KENYA IN 2040

Mapping Kenya's future - Four different scenarios

OXFORD ECONOMICS AFRICA

Institute of Economic Affairs

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Preface

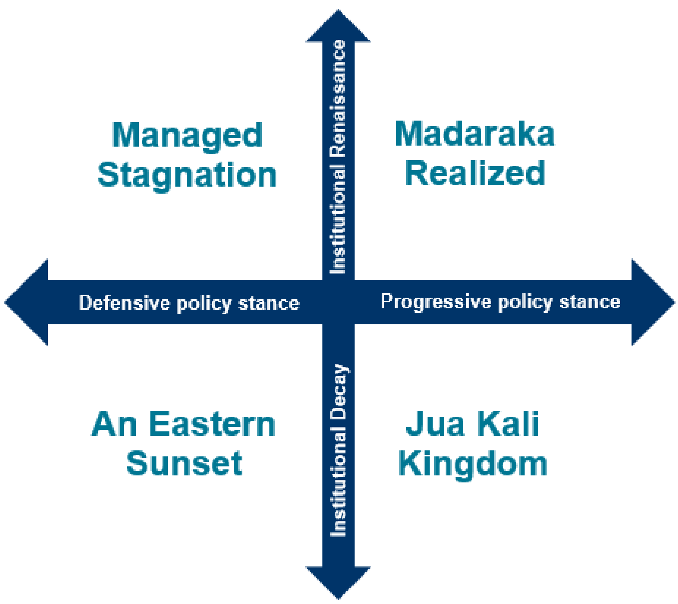
The Institute of Economic Affairs in Kenya has established a tradition of periodically reflecting on visible and less palpable trends in Kenya's socio-political and economic environment. This curiosity is informed by the need to generate insights and attempt to direct disciplined conversations on the future of Kenya, its institutions, and its people.

It is evident that 2022 presents an opportunity to re-examine and reflect on Kenya's future. Kenyan society and the country's economy, still coming to terms with the covid-19 pandemic, now have to navigate a global geopolitical transition that will have lasting repercussions. While these exogenous shocks are out of the country's control, Kenya's ability to deal with a changing external environment and pursue its national development goals are very much a function of its institutions and policy framework. Accordingly, the Kenya in 2040 scenarios will focus on the quality of these institutions and the direction policy takes. Scenario building techniques are important in moments of uncertainty and as tools for questioning comfortable narratives that people are accustomed to telling themselves.

In addition to the qualitative analysis of the interplay between institutions and policies, the IEA has partnered with Oxford Economics Africa to lend this scenario analysis qualitative credibility by formally modelling the various scenarios. Not only does this produce a more vibrant picture of the economic outcomes, but it also allows for more informed discussion and policy debates. Unlike many other scenario projects that have been undertaken, this edition contains an element of prescription. We maintain that the country's future is far from pre-determined, and that healthy debate and public discourse is the main channel through which to pursue the most desired outcome. May the scenarios presented in this publication contribute towards identifying that outcome and making Kenya's path towards that outcome clearer.

Scenario Framework

The two central uncertainties that will form the basis of these scenarios is institutional quality and the direction that economic policy takes. By institutional quality we refer to state capacity: the level to which institutions are effective, inclusive and accountable. Accordingly, this looks at the potential scope and effectiveness of government actions, and its ability to enact and enforce its policies. In turn, the other axis will look at the chosen policy direction. The one end of the spectrum (progressive policy stance) will embody policies aimed at creating an open economy and that nurture an environment conducive to the development of a sophisticated private sector. In turn, the defensive policy stance refers to policies that permeate government involvement in the economy and that protect vested interest – interest that are furthered by maintaining the status quo.



SCENARIO 1: MADARAKA REALIZED

The Madaraka Realized scenario is the most favourable, with an improvement in state capacity accompanied by greater economic freedom and the transition towards a private sector-led economic growth model. The name of the scenario intends to evoke a feeling of independence as the country takes control of its own destiny and emerges as a truly self-sufficient and independent developed African nation.

SCENARIO 2: JUA KALI KINGDOM

The Jua Kali Kingdom scenario incorporates favourable policy reforms, but an ineffective state and weak institutions prevent these more favourable 'rules of the game' from being implemented effectively. Issues surrounding state capacity and corruption weigh on market friendly reforms. The name means that Kenyans take it upon themselves to further the country's development, without the support of a strong and capable state – in the spirit of Jua Kali.

SCENARIO 3: MANAGED STAGNATION

The Managed Stagnation scenario sees an improvement in state capacity, but the policy direction prevents the development of a sophisticated private sector. Improvements in the realms of basic services and corruption are accompanied by restrictions on private sector activities and inward-looking trade policies. In addition, macroeconomic imbalances due to external pressures and failed industrialisation efforts result in monetary instability. The name points towards a capable state presiding over an undynamic and underdeveloped private sector.

SCENARIO 4: AN EASTERN SUNSET

The Eastern Sunset scenario is the least favourable. An ineffective state is accompanied by a policy environment not conducive to the development of a vibrant private sector. Inadequate basic services and excessive bureaucracy are indicative of institutional weakness, while policy missteps weigh on overall macroeconomic stability. The name suggests the fading of hope that Kenya would become a shining beacon of development on the east coast of Africa.

The Picture of Now

Constitutional and political tensions

It has been over a decade since Kenya adopted a new Constitution. This led to a major paradigm shift and ushered in the establishment of devolved county governments, an electoral body, a constitutionally incumbent judiciary, and a bicameral legislature. This major change was made possible by 67% of Kenyans who voted in favour of the new piece of legislation, with the hope of overcoming post-colonial development challenges, such as inequalities in service delivery, poor governance and a lack of progress at grass roots level.

