



AFRICAN FORUM AND NETWORK
ON DEBT AND DEVELOPMENT

DOMESTIC DEBT CONUNDRUM IN AFRICA

IMPLICATIONS ON NATIONAL AGENDA AND FISCAL
CONSOLIDATION: THE CASE OF SENEGAL, KENYA
AND ETHIOPIA

EXECUTIVE SUMMARY

Domestic debt has come to be a focal point, often the leading source of funding to African governments as access to concessional and commercial external financing becomes increasingly constrained, exposing exchange-rate risks to increase and fiscal deficits continue to persist. Often, domestic borrowing is rationalized as safer since it is denominated in local currency and can further develop domestic financial markets. However, in most contexts, domestic debt is increasingly short-term, expensive and employed to manage liquidity, as opposed to financing productive investment and making what should be a developmental tool, a source of fiscal stress. The paper uses Kenya, Ethiopia and Senegal to demonstrate how structural revenue weaknesses, macro shocks (commodity-price volatility, global interest-rate tightening) and political incentives (election-cycle spending and patronage dynamics) interact with governance gaps to speed domestic debt accumulation.

The analysis highlights that the sustainability of domestic debt is being compromised not so much by the presence of borrowing but by the nature and management of borrowing. Kenya's reliance on high-yield Treasury bills and bonds, along with rollover exposure and a small, concentrated investor base mainly composed of regulated institutions, has raised refinancing risks and resulted in costly debt servicing. This situation limits fiscal space for Vision 2030 priorities, particularly in health, education and infrastructure. The centralized and state-oriented financing model, coupled with limited market depth and opaque institutional arrangements, such as the debt footprint of SOE, creates hidden fiscal risks in Ethiopia and complicates macroeconomic stabilization, and domestic borrowing and channels of financing linked to the central bank exacerbate inflationary pressures and undermine confidence in market-based domestic issuance. Access to the WAEMU regional market in Senegal presents a more structured issuance environment and pooling of liquidity but leaves the country vulnerable to changes in regional monetary conditions and to risks associated with contingent liabilities (including PPPs), with volatility in debt services translating into budget volatility and delays in social and capital investments under the PSE.

One of the key conclusions of the draft is that domestic borrowing can only be stabilizing and developmental when it is regulated by clear legal mandates, strong institutional coordination, transparent issuance and reporting, and a deliberate strategy to lengthen maturities and tie borrowing to development outcomes. In the absence of these checks, domestic debt increases the fiscal rigidity, crowds out private credit, and shifts adjustment into social and capital expenditure. The paper then prioritizes reforms that: (i) introduce specific domestic-debt governance rules (including stricter limits, approvals, and accountability), (ii) reprofile domestic debt to longer tenors and development-linked instruments, (iii) diversify the investor base and thereby reduce concentration and systemic risk, and (iv) enhance transparency, parliamentary scrutiny and auditability so that borrowing decisions are consistent with national development plans and macroeconomic stability.

LIST OF ABBREVIATIONS

ATM	Average Time to Maturity
BCEAO	Central Bank of West African States (Banque Centrale des Etats de l'Afrique de l'Ouest)
CFA	West African Franc (Communauté Financière d'Afrique)
CNDP	The National Debt Committee (Comité National de la Dette Publique)
COVID-19	Coronavirus Disease 2019
ECB	European Central Bank
ETB	Ethiopian Birr
FDRE	Federal Democratic Republic of Ethiopia
FED	Federal Reserve
FY	Financial Year
G20	Group of Twenty
GDP	Gross Domestic Product
GEAR	Growth Employment and Redistribution
HIPC	Highly Indebted Poor Countries
IMF	International Monetary Fund
KSh	Kenyan Shilling
LAMC	Liability and Asset Management Corporation
MDRI	Multilateral Debt Relief Initiative
MPs	Members of Parliament
MTDS	Medium Term Debt Management Strategy
PDMO	Public Debt Management Office
PEPs	Politically Exposed Persons
PFM	Public Finance Management
SAPs	Structural Adjustment Program
SOEs	State Owned Enterprises
UHC	Universal Health Coverage
US	United States
USD	United States Dollar
WAEMU	West African Economic and Monetary Union
ZAR	South African Rand

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1.0

INTRODUCTION

Domestic public debt in several African economies has expanded rapidly in recent years, raising concerns about fiscal sustainability, financial sector stability, and the impact on national development plans. While domestic borrowing is often perceived more sustainable than external debt because it is denominated in local currency, rising interest burdens, shortened maturities, and increasing reliance on domestic financial institutions have altered the risk profile of public finances. In several countries¹, over 40% of government revenues are now devoted to debt repayments, constraining fiscal space for priority social and capital expenditure. The issue is not merely the size of domestic debt, but whether the institutional, monetary, and political frameworks within which it operates reinforce or undermine macroeconomic stability and inclusive growth.

Conventional fiscal analysis tends to assess domestic debt through a narrow “sound finance” framework that equates rising deficits and debt ratios with heightened vulnerability. Since the 2008 global financial crisis, Africa’s aggregate debt-to-GDP ratio increased by 39.3 percentage points between 2008 and 2020 to 71.7%, declined to 68.6 percent in 2023 and is projected to fall further to 63.5 percent by 2028, driven by economic growth and improving fiscal balances². By early 2025, gross public debt level in Sub-Saharan Africa was over 60% of GDP, with debt servicing costs escalating steeply³. This approach often relies heavily on the debt-to-GDP ratio as a primary sustainability metric. However, such a framework may obscure critical structural differences across countries, particularly with respect to monetary sovereignty, exchange rate regimes, investor composition, and the interaction between public borrowing and domestic financial systems. A more comprehensive assessment requires evaluating interest-growth differentials, debt service-to-revenue ratios, maturity structures, and the transparency of contingent liabilities.

