu, and Australia, Brunei, Canada, Mauritius, New Zealand, South Korea and Swaziland. Other countries prefer to make a distinction between trade policy issues (combined with foreign affairs) and trade promotion activity, handled by a separate entity outside the foreign ministry. Others fully integrate trade and investment promotion and policy management into the foreign ministry with a single set of officials handling the matters. The other method is to establish a special coordination mechanism to handle external economic work such as joined

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<sup>244</sup> Ibid p.211

<sup>245</sup> Ibid p.203

up oversight as practiced by the UK or through entrusting trade and investment to dedicated agencies as in the case of Singapore.<sup>246</sup>

Despite the importance of harmonization or integration of the structures of foreign affairs and external economic management structures, developing countries especially in Africa are still grappling with the lack of coordination between the two. In Kenya for instance the ministry of foreign affairs has an economics department that deals with trade and investment issues among others. The ministry of trade also has an external trade department that deals with the same hence apparent duplication of roles.

The absence of coordination or harmonization of the two functions in developing countries can be attributed to the institutional weight of traditional systems that blocks experimentation and fact that the trade and commerce ministries play a vital domestic trade management function and thus the idea of a joint ministry becomes unattractive<sup>247</sup>. The lack of coordination of foreign affairs and external economic management is manifested in the great deal of effort on turf disputes on bilateral economic issues as well as on multilateral tasks and failure to utilize their overseas diplomatic network for the exploitation of trade and investments<sup>248</sup>

#### 4.4.3 *Aggressive Promotion of Trade and Investments*

A successful economic diplomacy must employ a full range of activities to attract trade and foreign direct investments. Export promotion involves helping home commercial enterprises to seek out foreign markets through market studies, visits by business delegations, participation in international trade fairs and buyer seller meets. These are some of the areas where official agencies play a role. FDI mobilization on the other hand involves first sensitizing potential

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<sup>246</sup> Ibid

<sup>247</sup> Ibid p.203

<sup>248</sup> Ibid



foreign investors on the opportunities in the home country and thereafter undertaking targeted promotion. The former produces catchments of investors and the latter works to translate intention to action. These activities by the official agencies hinge on close harmonization with business associations and individual enterprises.<sup>249</sup>

Kenya has employed several measures to attract trade and investments. These include the creation of institutions to help in carrying out these functions. The Export Promotion Council (EPC) was created in 1992 to develop and promote Kenya's exports of goods and services and to harmonize export related activities.<sup>250</sup> The EPC does this through provision of information on trade, training of exporters on export skills, provision of export credit, insurance and trade finance, facilitation of the trade policy, market analysis and export readiness assessment. The EPC also carries out promotion of Kenyan goods and services in international trade fairs. The KIA on the other hand plays a crucial role in Kenya's economic diplomacy through attraction of FDI. It does this through facilitation of the implementation of new investment projects, providing after care services for existing investments, as well as organizing investment promotion activities both locally and internationally.<sup>251</sup>

The aggressive promotion of trade and investments in themselves may not necessarily mean increased trade and FDI. The latter however depend on other factors such as political stability, regulatory framework, infrastructure and a favourable business environment to succeed. Though Kenya has aggressively pursued foreign trade and FDI the efforts appear to be curtailed by these factors.

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<sup>249</sup> Ibid p.204

<sup>250</sup> [www.epckenva.org](http://www.epckenva.org). accessed on 30<sup>th</sup> October 2010.

<sup>251</sup> [www.investmentkenya.com](http://www.investmentkenya.com)

#### 4.4.4 Empowerment of Ministry of Foreign Affairs

Successful economic diplomacy calls for a distinction between its operation at home and the way it operates out of the home capital through its networks of embassies and consulates.<sup>252</sup>

While these are charged with implementing the whole of government mindset, it is still the foreign ministry that is their immediate master thus in the best position to mobilize them. Thus countries that marginalize their foreign ministries in their economic diplomacy handicap themselves from the very beginning. In line with this a country needs to have a powerful drive amongst its diplomatic service to effectively push its economic diplomacy agenda. The diplomatic service thus needs to be well resourced and well staffed to adequately handle this noble task.