Institutional quality is affected due to the incomplete implementation of the constitution

The constitutional experiment is ongoing but not without challenges, which include 1) incomplete implementation of administrative and institutional measures mandated by the Constitution; 2) political and legal crises 3) reduced effectiveness of institutions and 4) general instability in the country. These challenges are manifested through corruption; arbitrary passing of laws by Parliament; political interest groups, tribalism and special interest appointments; widespread lack of public participation in the review and development of policies; lack of proper consultation among government institutions; threatening the constitutional capacity of the Judiciary; delayed service delivery in devolved governments largely because of delayed disbursements to counties and several failed attempts to amend the Constitution.

The fragmented implementation of the Constitution has had a negative impact on the effectiveness of state institutions. This is illustrated by a lack of synergy and conflicts within institutions and commissions mandated to uphold the law and formulate policies. Although established commissions have clear mandates, their implementation has been politicised which has hindered their ability to institute reforms. They are also underfunded which limits their power to fulfil their mandate fully.

Another major challenge is the failure by both county and national authorities to effectively separate government functions which has created disarray in critical sectors such as health, education, agriculture and infrastructure. To address this, the national government has attempted to pass laws and policies aimed at recentralizing devolved functions which is contrary to what is stipulated in the Constitution.

Parliament exercises its power through passing laws that are largely in favour of those in high positions of power. Political interest groups indirectly hinder the full implementation of the Constitution through policies regarding increased remuneration for politicians, the Constituency Development Fund and undermining other arms of government, particularly the judiciary.

The government has passed laws and policies which attempt to recentralize devolved functions contrary to what the constitution stipulates

Several protests against extrajudicial killings have taken place countrywide since the outbreak of Covid-19 pandemic. Kenyans say that they are facing a 'twin pandemic', as restrictions to curb the spread of the coronavirus, such as the night-time curfew, was accompanied by police brutality since inception in March 2020. Extrajudicial killings at the hands of state security forces remain largely unaddressed by authorities leaving those affected pleading for justice.

The president recently declared the ongoing drought a national disaster. Poor rainy seasons over the past two years have awakened longstanding conflicts between herders and farmers in Laikipia. The severity of the conflicts has been attributed to issues related to water scarcity, politics and land grievances. Many families have been displaced by intercommunal violence, while others have been killed. Although the government is rebuilding new structures for displaced families, they fear that they will be attacked again when they return home.

Positively, though, not every attempt by the executive to undermine the judiciary is successful. A recent example of this is when the High Court blocked an attempt to amend the constitution through President Uhuru Kenyatta's Building Bridges Initiative (BBI). The court declared the process illegal on grounds that a sitting president cannot initiate the process to amend the constitution. The proposed reforms were widely controversial as they were perceived by many as an attempt by President Kenyatta to hold on to power after he leaves office in August 2022 and reward politicians loyal to him.

Going forward, frequent attacks by the executive on independent institutions such as disobeying court orders, undermining the Judicial Service Commission and deliberately cutting the judiciary's budget allocation will continue to hinder the judiciary's ability to deliver justice and uphold the Constitution. Public service delivery at the county level also continues to suffer, despite the intention of its improvement laid out in the Constitution. Therefore, Kenyans are yet to reap the full benefits of the country's fundamental laws.

Immense economic potential

Kenya's economic policy is predominantly orientated towards creating an accommodative business environment. The country boasts the most sophisticated private sector in the East Africa region and its capital markets are one of the most developed on the continent. In addition to establishing Kenya as a regional technology and services centre, the country's broader economic strategy aims are to consolidate its position as a gateway into Africa, acting as a trade and services hub for both imports and exports. Long-term national development is guided by Kenya Vision 2030, which aims to establish Kenya as an industrialised, middle-income country by the end of the decade. Policies to achieve this goal are formulated around a series of five-year medium-term plans (MTPs). The latest incarnation of these, MTPs, is the Big Four Agenda, also referred to as the Big Four Plan. The main pillars of the Big Four Plan are universal healthcare, food security, manufacturing sector growth, and affordable housing.

The country's broader economic aims are to consolidate its position as a gateway into Africa

Kenya has been able to hold together a number of strong annual GDP growth performances, and the slight contraction in 2020 compares favourably to those seen across the continent. That being said, more than two years after the outbreak of Covid-19, the adverse economic effects of the pandemic are still evident: Kenya's local and international trade performance, financial markets, tourism sector, and government finances continue to show the impact thereof. These effects stem from the implementation of a curfew as part of lockdown restrictions (since vacated), travel restrictions (both domestic and abroad), social distancing measures (which knocked consumer spending), and the fiscal stimulus provided to cushion the economic blow (as reflected in a precarious fiscal position). All of these factors had a detrimental effect on Kenya's overall economic growth.

Looking ahead, Kenya is expected to again climb onto a healthy growth trajectory. This outlook is supported by strong growth in services, both private and public investment, and favourable demographics. Downside risks to our outlook include the country's low vaccination rate, the upcoming presidential elections, fiscal mismanagement, tighter external financing conditions, and the ongoing drought.