Monetary and institutional arrangements fundamentally shape the sustainability of domestic debt. In countries with full monetary sovereignty, governments issuing debt in their own currency face liquidity constraints that differ materially from solvency constraints associated with foreign currency liabilities. Conversely, economies operating within fixed exchange rate regimes or regional monetary unions, such as members of the West African Monetary Union, may face reserve-dependent liquidity conditions that constrain domestic credit expansion. In such settings, external borrowing can become intertwined with domestic debt dynamics, complicating the sustainability analysis.

Domestic debt also reflects political economy incentives that influence fiscal behavior beyond technical macroeconomic parameters. In some contexts, government securities constitute a highly profitable asset class for domestic banks and pension funds, potentially creating structural incentives that favor public borrowing over private sector credit allocation. Expansionary development agendas, particularly those centered on large-scale infrastructure commitments, may institutionalize persistent primary deficits and normalize debt-financed growth models. Where parliamentary enforcement of fiscal rules is weak, borrowing can become embedded as a default financing mechanism rather than a temporary stabilization tool.

This paper therefore adopts a broadened analytical framework that integrates macro-fiscal indicators, monetary sovereignty, and political economy dynamics to assess domestic debt sustainability in Kenya, Senegal, and Ethiopia. By moving beyond headline debt ratios and incorporating institutional and structural constraints, the analysis seeks to identify the conditions under which domestic debt functions as a developmental instrument and those under which it becomes a source of fiscal fragility. The objective is not to prescribe uniform fiscal contraction, but to clarify the institutional reforms and policy adjustments necessary to ensure that domestic borrowing supports, rather than undermines, long-term economic stability and inclusive development.

The experience of Senegal within the West African Monetary Union (WAMU) highlights the importance of monetary sovereignty in this analysis. Unlike fully sovereign currency issuers, WAEMU member states cannot independently create domestic liquidity without reserve constraints linked to the euro peg. As a result, foreign borrowing often becomes a prerequisite for domestic credit expansion. The 2018 liquidity episode, where Senegal and Côte d'Ivoire issued Eurobonds to recapitalise the regional financial system, illustrates how external debt can underpin domestic market functioning. In such contexts, domestic borrowing cannot be analyzed independently from exchange rate regimes and regional monetary architecture.

Similarly, Ethiopia's debt trajectory must be understood within a context of geopolitical isolation and diminished policy space. Domestic borrowing during 2020–2022 was not simply a discretionary fiscal choice but a response to withheld external financing. Domestic debt in such circumstances becomes a survival mechanism rather than a market-optimizing strategy.

1.1 Rationale of the study

Domestic debt, once considered a safer and sovereign-controlled financing option, is increasingly becoming a source of fiscal stress⁴. For countries with weak or stagnant revenues, rising reliance on domestic borrowing has created a cycle of high interest costs, crowded-out investments and eroded fiscal space⁵. Understanding this domestic debt conundrum is therefore important not only for stabilizing public finances but also for safeguarding national development agendas and fiscal consolidation (governments ability to consolidate revenue through tax collection to improve a country's fiscal balance) in Africa.

This study seeks to untangle the conundrum by analysing domestic debt accumulation in Kenya, Ethiopia and Ethiopia, the drivers and implications. The study draws lessons from South Africa's approach to domestic debt management and makes recommendation towards a human rights-centred approach to managing risks and challenges associated with domestic debt.

Accordingly, this study adopts a broadened analytical framework. It examines domestic debt through three lenses: (i) macro-fiscal sustainability; (ii) institutional and monetary arrangements; and (iii) political economy incentives. Rather than assuming domestic borrowing is inherently destabilising, the paper investigates when and why domestic debt shifts from developmental tool to fiscal constraint to national development plans.

1.2 Research Objectives

This study aims to address the following objectives:

- 🌀 Analyze the political economy and macroeconomic drivers of domestic debt accumulation.
- 🌀 Examine the impact of domestic debt on key sectors such as health, education, and infrastructure.
- 🌀 Investigate the role of domestic debt in shaping fiscal policy decisions, including national budgeting, prioritization of government expenditures, and revenue generation.
- 🌀 Analyse the sustainability of domestic debt in relation to economic growth and the fiscal capacity of African countries.
- 🌀 Propose policy recommendations for improving debt management and aligning borrowing with long-term development goals.

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2.0

Regional Overview

Senegal and Ethiopia present contrasting but equally complex patterns. Senegal's revenues remain modest at 19–21% of GDP, yet its debt trajectory is explosive: total debt more than tripled from 35% of GDP in 2010 to 114% in 2024, with domestic debt climbing sixfold to 71% and external debt approaching 50%. This dual dependence exposes the country to significant repayment risks, as debt servicing consumes an increasing share of revenue. Ethiopia, by contrast, faces a collapsing revenue base, which fell from 19% of GDP in 2010 to just 11% in 2024, severely constraining its borrowing capacity. Domestic debt declined from 19% to 11% of GDP over the same period, largely due to the transfer of state-owned enterprise obligations to the federal government through the Liability and Asset Management Corporation (LAMC), combined with faster nominal GDP growth relative to debt.⁶

South Africa offers a striking contrast. With revenues consistently above 24% of GDP since 2010, reaching 28% in 2024, it demonstrates the importance of a strong fiscal base. While its total debt has also surged, from 31% in 2010 to 76% in 2024, reliance on deep domestic markets has allowed South Africa to finance deficits. Although sustainability concerns remain, South Africa's stronger revenue mobilization, strong regulations around domestic borrowing and mature financial systems highlight a critical lesson.