The performance of the ministry of foreign affairs of Kenya has been at best lukewarm. The MFA which is primarily charged with implementation of Kenya's foreign policy including attraction of FDI has been accused of many failures ranging from failure to deliver on its role of formulation of Kenya's foreign policy and defending and promoting the nation's interests internationally, abdicating its role to the Office of the President as well as being obsessed with presidential trips. The process of selection of diplomats to represent the country abroad has been criticized as being opaque and in which undeserving politically connected individuals are appointed envoys. The latter are also accused of being lazy and lacking in professional zeal and for seeing foreign postings as opportunity to accrue hefty savings and benefits.<sup>253</sup> This is in stark contrast to the Brazilian Ministry of External Relations which enjoys a primacy that is unrivalled

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<sup>252</sup> K. Rana, "Economic Diplomacy: The Experience of Developing Countries" in N. Bayne and S. Woolcock (eds), *The New Economic Diplomacy*, op.cit. p..204

<sup>253</sup> Y. A. Nzibo, "Kenya's Foreign Service in the 21st Century" a paper presented to The Kenyan Community Abroad (KCA) 2003 A.G.M. & Fourth Conference "Rebuilding Kenya in the 21st century" Hanover Marriott Whippany, New Jersey, United States July 4th, 2003

among its counterparts in developing countries. The professional competence of the staff, their mastery of foreign languages, and their long service coupled with adequate funding from the government combine to create a powerful tool for the advancement of the country's foreign economic policy aims.<sup>254</sup>

If the Kenyan Foreign Service is to play a decisive role in perpetuating Kenya's foreign policy it will have to undergo restructuring to conform to the aspirations of the people of Kenya as well as the new realities in the era of globalization.<sup>255</sup> This would entail an aggressive and effective representation around the world and a departure from the traditional diplomat associated with wining and dining in diplomatic banquets to those who champion the marketing Kenya and articulate its core values and national interests.

#### **4.5 Economic Diplomacy and Economic Development: Comparative Analysis of Kenya and Malaysia/Singapore**

The role that FDI plays in economic development is generally viewed as crucial by authors of foreign policy.<sup>256</sup> Thus countries must put in place measures that are geared towards attraction of the same. While others have succeeded in attracting significant FDI volumes into their countries hence benefiting from the same in economic development, others have continued to lag behind despite developing and implementing measures towards the same. A comparison between Kenya on the one hand and Malaysia and Singapore on the other offers a perfect example of two contrasting fortunes as far as foreign policy targeting FDI and economic development is concerned. The three countries inherited a rich colonial heritage in terms of a

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<sup>254</sup> K. Rana, "Economic Diplomacy: The Experience of Developing Countries" in Nicholas Bayne and Stephen Woolcock (eds), *The New Economic Diplomacy* op cit.210

<sup>255</sup> Y. A. Nzibo "Kenya's Foreign Service in the 21st Century" a paper presented to The Kenyan Community Abroad (KCA) 2003 A.G.M. & Fourth Conference "Rebuilding Kenya in the 21st century" Op.Cit

<sup>256</sup> Huang, Y., and Khanna, T., "Can India Overtake China?" *Foreign Policy* July/August 2003 pp 74-81: 74

well developed infrastructure, economic structures relying on primary production, vibrant agriculture dominated by foreign investment as well as an ethnically divided society.<sup>257</sup> However the similarities end here, since Malaysia and Singapore have been able to forge ahead and exploited FDI to enhance their economic development while Kenya seems to be still looking for a formula to reach its destination.

#### *4.5.1 The Role of Institutions*

Malaysia has succeeded in attracting significant FDI due to the proactive role of the government in coordinating economic activities as suggested by the development economists. Since the 1970s, the government in Malaysia has undertaken conscious efforts to attract labour intensive FDI to the manufacturing sector through the establishment of institutions which offer a wide range of incentives depending on the investors' needs. The institutions are also well staffed and adequately funded to aptly carry out their functions. One such institution is the Malaysia Industrial Development Authority (MIDA) that acts as a one stop shop for FDI. This has been able to exploit Malaysia's comparative advantages to the point of making the country among the top recipients of FDI.<sup>258</sup> Singapore offers an excellent example of how well established, properly funded and run institutions can make a difference in economic diplomacy. In 1961 Singapore established the Economic Development Board a budget of then about US\$25million. The institution was charged with the establishment of new industries and to accelerate the growth of existing ones. It had four divisions among them Investment Promotion Division whose function was to attract foreign and local investment and encourage co-operation between domestic and