Socio-economic development has been constrained by widespread corruption and economic mismanagement

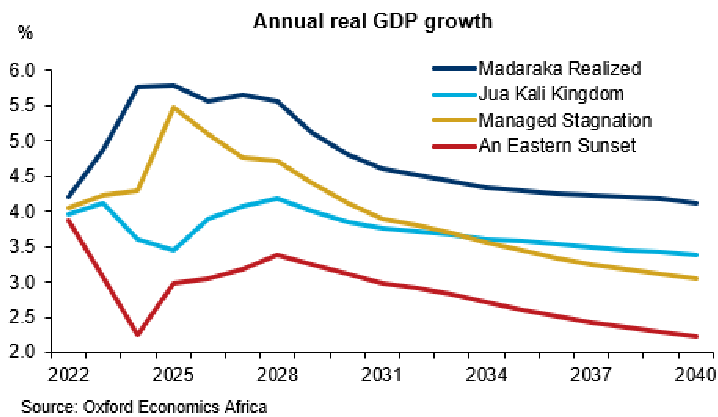
Despite the country's potential, socio-economic development has been constrained by widespread corruption and economic mismanagement. The former has led to considerable fiscal slippage, and Kenya's fiscal position remains a perennial concern, weighing on both service delivery and the effectiveness of government investment. As a proportion of GDP, public debt has nearly double over the past decade, trending just under 70% by the end of 2021. Borrowing costs have increased accordingly, and the government has been forced to absorb a large proportion of domestic credit, meaning the private sector has been starved of this potential borrowing.

All the ingredients of a lodestar for African industrialisation remain in place in Kenya. Policy decisions have played a central role in creating this environment, but policy implementation and governance shortcomings remain the biggest hurdles to fast-tracking further development.

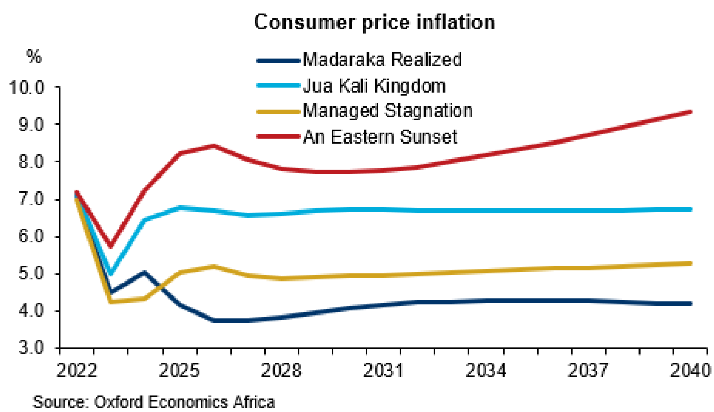
Scenarios: Economic outcome

The economic outcomes of the four different scenarios are indicative of the importance of institutions and policy. At the one end of the spectrum, as reflected in the Madaraka Realized scenario, an improvement in institutional capacity and the adoption of growth-enhancing policies is expected to push real GDP growth to an average rate of just over 5.0% p.a. over the next decade. Growth is then expected to ease to a still-robust average rate of just over 4.0% p.a. during the subsequent ten years. At the other end of spectrum, An Eastern Sunset scenario sees GDP growth averaging just 3.0% p.a. during the next decade, before averaging around 2.5% p.a. during the remainder of the forecast period. The compounding effect of stronger growth over an extended period is made clear when looking at total economic size by the end of the forecast period: In An Eastern Sunset, the Kenyan economy is estimated at around KSh16trn in real terms by 2040; in Madaraka Realized, the economy is estimated at KSh22.7trn by that time, reflecting a 42% variation.

Each scenario results in a unique economic trajectory with significant long-term implications



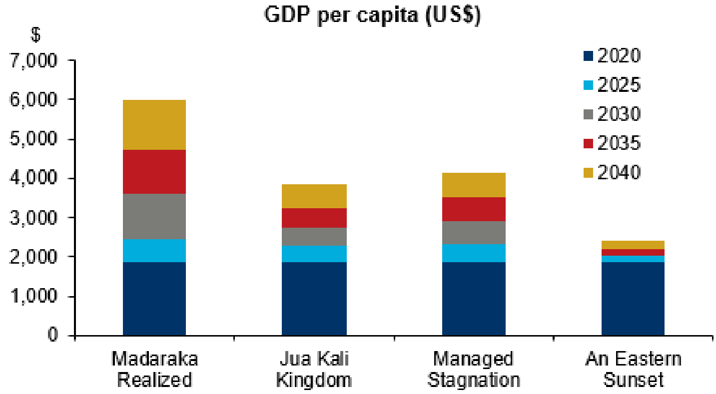
Institutional quality and policy orientation will have a macroeconomic impact well beyond headline GDP growth rates. For instance, an openness to trade amid increased domestic production capacity is expected to see consumer price inflation stabilising at around 4% p.a. in the Madaraka Realized scenario. In turn, price inflation is expected to trend around 8.0% p.a. over the forecast period in An Eastern Sunset, while stabilising at 6.5% and 5.0% in Jua Kali Kingdom and Managed Stagnation, respectively. A prolonged period of strong economic growth in the context of favourable investor sentiment and robust capital inflows will also have an impact on the shilling exchange rate. In the Madaraka Realized scenario, the shilling exchange rate is projected at around KSh140/$ by 2040. At the other extreme, in An Eastern Sunset, the shilling ends the forecast period at KSh457/$, meaning its value is less than a third vis-à-vis the US dollar compared with that in the more favourable scenario. Accordingly, the Kenyan economy is projected to equate to $4.8trn by 2040 in the Madaraka Realized scenario, which is 45% larger than the corresponding figure in the Managed Stagnation scenario, 56% larger than that in the Jua Kali Kingdom scenario, and 153% larger than the Kenyan economy in An Eastern Sunset.