In Kenya, revenues have stagnated at just 16–18% of GDP, while total debt nearly doubled from 37% of GDP in 2010 to 67% in 2024. As access to external financing tightened, the government relied more heavily on domestic borrowing, which increased from 19% to 40% of GDP over the same period. This reliance has proven costly: domestic interest rates stood at 11.3% in December 2024, among the highest in the region compared to Uganda (9.9%), South Africa (9.0%), Senegal (5.7%), and the African average (8.2%).⁷ The rising servicing burden now crowds out spending on health, education, and infrastructure, illustrating how weak revenue performance and expensive domestic borrowing combine to create a fiscal pressure that undermines growth and consolidation.



3.0

Domestic Debt Landscape in Africa – Key Trends and Drivers

3.1 Contextual Evolution of Domestic Debt in Africa

Domestic debt refers to public borrowing by a government within its own territory, usually in local currency and held by commercial banks, pension funds, central banks and other domestic investors.⁸ It is a key part of total public debt alongside external debt and has gained importance in low and middle-income countries as governments develop local financial markets and reduce dependence on foreign borrowing.⁹

Economically, domestic debt is a vital tool for fiscal and macroeconomic policy. Governments mainly borrow domestically to cover budget deficits, manage expenditure over time and support countercyclical policies, especially when revenues are insufficient or volatile. A primary reason for domestic borrowing is its relative immunity from external risks. Unlike external debt, domestic debt does not expose governments to exchange rate risk, lowering the chance of debt distress caused by currency depreciation. This has led many developing countries to favour domestic financing as part of broader debt management strategies aimed at increasing financial sovereignty and resilience to external shocks.¹⁰

Beyond funding, domestic debt also supports financial sector growth and macroeconomic stability. Evidence shows that strong domestic debt markets promote growth by boosting monetary policy, encouraging financial deepening and savings and enhancing governance and accountability. When kept at moderate levels, these benefits can promote growth; however, excessive domestic borrowing might crowd out private credit and threaten financial stability, especially in shallow banking systems or where banks are heavily exposed to government securities. In practice, governments prefer domestic debt because it provides more policy flexibility, lower currency risk and opportunities to develop local capital markets. However, its rising prominence brings challenges like increased borrowing costs, shorter maturities and rollover risks, all of which need careful handling within a comprehensive public debt strategy.

In the decades after gaining independence, most African countries relied heavily on external borrowing since their weak industrial bases and limited domestic revenues constrained their ability to mobilize domestic resources.¹¹

This early reliance also reflected structural asymmetries in global finance, where access to concessional external funding was easier than developing domestic capital markets, effectively delaying the institutional and regulatory investments needed for local debt market development. The debt crisis of the 1970s and 1980s, which was triggered by oil shocks, rising global interest rates and falling commodity prices resulted in unsustainable external debt burdens. Importantly, the crisis's severity differed among countries based on export dependency and exchange rate policies with economies reliant on imported commodities facing more significant declines in debt sustainability.

Structural Adjustment Programs (SAPs) introduced during the 1980s and 1990s emphasized fiscal discipline and external debt restructuring but did little to strengthen domestic debt markets. In practice, SAPs often focused more on macroeconomic stabilization than on deepening the financial sector. This led to a policy imbalance where debt sustainability improved in the short term, but domestic financing systems stayed underdeveloped in countries like Kenya, Ethiopia and Senegal. The extent of underdevelopment varied depending on the speed of financial sector reforms. International debt relief initiatives such as HIPC and MDRI in the early 2000s reduced the external debt burdens and restored temporary fiscal space.¹² However, this relief did not consistently lead to lasting fiscal resilience, as countries varied in their use of fiscal space, with some investing in sectors that promote growth while others faced renewed fiscal pressures due to structural expenditure demands.

However, declining concessional finance and the pursuit of large-scale infrastructure investment in the 2010s drove governments toward international capital markets, resulting in a surge of Eurobond issuances and commercial loans.¹³ The risks of this strategy became evident as global interest rates rose, currencies depreciated, and refinancing pressures mounted. These vulnerabilities were particularly pronounced in countries with higher shares of non-concessional external debt and limited export diversification reinforcing the procyclicality of external borrowing across the region. It is within this context that domestic debt began to take on greater importance. Initially underdeveloped and secondary to external borrowing, domestic markets became more prominent in the late 2010s and 2020s as governments sought more reliable and less externally vulnerable sources of financing.¹⁴ Countries with relatively more developed financial systems such as South Africa expanded domestic borrowing more rapidly while those with shallower markets faced constraints in scaling up local debt issuance.

As of 2023, Africa's total public debt stood at USD 1.8 trillion with domestic debt accounting for 43% of total debt.¹⁵ The size and makeup of domestic debt differ greatly among African nations but have some common traits. The debt structure is increasingly led by government securities while investor ownership in most countries is mainly concentrated among commercial banks and pension funds. Additionally, many markets face limited secondary trading, shallow liquidity and low participation from retail and foreign investors.

This contextual evolution reflects both necessity and strategy. Domestic borrowing reduces exposure to exchange rate shocks and grants greater fiscal policy flexibility, but it also comes with trade-offs: higher borrowing costs, rollover and liquidity risks and in some cases, limited absorption capacity due to shallow domestic markets dominated by commercial banks and pension funds. The balance of these trade-offs varies across countries, with more mature markets better able to manage costs and risks while less developed systems face tighter fiscal constraints and greater vulnerability to domestic financial-sector stress.

Thus, the rise of domestic debt in Africa is not just a financing choice but the product of decades of shifting debt dynamics, external vulnerabilities and the gradual maturation of domestic financial systems. These trends indicate a shift in African debt structures from being mainly vulnerable due to external factors to facing more domestically rooted risks. This shift calls for tailored policy measures that consider each country's unique financial sector size, institutional strength and debt management strategies.