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<sup>257</sup> Kinuthia, B.K., "A Comparative Study between Kenya and Malaysia on the role of Foreign Direct Investment in Economic Development: A Survey of Literature," Tracking Development Africa Studies Centre, Leiden University Netherlands

<sup>258</sup> Ibid

foreign industries, especially in technology. This was to be accomplished by providing information to prospective foreign investors about the advantages of locating manufacturing industries in Singapore. Efforts were to be made to reach them in their own countries as well as by receiving them in Singapore and rendering assistance.<sup>259</sup> The level of the success of EDB in fostering Singapore's economic development goals is self evident. In Kenya on the other hand although the government set out to FDI, the institutions that were established towards the same lacked capacity and a clear policy to function properly.<sup>260</sup> They were and still are, poorly funded, lack the requisite independence to function since they are departments of the central government hence political interference cannot always be ruled out. This has translated in comparatively poor performance as far as inward volumes of FDI and by extension economic development is affected.

#### 4.5.2 *Role of Leadership*

One of the areas where Malaysia and Singapore have succeeded is in leadership. Right from independence, the two country's leaders were nationalists who had their interests at heart. They managed ethnic tensions which have been the cause of instability in many developing states jeopardizing growth. In the case of Malaysia, the *Barisan Nasional*, a coalition government comprising the three major ethnic groups, managed to contain the inherent tendencies towards inter-ethnic conflicts and succeeded in sustaining the political and social commitment to the growth process. Kenya on the other hand has experienced both latent and violent internal conflict since independence. Successive leaders from independence have failed

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<sup>259</sup> H.H.A. Tan, "Official Efforts To Attract FDI: Case Of Singapore's EDB" EWC/KDI Conference on Industrial Globalization In The 21st Century: Impact And Consequences For East Asia And Korea. 2-3 August 1999, National University of Singapore, p.1

<sup>260</sup> B.K .Kinuthia, , "A comparative study between Kenya and Malaysia on the role of Foreign Direct Investment in Economic Development: A Survey of Literature," Tracking Development Africa Studies Centre, Leiden University Netherlands.

to deal with the issue of tribal diversity. Instead they have used tribal stereotypes and long standing rivalries between major ethnic groups for political expediency. Tribal clashes that have served to reverse any gains made.<sup>261</sup> A good example is the politically instigated clashes of 1992, 1997 and especially 2008 which reversed growth from 7.1 percent in 2007 to 1.7 percent in 2008. Political instability is in deed one of the main barriers to FDI in Kenya with the others being crime, insecurity and institutional factors.<sup>262</sup> With politically instigated chaos occurring on almost every election year, no foreign investors would risk long-term investments into Kenya.

#### ***4.5.3 Flexibility and Innovation***

Singapore has been able to take great strides in economic development through innovation. While the country, like Kenya lacks significant mineral resources, it combined its strategic comparative advantages with innovation to enable it attain the Newly Industrialized Country (NIC) status within a few decades of independence. It therefore opted to optimize its human resources through adequately development and deployment to get the best results. The government decided to provide market rate remuneration to employees as well as welcoming foreign talent. This had the effect of equipping government institutions with highly qualified and motivated staff especially at the EDB which in turn contributed to its capacity to formulate and implement policy as well as steer other government and non-government institutions towards the realization of development goals.<sup>263</sup> The country also had adequate and appropriate policy

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<sup>261</sup> B.K. Kinuthia, "A Comparative Study between Kenya and Malaysia on the Role of Foreign Direct Investment in Economic Development: A Survey of Literature," Tracking Development Africa Studies Centre, Leiden University Netherlands.

<sup>262</sup> B.K. Kinuthia, "Determinants of Foreign Direct Investment in Kenya: New Evidence," Op Cit.