Institutions and policy will have a direct bearing on the monetary environment

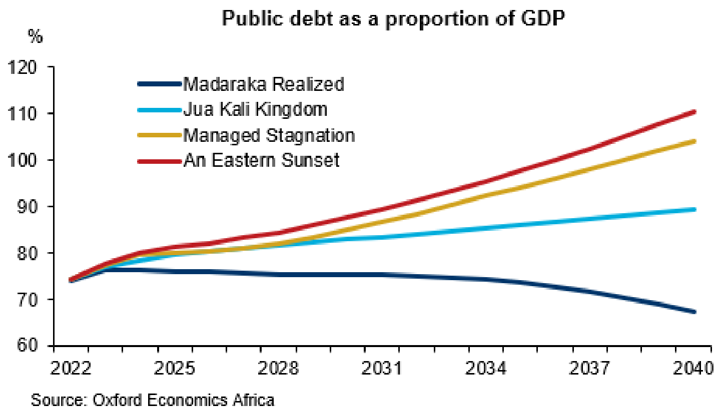
A macroeconomic metric that incorporates a number of factors is GDP per capita in US dollar terms. Not only does this factor in momentary developments in the form of consumer price inflation and exchange rate fluctuations, but also accounts for the difference between economic growth and population growth. From the 2021 estimate of around $2,000, GDP per capita is projected to increase marginally to $2,370 by 2040 in An Eastern Sunset. In the Jua Kali Kingdom scenario, this figure reaches $3,845, while reaching $4,150 in Managed Stagnation. In turn, the Madaraka Realized scenario sees GDP per capita increasing three-fold by 2040, reaching just over $6,000.

Kenyan wealth levels will also see a marked diversion



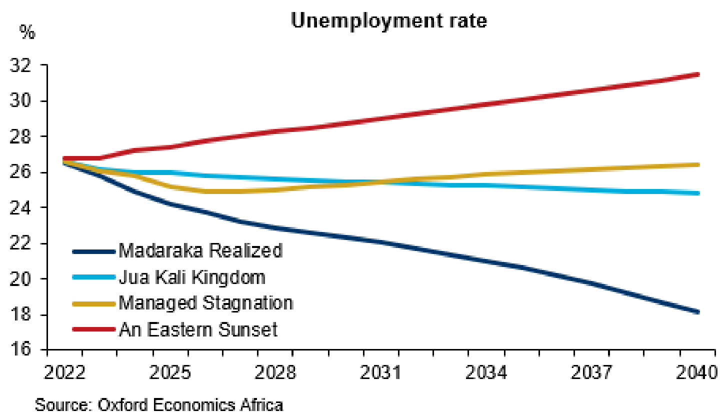
Source: Oxford Economics Africa

Turning to government finances, a combination of unproductive fiscal spending, slower revenue growth due to more measured economic expansion, and much higher borrowing costs due to a widening risk premium sees public debt increasing considerably in An Eastern Sunset. The modelling incorporates three sovereign credit rating downgrades between 2023 and 2025, which pushes debt yields much higher. In turn, the Managed Stagnation scenario also sees public debt increasing considerably due to stronger fiscal spending growth and higher domestic interest rates as the government contends with the inflationary pressure stemming from protectionist policies. By 2040, public debt is expected to equate to 110% of GDP in An Eastern Sunset, while reaching 104% of GDP in the Managed Stagnation scenario. In turn, the public debt to GDP ratio is contained somewhat in the Jua Kali Kingdom scenario due to higher inflation translating into higher nominal GDP growth, while the difference between revenue growth and spending growth also compares more favourably relative to the aforementioned two scenarios. In the Madaraka Realized scenario, stronger revenue growth relative to the other three scenarios due to a more favourable economic performance, accompanied by more measured spending growth, puts government finances on a much firmer footing. Public debt is expected to stabilise around 75% of GDP towards the end of this decade before commencing a downward trajectory thereafter, ending 2040 at around 67% of GDP.



Public debt reflects broader economic (mis) management

The differing economic performances in this scenario analysis will not just affect headline macroeconomic variables but will also have an impact on the lives of Kenyans. Case in point is the varying trajectories in the unemployment rate. In the best-case scenario, Madaraka Realized, the unemployment rate continues a downward trajectory, falling from the current figure of around 27% to 18% by 2040. In the worst-case scenario, An Eastern Sunset, the unemployment rate continues to trend higher, breaching the 30% threshold towards the end of the forecast period. This means that nearly one in three Kenyans, able to work and actively looking for employment, is unable to find a job.



Institutional quality and policy decisions will be felt by all Kenyans

The variation in unemployment, inflation, and broader economic growth will also have a clear impact on poverty levels. Disposable income per capita will vary from $7,742 in the Madaraka Realised scenario to $3,125 in An Eastern Sunset. However, inequality should also be considered, as a large proportion of the population will spend much less than the average figure, even in the most optimistic scenario. To put this into context, the World Bank estimates that the income share held by the poorest 20% of households equated to 6.2% in 2015. If this were to remain the case, around 20% of Kenyans will live under $0.5 per day by 2040 in An Eastern Sunset, which is not too far from current estimates. In turn, in Madaraka Realised, this figure amounts to $1.3 per day. While this still looks low, it is a notable improvement from current estimates, and the reduction in inequality should also be considered in the more favourable scenarios. Broad-based economic growth driven by a vibrant private sector will go a long way in reducing inequality, while weak growth that is highly concentrated in specific sectors runs the risk of further exacerbating inequality.