3.2 Political Economy Analysis of Domestic Debt

3.2.1 Historical Experience with Structural Adjustment Programs

Domestic debt accumulation in many African countries is not merely the outcome of macroeconomic imbalances; it reflects a set of political incentives, institutional constraints, and structural features that shape fiscal decision-making. Understanding these political economy drivers is essential for explaining why domestic borrowing has expanded rapidly across the continent over the past decade, often despite repeated commitments to fiscal consolidation.

Additionally, **historical experience with external debt crises has shaped policymakers' preferences. Following the structural adjustment era of the 1980s and 1990s, many African governments view domestic debt as a means of preserving policy autonomy and avoiding intrusive conditionality.** Borrowing in local currency reduces exchange rate risk relative to external commercial debt. However, while it mitigates currency mismatches, it can increase interest rate risk and crowd out domestic investment if yields remain elevated.

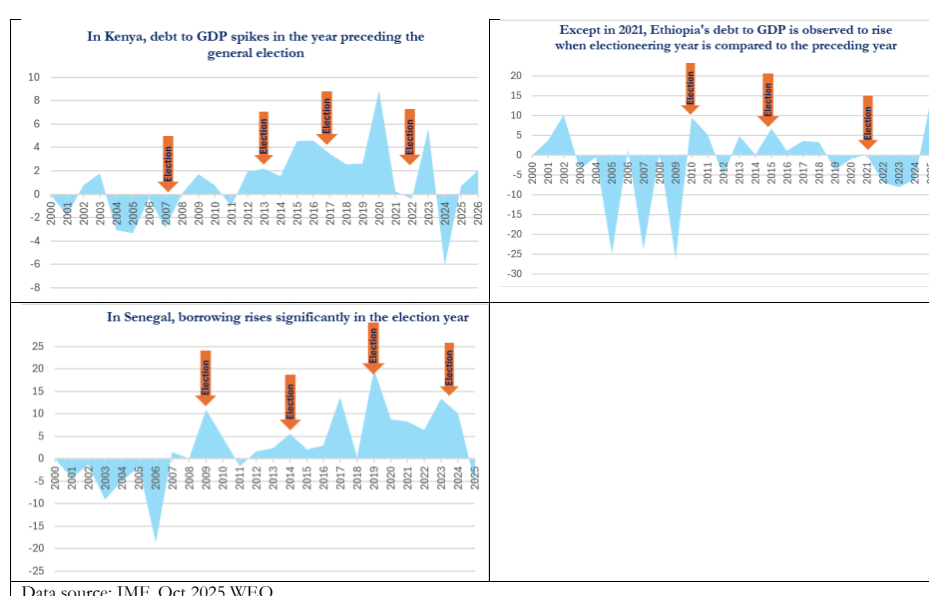
A Skewed Global Financial Architecture

The global financial architecture, which is the overall global system that governs the operations of money, credit, debt, reserves and financial rules, is notably skewed toward favoring advanced economies. The United Nations Conference on Trade and Development reveals that developing countries normally operate within an unequal international financial system. It is noted that, African countries face persistently high borrowing costs,¹⁶ and African countries are mostly subject to risk perceptions and poor credit ratings and are consequently raising their financial costs. Additionally, as the IMF notes, global financial conditions especially shift in interest rates in advanced economies has a disproportionately pro-cyclical effect on African countries. Whenever there has been monetary tightening in advanced economies, it has been accompanied by capital outflows, exchange rate depreciation, and reduced access to international capital markets for developing economies.¹⁷ This further contributes to governments often being compelled to rely heavily on domestic borrowing.

3.2.2 Electoral Cycle Incentives

Moreover, electoral cycles and short-term political incentives play a central role. Governments facing competitive elections often prioritize visible public spending, such as infrastructure projects, wage increases, and subsidies, while postponing politically costly revenue measures. Domestic borrowing becomes an attractive instrument in this context because it is quicker to mobilize and less externally scrutinized than concessional or commercial external financing. Unlike IMF-supported programs, domestic debt issuance does not immediately trigger policy conditionality, making it politically expedient. The result is often pre-election fiscal expansion financed through short-term domestic instruments, contributing to rollover risks and rising interest costs.

Figure 1: Changes in Gross Debt, Percentage of GDP



Election-cycle spending is a notable phenomenon in Kenya, Ethiopia and Senegal as shown in Figure 5. This trend is driven by the preference to spend on politically visible projects. In an environment where fiscal indiscipline and weak oversight are present, spending spikes that are driven by political timelines compromises investment in long-term viable projects. One possible way of determining political influence is the case of Kenya, whereby the highest composition of debt is primarily domestic. Regarding this, politically exposed persons (PEPs) and their affiliated institutions, including banks and insurance companies, hold a substantial share of domestic government securities, thus becoming creditors to the state.¹⁸ This may imply that there is a political hand in the concentration of domestic debt. Additionally, similar research has identified core political drivers of debt, i.e. senior government officials pursue high-visibility projects for legacy and patronage reasons; MPs lobby for local spending to shore up re-election prospects; and parliamentary oversight remains underutilized relative to its constitutional mandate.¹⁹ This creates opportunity for a continuous power cycle in which debt decisions respond more to political motives and electoral incentives than prudent fiscal management or long-term sustainability. While most of these dynamics may be difficult to establish through direct causal evidence, owing to a lack of a direct political link, it is highly necessary that the responsible authorities such as parliament investigates and address how elite capture, partisan incentives, institutional imbalances, and legal gaps shape debt decisions.