<sup>263</sup> H.H.A. Tan, "Official Efforts To Attract FDI: Case of Singapore's EDB" EWC/KDI Conference on Industrial Globalization In The 21st Century: Impact And Consequences For East Asia And Korea, 2-3 August 1999, National University of Singapore

response to the changing economic and political climates in order to adapt to prevailing situation.<sup>264</sup>

Kenya on the other hand was intransigent in policy formulation and implementation. For instance, while Singapore and Malaysia dispensed with the import substitution industrial (ISI) policy in the 1960s owing to its inability to transform the countries' economies, Kenya stubbornly stuck with the strategy until the mid 1980s despite its obvious limitations. Kenya also failed to use its comparatively highly educated human resource in the region to its advantage.<sup>265</sup>

#### 4.6 Conclusions

This chapter has critically analyzed the role of foreign policy in economic development during the post-cold war era with special emphasis on Kenya. The study narrowed down on one of the many goals of foreign economic policy that is attraction of FDI. It has been demonstrated in the study that foreign policy of Kenya during the post-cold war period has largely failed in its efforts of attracting FDI. The study showed that despite employing a raft of policy measures including economic reforms and setting up of institutions to promote inward FDI, Kenya still falls far behind in inward FDI volumes in the region. However it would be naïve to lay the blame solely the policies and instruments that Kenya employed in its external environment to attract FDI. Other factors including the performance of the economy, political instability, weak institutional and regulatory systems, and corruption have conspired to undermine the efforts that the country has put in place to attract FDI.

The Chapter also analyzed the role of FDI in economic development. It was established that FDI indeed plays a crucial role in economic development. However this is dependent on the

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<sup>264</sup> See more in Chapter 1

<sup>265</sup> B.K. Kinuthia, "Determinants of Foreign Direct Investment in Kenya: New Evidence," op.cit.

ability of the host nation to innovatively exploit its comparative advantages so as to attract FDI that is meaningful and can contribute to economic development through creation of employment opportunities, technology and skill transfer and accumulation of capital among others. A comparative study of Kenya and two countries in the South East Asian region that is Singapore and Malaysia was also carried out in this chapter to draw differences in the experiences of the states. It was established that the two countries have combined a mixture of zeal, innovation, political and economic stability brought about by good leadership and a strong institutional capacity to realize the benefits of economic diplomacy. On the other hand, Kenya has suffered from a weak institutional framework, political and economic instability arising from negative ethnicity inspired politics as well as intransigence in policy reforms to conform with the prevailing international political and economic realities

It was also concluded that though Kenya's foreign economic policy was inadequate in attracting FDI, the little that was obtained contributed significantly to economic development especially in ICT and horticulture and floriculture industries. However, if the experience of the South East Asian nations is to be taken as the yardstick then the contribution falls way behind. All the same, it cannot be discounted that FDI though little in quantity has played a significant role in the economic development of Kenya during the period under review.

Chapter five will make conclusions of the study and provide recommendations for policy makers.



## CHAPTER FIVE

### CONCLUSIONS

#### *5.1 Summary*

Chapter one was an introduction to the study. It introduced the basis of the study and provided an overview of the issues that have been discussed in the study. The Chapter introduced and gave a background to the study, stated the research problem and the objectives of the study. Further, the chapter reviewed literature of works by different authors that is related to the study. The review covered the concept of economic diplomacy, case studies of successful foreign policy in economic development in one country in South East Asia and another one in Africa before reviewing literature on the foreign economic policy of Kenya since independence. Chapter one also gave the justification of the study, the theoretical framework, hypotheses, the research methodology and chapter outline. Having justified that foreign policy was one of the crucial strategies that states employ in their quest to achieve economic development, the chapter prepared the way for the study to determine the relationship between foreign policy and economic development with a view to establishing possible recommendations for policy makers and scholars.

Chapter two was an overview of the Kenyan situation within the context of the link between foreign policy and economic development, from the pre-colonial to the end of the cold war in the late 1980s and early 1990s. The chapter analyzed the domestic and systemic influences on Kenya's foreign economic policy and the strategies that the country employed during the time to attain economic gains. It also traced the economic development of the country including the flow of FDI during the period under review.

Chapter three was the case study of the effectiveness of the foreign policy of Kenya in the post cold war in economic development of the country. The case looked at the post Cold War foreign economic strategy employed by Kenya (in terms of policy and institutions), the latter's reaction to the changing international political climate, the trends and nature of inward FDI into the country and the role that the FDI played in economic development.

Chapter four critically analyzed the findings in the previous chapters. The key issues that emerged in the course of the study included the changing nature of foreign policy of developing states in the post-Cold War era, the big debate on the role of FDI in economic development of developing states and the imperatives of a successful economic diplomacy. The chapter also carried out a comparative study of the economic diplomacy of Kenya and two Asian countries namely Singapore and Malaysia.