Scenarios: Personal journeys

An Eastern Sunset

1 A well-functioning labour market

An inefficient and inflexible labor market represents one of the main obstacles to formalizing economic activity and creating a vibrant private sector. Approximately 80% of the workforce is employed informally and the government remains the largest formal-sector employer.

Sarah was caught aback when she saw her address on a piece of documentation while clearing up the laundry room. The Gigiri of 2040 is a world apart from that two decades ago when she moved there. After accepting her dream job at the United Nations, she and her husband bought a house in Gigiri and very quickly joined a vibrant expat social scene. However, since then most of her expats friends have moved back to their countries of origin, the United Nations offices have closed down, and large parts of the once clean and prosperous Gigiri neighborhood have deteriorated into what can only be described as informal settlements.

The trouble started in the mid-2020s, when the constitutional order effectively broke down, leading to a disruption in the provision of public goods and services. The need to appease constituents in the context of little to no checks on the executive resulted in a marked expansion of government ministries, departments and agencies. Increased government bureaucracy knocked public service delivery, while the bloated public sector meant that government finances entered unsustainable territory. Public debt breached 100% of GDP in the mid-2030s and kept on trending higher every year. At first this had little impact on Sarah personally, but when it took her a year to renew her drivers license and she was unable to obtain affordable funding for a new car due to government borrowing crowding the private credit, she knew the country was on the wrong track. Rigid **labor policies**[1] also encouraged private companies to think twice before employing, which just made it all the more attractive to look for public sector employment. However, the expanding public sector was insufficient to absorb the burgeoning labour force, and by 2040, one in three Kenyans activily looking for work was unable to find a job.

Sarah was making space in her laundry room because her eldest brother, a renowned lawyer, is being deported to his second country of citizenship. Constant interference from the executive has denied the judiciary the ability to **adjudicate independently**[1]. Consequently, most citizens have little recourse to injustices and cases of corruption cited in the judiciary system are on the rise. Some NGOs, including Lawyers for a Better Kenya – the NGO that Sarah's brother was involved with – have tried to expose this corruption to no avail. Anti-terrorism laws and riot police are weaponized to quell dissent and maintain the status quo. Sarah has had the concerning thought that her young niece may have never seen a regular police officer, but she has undoubtedly seen a number of riot police dispatches. The rule of law is non-existent in some urban areas, and vigilante/private security has become the norm.

1 Judicial independence

A well-resourced and independent judiciary is the guarantor of property rights and adherence to the rule of law. Maintaining checks and balances regarding executive intervention in the courts and ensuring that the judiciary is well-funded are central to increasing the business and consumer confidence

While Sarah and her brother catch up before his deportation, the news on the television in the background is covering a deadlock among political leaders that have failed to form an amicable government. The signing of a multitude of power-sharing agreements among key government officials has become commonplace, as no parties are willing to forgo the lucrative official positions. Violation of these agreements has led to a wave of violent crashes by youth militia between government and opposition supporters over key cabinet positions. Voter apathy has become widespread among citizens, and Sarah has considered it pointless to exercise her democratic right to vote for over a decade.

Dwindling fiscal coffers and the rise of the 'tenderpreneur' class resulted in haphazard and misguided policy formulation. The partial nationalization of mining, telecom and transport firms and slapdash regulation/deregulation meant that government assumed an omnipresent role in the economy. Vested interests pushed for protectionist policies in certain sectors, which inhibited trade liberalization and Kenya was considered a pariah within the context of deeper **economic integration**[2] within Africa .

2 Economic integration on the continent

Deeper economic integration across the continent poses a significant opportunity for those countries willing to embrace open borders. Trade policy focused on making it easier to import inputs and aimed at facilitating exports will be the cornerstone of a prosperous, open economy. The African Continental Free Trade Area (AfCFTA) will change the economic landscape but those willing to adapt will benefit most.

The past decade has seen the emergence of a vibrant black market for everything from consumer goods to foreign exchange. A number of goods are constantly smuggled into the country as bribes at borders posts are more affordable than the inextricable taxes that the government places on these goods. Ineffective efforts to reduce the tax thave only placed an undue burden on the formal market, pushing up both prices and the demand for illicit goods. The lack of long-term investment due to policy uncertainty, for both foreign and local investments, means that Kenya is highly dependent on imports of a number of consumer goods, as the country lacks both the fixed capital and know-how to produce these goods. This combination of import dependence, high taxes and a thriving black market have led to a number of bouts of surging price inflation, with double-digit price increase becoming all too common. Sarah remembers that while studying she and her now-husband could have a fun night out with KSh1,000, but now she would consider herself lucky to find a quality mshikaki for that price. Meanwhile, trips aborad are out of the question, with the shilling having weakened to over KSh200/$ in the late 2020s before breaching KSh400/$ in the late 2030s.

Unchecked executive power in the context of perverse and myopic incentives resulted in the degradation of state capacity, and vested interests created a policy framework that prevents the development of a vibrant private sector. It is with a sense of tragedy that many Kenyans refer to their own country as East Africa's 'Ndizi Republic', with efforts to immigrate becoming entrenched in the nation's psyche. Sarah has often thought about leaving her home in search of greener pastures, and while thus far she has found an excuse to be hopeful about het homeland, every year these hopes seem to be fading faster and faster.

Jua Kali Kingdom

As is the case every Saturday, Sarah was already well awake by 05:00 in order to ensure that her stall is ready for the morning market rush. The markets of 2040 look much different to those a few decades earlier when Sarah's family started their spice business. But the need to wake up early and prepare for weekend shoppers has endured. The family business continues to operate in the informal sector. Sarah's grandfather, who started the business all those years back, has often thought about formalising the business, but every time he comes to the conclusion that there is little benefit for him or his business in the formal business environment.