3.2.3 Decentralization and Subnational Fiscal Pressures

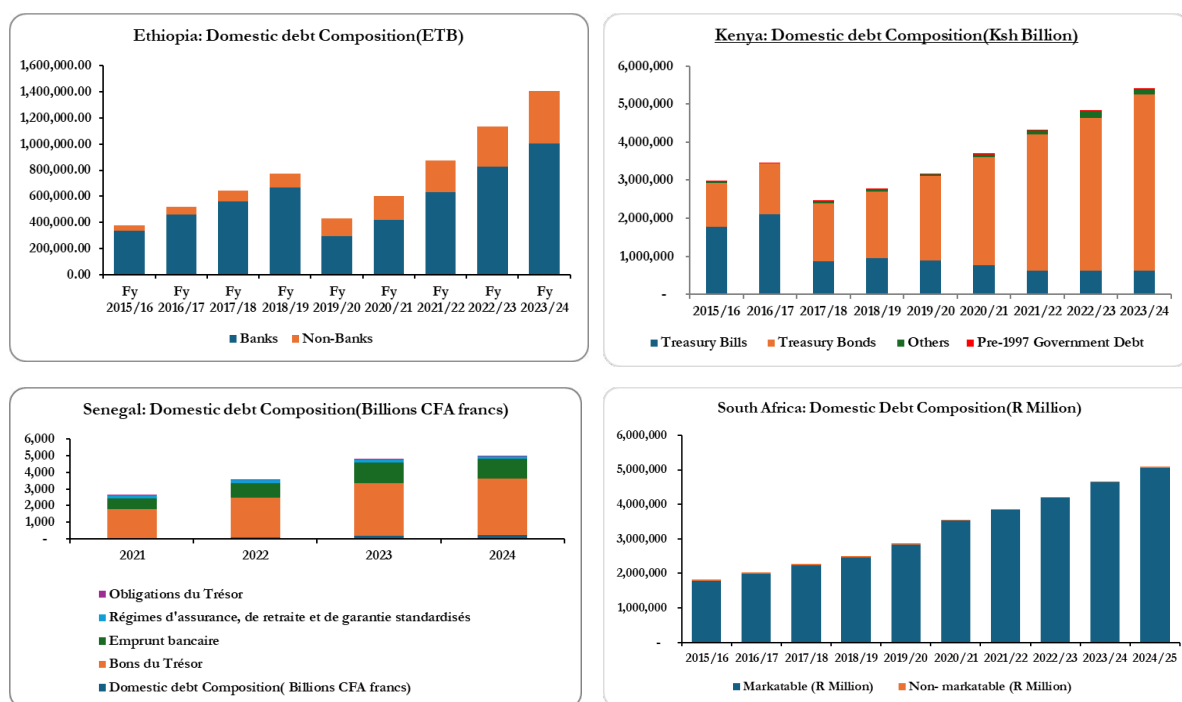
In a context like Kenya where national government shares revenue with county governments and Ethiopia where the federal government shares revenue with the regional states, decentralization and subnational fiscal pressures can intensify domestic financing needs. In devolved systems, central governments are obligated to finance intergovernmental transfers while managing their own expenditure commitments. Political bargaining over revenue-sharing formulas, combined with rising subnational wage bills and service delivery demands, can widen vertical fiscal imbalances. Domestic debt issuance frequently fills these gaps, especially where subnational borrowing is restricted or closely regulated.

3.2.4 Bank-Sovereign Nexus

Furthermore, the close relationship between governments and domestic financial sectors (bank-sovereign nexus) reinforces domestic debt growth. Commercial banks frequently hold a large share of government securities, attracted by relatively high yields and low perceived risk. This creates a “lazy banking” equilibrium in which lending to government crowds out private sector credit, particularly to small and medium-sized enterprises.

In some contexts, political and business elites have overlapping interests in both public office and financial institutions, further entrenching incentives to sustain high levels of domestic issuance. Over time, this symbiotic relationship reduces pressure for fiscal adjustment while increasing systemic financial vulnerability.