## **5.2 Key Findings**

This study set out to determine the role that foreign policy has played in the economic development of Kenya in the post-Cold War period specifically through the attraction of inward FDI. It has been established that the foreign policy of Kenya has not played a significant role towards the attraction of inward FDI into the country during the period under review. The data available in chapter 3 clearly shows that the inward FDI volumes into Kenya have been on the decline, despite the institutional and policy measures that the country has employed towards attraction of the same. Up to the end of the Cold War Kenya was the leading destination of FDI in the region but the trend has reversed owing to a raft of issues that can be summed up as an unstable political and economic environment, which plays a big role in deterring would be investors.

The study also established that even though the FDI that Kenya has been able to attract is comparatively very minimal, it has nonetheless played a significant role in the economic development of the country. FDI in the sectors of ICT, horticulture and floriculture industries have benefitted the country through technology and skills transfer, employment opportunities as well as spillover effects. The ICT sector has particularly led to technological innovations that have revolutionized communication and financial transactions throughout the country. The money transfer through the mobile phone stands out.

The study also carried out a comparative analysis of economic diplomacy in Kenya and two Asian countries and further strengthened the argument that FDI plays a crucial role in economic development. Singapore and Malaysia have managed to combine aggressiveness and innovation to attract significant volumes of meaningful FDI that has catapulted them to Newly Industrialized status within a short time. Kenya on the other hand continues to grapple with policy and institutional challenges that have handicapped her ability to attract and effectively attract and exploit FDI for economic development.

### **5.3 Recommendations**

Based on our critical analysis of the link between foreign policy and economic Development, this study has come up with a few recommendations for consideration among policy makers and scholars.

#### ***5.3.1 Reexamination of Foreign Economic Policy implementation Structures***

As stated earlier, Kenya's economic diplomacy structures and institutions are wanting. The MFA has been accused of ceding its functions to the office of the president. There is need for the MFA to take its central role in promotion of Kenya as a prime destination for FDI,

promotion of external trade and tourism among other economic diplomacy goals. There also appears to be a duplication of roles between the MFA and the Ministry of Trade which also deals with external trade. Policy makers may consider amalgamating foreign trade with the ministry of foreign affairs for efficient and effective representation. The other alternative would be to establish a coordination mechanism that will coordinate activities of all the state and non state actors engaging in economic diplomacy. Policy makers may need to explore ways of establishing an independent well funded and staffed Economic Development Board that would establish or harmonize all existing policies targeting external trade and FDI and aggressively pursue their realization.

### ***5.3.2. Enhancing Political Stability***

One of the main factors affecting the effective realization of foreign economic policy aims in Kenya including FDI is political stability. China, Singapore, Malaysia and other countries that have done well in attracting FDI have political stability as one of the major factors to thank for. It is instructive to note that the FDI volumes into Kenya started a downward trend in the 1990s owing partly to the unstable political environment prevailing at the time. It is therefore imperative that the country establishes independent and effective political structures as well as a culture of respect for the same to enhance stability. It is however encouraging to note that Kenya recently promulgated a new constitution that in theory addresses major sociopolitical and economic problems that have affected the country. It remains to be seen whether the country will attain political stability as a result.

### ***5.3.3 Aggressive Pursuit of Regional Integration***

One of the factors that have led to China attracting the highest level of FDI is the size of the geographical territory and the large population which translates to a huge market. Kenya as it

stands has a population of about forty million people. This is hardly the market that serious investors would be willing to invest substantially in. However, Kenya may need to aggressively pursue speedy integration at the level of the East African Community which collectively has a market of over 100 million people. In line with this, there also may be need to formulate a common foreign policy for the EAC modeled along the EU in order to negotiate effectively and with common goals in mind. Common infrastructure projects within the EAC may also need to be fast tracked to make the market more attractive.

While the integration efforts are underway, Kenya may need to aggressively use its comparative advantage of having the most highly skilled human resource and largest economy in the region to position itself as the regional industrial, service, communication and ICT hub through which investor can access the regional market. It is however encouraging to note that some of the recommendations above are being implemented but a lot more needs to be done.

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