2 Addressing the corruption menace

Corruption perceptions deter the formalization of all economic activity. Constitutional reforms such as judicial reforms that strengthen the courts in their duty to preside over cases independently are needed in order to reduce the prevalence of corruption and produce more effective public institutions.

The need to secure external funding, both private and multilateral, as well as in an attempt to address the unemployment issues, the Kenyan government adopted a number of business-friendly policy reforms over the past two decades. However, while favourable policy adjustments had encouraging implications for the overall business environment, the lack of progress on institutional capacity and the lack of political will to address **governance shortcomings**[2] weighed on the implementation of these new policies. Sarah's grandfather, a well-known entrepreneur in the spice industry, often quipped "Ask not what the Kenyan government can do for you, because it cannot do much" – a reference to the famous speech by US President John F. Kennedy.

This paradox of progressive business policies in the context of institutional weakness was most starkly displayed in the cross-border trade sector. The reduction in tariff barriers and licencing requirements resulted in a thriving trade sector, with Sarah's family business seeing its products traveling across the East Africa community. However, every so often a shipment of spices would be seized at the airport for months on end because of a lag at the Kenya Revenue Authority customs department, the latter due to understaffing.

Governance shortcomings also had a negative impact on foreign investment, with large multinational companies preferring to set-up headquarters in other countries in the region. Some foreign companies did enter the Kenyan market, but the murky relations between these companies and Kenyan government officials created an uncompetitive market, and increased resentments towards these companies from domestic businesses. This was luckily not something that Sarah's family business had to confront, but a family friend in the textiles business often complained that his factory is plagued by intermittent power outages and the road infrastructure surrounding it has fallen into disrepute, while the Turkish textiles factory not even 10km away encounters none of these issues. The fact that the Turkish factory is a major sponsor of the local mayor's annual gala is no coincidence.

As confidence in government entities began to wane over the years, citizens were more inclined to seek out private sector provision of basic goods and services. This led to thriving private education and private healthcare sectors, with the much better quality, but significantly more expensive, private services preferred over the cheaper but inferior public services. Consequently, inequality worsened as those with means were able to afford private education and healthcare while the poor quality of public education and healthcare represented a stumbling block to social mobility. The success of Sarah's family business allowed her to enrol in a private secondary institution, but as she grew older she become more aware of how the facilities and quality of education that she enjoyed was in a different league to that received by her primary school friends that weren't so fortunate. Pockets of prosperity saw an increase in gated communities as inequality become more pervasive. This emergence of a two-tier society increased the risk of social unrest and this uncertainty weighed on foreign investor sentiment.

A simplified tax regime and positive labour market reforms encouraged the creation of a number of **small businesses**[3], but government inefficiencies and the inability to monitor compliance resulted in many businesses preferring to enter the informal sector which enjoyed less government involvement. A thriving small business sector supported job creation and played a central role in driving economic growth, with the country's informal sector flourishing. Corruption perceptions and governance concerns also prevented the emergence of large Kenyan multinational companies as the lack of government support and institutional hurdles contained company growth.

Under the guise of a seemingly robust growing economy, corruption flourished, parastatals became entrenched and unproductive, while new entrants struggled to gain meaningful market share. Above inflation caused increases to civil servant salaries were not sustainable over the long term and private sector provisioning for

3 Supporting small businesses

A vibrant small-business sector is critical in addressing elevated unemployment. Reducing barriers to entry through tax reforms easing the regulatory burden associated with starting a business will be vital. Specific areas that require attention include reducing the number of licenses and the cost of licensing required to keep businesses, particularly SMEs, in operation.

essential services meant that state entities became less competitive. A lack of institutional depth and credibility meant that local capital markets never realised their full potential, as low levels of liquidity kept financial markets relatively underdeveloped. A reduction in capital controls was praised by the private sector, but caused some tension between Sarah and some of her friends. One friend in particular constantly encouraged Sarah to move her savings outside of Kenya due to the lack of formal investment opportunities in the country. While there is little doubt that her friend is correct, Sarah still felt like she was contributing to the problem and not the solution by investing elsewhere.

The commendable growth stemming from the favourable policy reforms allowed some within government to boast of the progress that the country has made. While many Kenyans have seen an improvement in their circumstances, the lack of state capacity meant that there was a limit to economic sophistication, and Kenya lost ground relative to many African peers from a developmental perspective. In addition, economic inequality intensified, weighing on societal cohesion and further entrenching rent-seeking behaviour. The Kenya of 2040 in many respects looked better than the Kenya a few decades earlier, but a number of new issues arose and many Kenyans were left pondering a decade of foregone development.

Managed Stagnation

Sarah was filled with pride when her daughter took second place in the Kenya National Math Olympics. The 2040 event was the largest one thus far, with every year's event seeming much more extravagant than the one before. After fully nationalizing all the higher education establishment in the country and committing an extraordinary amount of resources towards primary and secondary schooling, the government has made great strides in improving the Kenyan education system[3], and most major international education-related tournaments usually have Kenyan representation.

On the way home Sarah is delighted to hear that her daughter was approached by a government representative after the competition. The government has made a concerted effort to attract the brightest Kenyan talent to its various departments, particularly those in the security cluster, and these competitions are a good recruitment ground. Most Kenyans also strife to join the public sector due to the much higher remuneration and the general lack of employment opportunities in the private sector.