Figure 2: Domestic Debt by Creditor Type

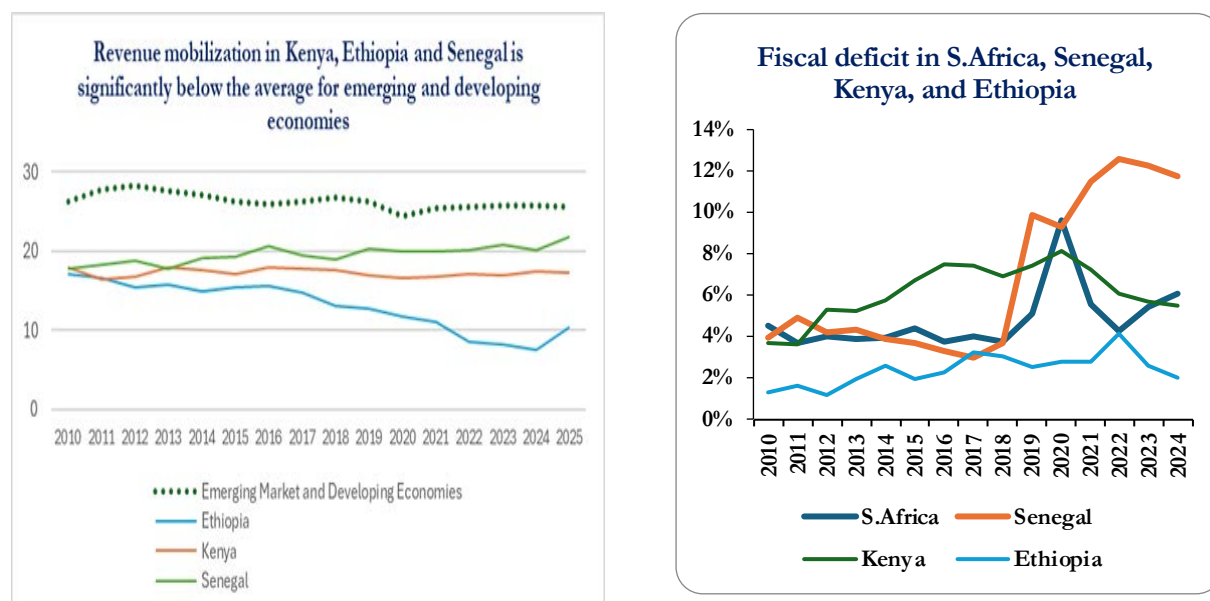


Data sources: FDRE - Ministry of Finance, The National Treasury - Republic of Kenya, National Treasury - Republic of South Africa, Ministère De Finances Et Du Budget - République Du Senegal

3.2.5 Revenue Performance and Politically Sensitive Tax Reforms

Persistent revenue weaknesses and resistance to structural tax reform contribute to reliance on borrowing as efforts such as tax base expansion, improving compliance, or introducing politically sensitive taxes - such as property or wealth taxation - often encounter elite resistance and administrative challenges. In economies with large informal sectors and narrow tax bases, governments may find domestic borrowing less politically costly than comprehensive tax reform or expenditure rationalization. Thus, borrowing becomes a substitute for politically difficult fiscal restructuring.

Figure 3: Revenue and Fiscal Deficit, Percentage of GDP



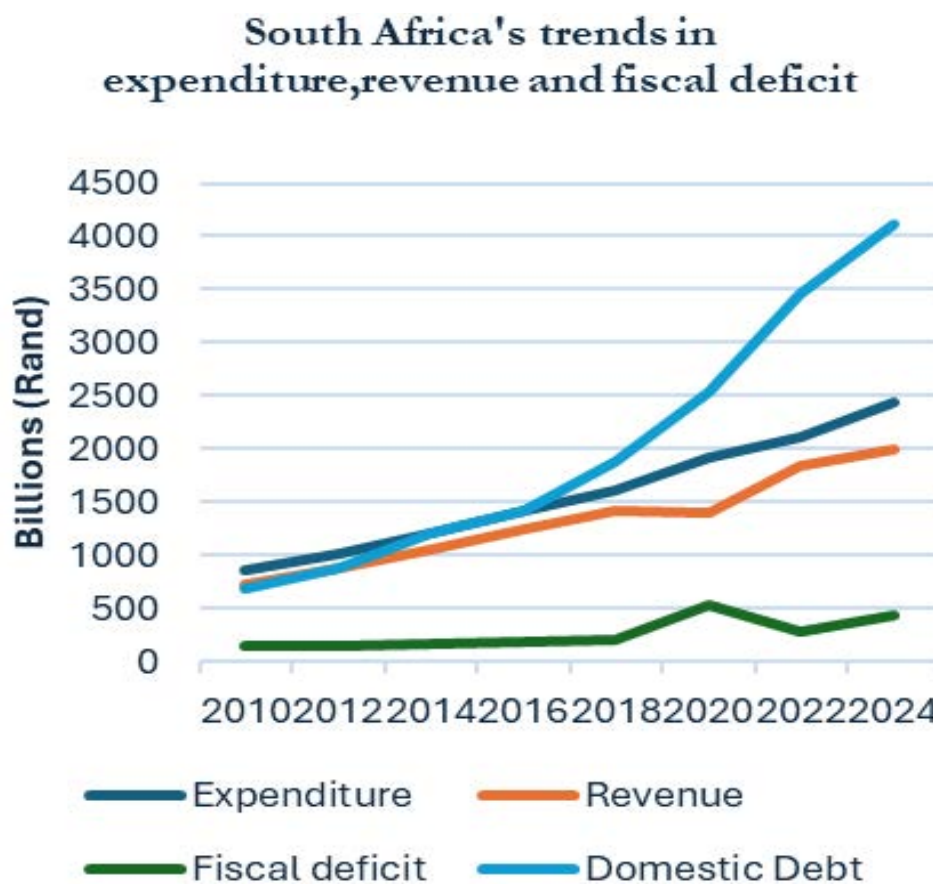
Data source: IMF, October 2025 WEO

Weak revenue mobilization remains a shared challenge across Kenya, Ethiopia and Senegal in comparison to how an economy like South Africa is performing. Ethiopia is particularly low in tax-to-GDP ratio, where at 2024, it stood at 8 percent. Senegal on the other hand has made good strides, with a tax to GDP ratio of 19 percent during the same year, while Kenya is at 17 percent. This is in comparison to South Africa which during the same period stood at 27 percent. Ethiopia portrays a unique scenario where revenue has been on a downward trend, from 17 percent in 2010 to 8 percent in 2024. In Kenya, revenues have stagnated at just 16 -18% of GDP, while total debt nearly doubled from 37% of GDP in 2010 to 67% in 2024 an indication of more reliance on debt to finance budget expenditures rather than revenue.

As access to external financing tightened amidst persistent revenue shortfalls, Kenya relied more heavily on domestic borrowing, which increased from 19% to 40% of GDP over the same period. This reliance has proven costly: domestic interest rates averaged around 10 to 14 percent among the highest in the region compared to other African countries like Uganda (9.9%), South Africa (9.0%), Senegal (5.7%), and the African average (8.2%).²⁰ It is worth noting that according to The 2026 MTDS, the Kenyan government aims to acquire borrowing with 82 percent from domestic sources over the medium term.²¹ As illustrated in section 2.4.2, the rising servicing burden now crowds out spending on health, education, and infrastructure, illustrating how weak revenue performance and expensive domestic borrowing combine to create a fiscal pressure that undermines growth and consolidation.