Throughout the 2025-30 period, a largely efficient and effective public sector started to enter a number of industries previously dominated by the private sector. In addition to basic services such as education and healthcare, the government started to dominate the transport sector with an effective monopoly on domestic flights, shipping and rail transport. The government even launched a mobile communications network, but many Kenyans were hesitant to sign up due to concerns over privacy. Sarah's father also jokingly said that he is looking forward to the first state-owned barber shop so that he can enjoy a subsidized haircut.

The omnipresent government also had a dark side. Protectionist policies and regulations were often passed in a haphazard manner with the aim of supporting state-owned enterprises in an increasing number of industries. Some larger firms are effectively nationalized because regulation is formulated in such a manner to support the SOE in that industry, and the competing private company is then promptly bought out by the public firm due to the latter's increasing market share.

There is increased government control in many aspects of the economy: price control policies, regulatory restrictions on trade

3 The importance of education

Kenya's most valuable resource over the next 50 years will be its human capital, thus enabling the population to acquire the appropriate skills is a policy imperative. Harnessing the demographic dividend will require increased investment in sectors such as education and healthcare.

in certain goods, and localization requirements benefiting specific companies at the expense of foreign competition. This inconsistency and uncertainty regarding government policy prevents companies from making long-term investment decisions, and the private sector remains **largely underdeveloped**[4]. Despite attracting the brightest young talent, institutional inertia and regulatory protection means that SOEs have little incentive to innovate and the same policies protecting government operations deter entrepreneurs from entering those sectors. Furthermore, the Kenyan operational environment has become notorious among larger foreign companies, and the 2030-40 period saw a marked reduction on foreign participation in the Kenyan economy, while the opposite trend is clearly observable in other East African nations.

4 Unshackling the private sector

Regulatory restrictions on private participation in some sectors and the lack of supportive measures in nascent industries will hamper the development of dynamic sectors of the future such as ICT. In addition, state protection of SOEs and incumbent enterprises would only further hamper the development of these sectors

Another benefit stemming from increased state capacity is the improvement in the security situation. Internal policing has been enhanced and crime rates have dropped considerably over the past decade. In 2040, Kenyans of all ages felt safer walking the streets at night than they had at any other stage in their lives. However, a large driver behind this increased security if unfettered use of surveillance technology, and critics have dubbed Kenya Africa's first surveillance state. Sarah has for sometime argued that the pros outweigh the cons – "If I can safely walk from my favourite restaurant to home at night, who cares if someone can listen to me complaining about my neighbours" dog", Sarah often quipped. However, she did feel some unease when those who did find the surveillance troubling were arrested following peaceful protest in central Nairobi. It is one thing if the government listens to your every word, but it is another if the government attempts to ensure that certain words are never spoke, Sarah thought.

Running the massive state machinery does not come cheaply, and the government has not recorded a budget surplus for at least 20 years. An underdeveloped private sector means that large public sector expenditure eclipses the potential tax revenue from an unsophisticated private sector, and public debt surges. In an attempt to contain borrowing costs, the government again implemented interest rate controls. A shrinking potential credit pool due to excessive borrowing by government and the unattractive prospect for lending to the private sector while similar rates of return can be generated by lending to government, which is much less risky, means credit dries up. Small- and medium-sized enterprises have been affected disproportionately by this crowding-out effect. Sarah's brother owned a promising home delivery business a couple of years earlier, but due to the lack of funding he was unable to expand and acquire the necessary economies of scale. A few years later a government-backed company started competing with him, and although Sarah's brother had a superior product, the lower prices charged by the SOE (due to subsidies) pushed Sarah's brother out of business.

In 2040, Kenyans feel safer than they have ever felt, many have very good government jobs, and a celebrated education system is a source of national pride. However, free speech is muzzled more than that observed in living memory, the Kenyan private sector is a show of its former self, and Kenya seems to be disengaging from the global economy while deeper integration is the trend seen elsewhere. There is much to be grateful for, but Sarah remains conflicted of whether the country she lives in is heading towards the Utopia the state espouses, or the Dystopia described in Orwell's Nineteen Eighty-Four.

Madaraka Realized

Sarah wakes up on the morning of 9 August 2040 to the sound of child's bicycle bell and a newspaper thudding against the front door – a service provided by a small Mombasa business aiming to satisfy nostalgia related to print media. As she picks up the newspaper, her attention is immediately drawn to the headline: 'Kenya still number one!'. The article refers to Kenya's position as Africa's top performer in the UN's Human Development Index for the fifth-straight year. During the 2030s Kenya made considerable strides in poverty reduction and improvements to healthcare and education. By 2040, Kenya boasted world-class transport infrastructure and one of the continent's most diverse economies.

Scanning through the newspaper Sarah sees the conclusion to a story she has been following closely. A high-profile government official has finally been sentenced to 20 years in prison for the embezzlement of public funds. A week earlier, a close friend of Sarah who works in the Nairobi City Court told her this would happen. Her friend noted that due to **judicial independence and efficacy**[4], courts are able to, without fear or favour, sanction public officials who fail to account for public resources. The judiciary is able to prosecute anyone found culpable of breaking the law regardless of their status in society. Corruption cases are swiftly investigated, and the various arms of government are fully independent and functioning efficiently.