Senegal and Ethiopia present contrasting but equally complex patterns. **Senegal's revenues remain modest at 19-21% of GDP, yet its debt trajectory is explosive: total debt more than tripled from 35% of GDP in 2010 to 114% in 2024, with domestic debt climbing sixfold to 71% and external debt approaching 50%.** This dual dependence exposes the country to significant repayment risks, as debt servicing consumes an increasing share of revenue. Ethiopia, by contrast, faces a collapsing revenue base, which fell from 19% of GDP in 2010 to just 11% in 2024, severely constraining its borrowing capacity. Domestic debt declined from 19% to 11% of GDP over the same period, largely due to the transfer of state-owned enterprise obligations from the federal government to the Liability and Asset Management Corporation (LAMC), combined with faster nominal GDP growth relative to debt.

Figure 4: Domestic debt, revenue and expenditure in South Africa



South Africa has also experienced a steady rise in domestic debt since 2010, with a sharper increase from 2016 to 2024. During this 9-year period, domestic debt grew by 191 percent (13 percent average annual growth rate) and this growth in debt was accompanied by a 71 percent increase in government expenditure (7 percent average annual growth rate). However, despite these upward trends, South Africa has generally been able to maintain a lower fiscal deficit growth compared to regional peers such as Kenya, Ethiopia, and Senegal. Between 2010 and 2018, the deficit remained relatively stable at an average of 155 billion rand. The deficit surged in 2020 to 535 billion rand (10 percent of GDP), primarily due to the COVID-19 pandemic, but afterward experienced a decline of 47 percent to 283 billion rand in 2022, before experiencing a modest increase towards 2024.

Unlike Kenya, and Senegal, whose fiscal deficits have been on a rising trajectory, South Africa's growth in domestic debt is not as a result of fiscal deficits, but rather a deliberate prioritization of domestic debt to reduce exposure to exchange rate volatility. This can be evidenced as between FY 2022/23

and FY 2024/25, South Africa's domestic debt increased from 4,209,771 to 5,091,969, representing a growth of approximately 21 percent. Over the same period, external debt rose slowly from 555,657 to 601,902, equivalent to a growth rate of about 8 percent. This implies that domestic debt expanded faster than external debt by roughly 13 percentage points. It is imperative that a reliance on domestic debt be used as a risk management tool rather than a response to widening fiscal imbalances. Although sustainability concerns remain, South Africa's stronger revenue mobilization, strong regulations around domestic borrowing and mature financial systems highlight a critical lesson.

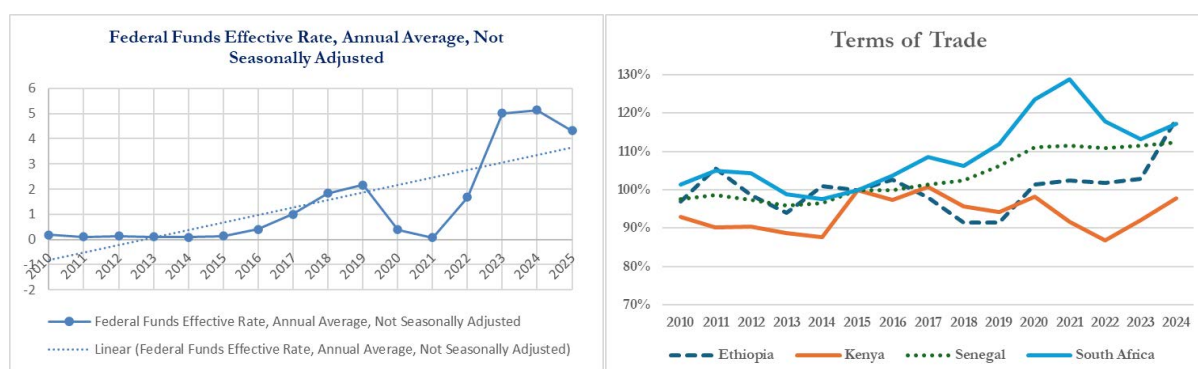
Furthermore, **exchange rate depreciation has played a significant role more so for Kenya and Ethiopia that have experienced substantial local currency depreciation over the past few years.** Firstly, a depreciating currency means that there will be a higher cost on any debt denominated in foreign currency. Additionally, there will be a reduction in foreign capital inflows, owing to declining investor confidence. This will significantly increase the cost of servicing foreign currency-denominated debt. This is especially problematic for Kenya; 67 percent of external debt is dollar denominated. Senegal, as a member of the CFA franc zone, is relatively more insulated from exchange rate risks due to its currency's peg to the euro. However, this insulation does not extend to broader global market dynamics, and the country still faces indirect vulnerabilities through trade and reserve pressures.

It is also worth noting that the **reclassification to lower-middle-income has affected countries such as Kenya and Senegal in terms of access to cheap external financing from multilateral lenders pushing the countries to consider domestic borrowing.**²² This is primarily because it may generally reduce the country's access to highly concessional finance, which thus pushes governments toward costlier domestic and external market borrowing. This thus raises debt-service burdens relative to revenues, which in turn narrows fiscal space for social and development spending.

3.2.6 External Factors Dictating a Shift to Domestic Borrowing

External pressures facing Kenya, Ethiopia and Senegal and also South Africa is pronounced due to the sharp rise in global interest rates (proxied by FED interest rates) from near-zero to above 5% by 2025. This follow policy tightening not only by the US Federal Reserve but also in other major central banks thus disproportionately impacting countries like Kenya and Senegal that have been tapping into international capital markets. Rising global interest rates have also increased the cost of refinancing and servicing these debts making debt management more challenging.