While making breakfast Sarah spots her neighbours outside, a young Brazilian couple that both work in the ICT sector. As economic growth picked up considerably, Kenya attracted expats from across the continent and indeed the world, further enhancing the country's endemic innovativeness. Both foreign companies and Kenyan firms that have become multinational compete in sectors that had been traditionally reserved for state monopolies. Businesses are no longer dependent on public sector procurement as government tightened its purse while the spending power of private consumer expanded. The Nairobi Stock Exchange saw flurry of new listings between 2025 and 2035 by both domestic and foreign companies, and the bourse consolidated its position as one of the continent's leading stock exchange. This boosted portfolio inflows and foreign investment, which, in turn, provided further impetus for the deepening of domestic capital markets. Sarah has little interest in portfolio investment, but her daughter enjoys dabbling in equity markets

4 Preserving constitutional order

Affirmation of the constitutional order and adherence will create a more stable institutional framework by elevating responsibilities of the judiciary and parliament and thereby enabling them to strengthen their ability to effectively check the tendency of the executive to abuse power and discretion. This protects the constitutional order and maintains the envisaged *"balance of power"* among all arms of government.

5 Leveraging private sector expertise

Improving fiscal finances is imperative. This will require the privatization of state-owned enterprises, like the national airline Kenya Airways, extension of the tenure of public debt and more transparent management of the debt procurement processes. This will allow the government to focus on providing quality public services.

with some extra disposable income at the end of the month. Sarah did, however, enjoy the tangible benefits of a stable and competitive currency in the context of relatively muted price pressures: with inflation trending around 4% p.a. for a number of years and the shilling remaining relatively stable, an annual trip abroad became the norm in Sarah's household.

While enjoying a bowl of locally sourced fruit and cereal, Sarah reminisces about the interesting debates that her daughter, an economics major, and her husband, a business school professor, have had around the breakfast table. One of the topics that Sarah is grateful has not come up for a number of years is that of public debt and state-owned enterprises – neither of which peak Sarah's interest. Most of the SOEs that were around two decades ago no longer exist **due to privatization**[5]. Those that are still in existence have been amalgamated, especially entities performing overlapping roles. Existing SOEs have seen such an improvement in transparency regarding both financial and non-financial reporting that Sarah's youngest son analyses these reports as part of his high school business studies curriculum. The full privatization of Kenya Airways was seen as the symbolic moment when the government transitioned away from State-driven development towards State-facilitated development. One of Sarah's friends often likes to gloat over how many international destinations she has seen every month since becoming an airhostess for Kenya Airways. In turn, public debt has become a non-issue in Kenya, with government liabilities as a proportion of GDP commencing a downward trend during the 2030s.

6 Streamlining the tax system

A predictable tax regime and effective investment schemes are central to allowing business owners to undertake long-term planning and in attracting new investment.

After breakfast, Sarah's brother paid her a quick visit on his way to the nearby golf course. Around a decade ago her brother quit his job as a tax practitioner to pursue his dream of becoming a golf coach. This decision was in part driven by his passion for golf, in part driven by the lack of business due to the ease with which citizens are now able to do their taxes using the government's e-services platforms. E-government has been used to improve tax administration and a **simplified and harmonized tax code**[6] has made it easier for both individuals and corporates to contribute their fair share. Kenyans are also much more willing to pay taxes because they see the results in the form of improved service delivery. In addition, a credible budget process, better targeting of budget programs and transparency regarding government expenditure ensure that citizens know where their money is going. Accordingly, the Kenya Revenue

Authority (KRA) has consistently met its revenue collection targets in recent years and the large tax base has allowed the government to keep effective tax rates very competitive in a global context.

Developmental progress and a stronger sense of unity became entwined in a virtues positive feedback loop. The government no longer played a patriarchal role in society and Kenyan individuals took it upon themselves to promote further development. Public participation in policy discussions has increased and citizens are actively involved in all matters governance. Civil societies and opposition parties are systematically included in the policy process, and elections revolve around policy debates and not personalities or rent seeking. Kenya is seen as a lodestar for the rest of the continent, epitomizing the developmental progress that can be made if political will and progressive policies combine. Sarah has never been more proud of calling herself a Kenyan.

Conclusion

The Covid-19 pandemic and Russian invasion of Ukraine have shown that global exogenous shocks are not a relic of the past, and that an increasingly integrated world is more prone to systemic shocks. That being said, these crises have also revealed how important domestic resilience is, especially in terms of a country's ability to react and adapt. This ability to react and adapt, in turn, is determined by the quality of institutions – the ability to effectively implement policy and provide basic services – and the policy framework – the rules of the game that determine economic depth and resilience.

Kenya's future will depend on what Kenyans demand from their leaders

The aim of this scenario analysis is to show that institutions and policy are the two pillars forming the foundation for a country's developmental trajectory. Importantly, weakness in one pillar despite strength in another will still lead to suboptimal outcomes. The macroeconomic analysis shows that the interplay between institutions and policy leads to a number of different economic outcomes, and the narratives attempt to portray just how material these different outcomes will be. Institutional quality and policy decisions have implications well beyond the impact on headline economic growth: the interplay between these two factors affect social cohesion and the national psyche.

Preserving and respecting the constitution while ensuring judicial independence increases society's trust in government institutions, which makes for a more engaged population. Effectively providing that population with basic services such as education and healthcare makes for a more productive population, with synergies between government capacity and private sector development. In turn, limiting state involvement in the economy to safeguarding the rule of law and creating a policy framework that supports the development of a vibrant, open and competitive economy increases economic resilience and fast-tracks broader socio-economic development.

Perhaps the most important message of this report is that Kenya's future is far from pre-determined. What Kenyans demand from their public servants and the manner in which the government delivers on those demands will determine which direction, among many, Kenyan society takes.

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