Figure 5: Interest rates and Terms of Trade



Data source: Federal Reserve Bank of St. Louis

Data source: World Bank

Terms of trade dynamics have also increased reliance on domestic borrowing as weak external position reduces foreign exchange inflows, widens the current account deficit, and raises the domestic currency cost of servicing external debt, thereby constraining access to external financing and pushing the government toward domestic markets despite higher interest costs.

Kenya's persistent deterioration in terms of trade remaining below the base index of 100 for most of the period reflects rising import costs relative to export earnings, particularly as an oil-importing economy.²³ Ethiopia faced external financing and foreign exchange pressures, alongside terms-of-trade fluctuations, while reduced external financing increased reliance on domestic and direct monetary financing, which the World Bank identifies as a driver of inflation.²⁴ By contrast, Senegal's steadily improving terms of trade suggests relatively stronger external purchasing power; however, domestic borrowing still increased, largely due to ambitious infrastructure spending and monetary constraints within the WAEMU framework, where domestic interest rates are influenced by European Central Bank tightening. South Africa's substantial terms of trade improvement during the commodity upswing strengthened external buffers and fiscal revenues, yet domestic borrowing remained dominant as a strategic choice supported by deep capital markets rather than as a crisis response. Overall, the graph underscores that deteriorating terms of trade tend to induce defensive shifts toward domestic borrowing in countries with external vulnerabilities, while countries with stronger trade performance and deeper financial systems use domestic debt more as a risk-management instrument than as a substitute for weakened external financing.

3.2.7 Legal and Regulatory Frameworks Guiding Domestic Debt Management

Domestic debt governance in Kenya, Ethiopia and Senegal reflects a broader continental pattern: **while formal legal foundations for public borrowing exist, institutional fragmentation, weak enforceability, and limited fiscal-monetary coordination undermine effective domestic debt management.** The core challenge is not the absence of laws, but the misalignment between legal mandates, operational practice, and political incentives.

Across the three countries, **borrowing authority is constitutionally or statutorily grounded within public finance management frameworks.** Kenya's Constitution (2010) and the Public Finance Management Act (2012), Ethiopia's public finance and central bank statutes, and Senegal's integration within WAEMU fiscal rules all provide formal authorization for public borrowing. However, these frameworks tend to treat domestic and external debt under unified provisions, without sufficiently differentiating their risk profiles. This legal conflation obscures the unique refinancing, interest rate, and financial sector spillover risks associated with domestic debt, particularly where short maturities and concentrated investor bases dominate.

Institutionally, the effectiveness of domestic debt governance hinges on three pillars: (i) clarity of borrowing authority, (ii) transparency of issuance and reporting, and (iii) coordination between treasuries and central banks. South Africa's model, anchored in the Public Finance Management Act and implemented through a predictable auction-based system with active primary dealers, illustrates how legal clarity combined with market-based issuance supports investor confidence and reduces refinancing risk. In contrast, Ethiopia's historical reliance on direct central bank financing weakens market discipline and blurs the boundary between fiscal and monetary policy, amplifying inflationary pressures and undermining domestic market development. Kenya and Senegal occupy intermediate positions: Kenya has formalized debt strategies and auction systems but faces rollover vulnerabilities due to short maturities and heavy banking-sector concentration; Senegal benefits from WAEMU's

regional framework, yet its monetary sovereignty constraints limit countercyclical flexibility and tie domestic borrowing costs to ECB-driven policy tightening.

The table below summarizes the legal and institutional frameworks governing public debt in Kenya, Ethiopia and Senegal.

Table 1: Comparison of Legal Frameworks across the 3 countries

Legal Framework	Kenya	Senegal	Ethiopia
Constitutional basis	2010 Constitution – Parliament approves public borrowing	Constitution of Senegal – subject to national and WAEMU rules	FDRE Constitution – Parliament approves borrowing
Primary debt law	Public Finance Management Act (2012) and PFM Regulations (2015)	WAEMU Regulations (e.g. 09/2007/CM/UEMOA) and national transparency and banking laws	Financial Administration Proclamation (2009) and Debt Management & Guarantee Directive (2011)
Standalone Public Debt Management Act (PDMA)	No	No	No
Legal distinction between domestic and external debt	No explicit distinction	No explicit distinction	No explicit distinction
Debt management authority	National Treasury (Public Debt Management Office)	Ministry of Finance and Budget (with CNDP advisory role)	Ministry of Finance (Debt Management Directorate)
Role of Central Bank	CBK as fiscal agent and monetary authority	BCEAO issues securities in regional market	NBE as fiscal agent
Parliamentary role	Statutory approval of borrowing	Limited due to WAEMU dominance	Statutory approval of borrowing
Auditor General / Supreme Audit	Office of the Auditor-General	Court of Audit	Office of the Federal Auditor General
Existence of MTDS	Yes	Yes (within WAEMU framework)	Yes
Treatment of contingent liabilities	Weak, especially guarantees and SOEs	Weak, largely regionalized	Very weak, especially SOE debt

A critical governance gap across the three cases is enforceability. **Statutory debt ceilings, medium-term debt strategies (MTDS), and borrowing plans exist, but upward revisions of ceilings, limited sanctions for non-compliance, and weak parliamentary scrutiny dilute their credibility.** Moreover, disclosure frameworks often lag in publishing granular information on contingent liabilities, guarantees, and subnational exposures, constraining effective oversight. Where domestic debt is increasingly held by commercial banks and pension funds, weak governance heightens systemic risk through the bank sovereign nexus, transmitting fiscal stress into financial stability concerns.

Ultimately, **domestic debt governance in these contexts suffers less from legal absence than from institutional fragility**. Strengthening governance therefore requires not merely new legislation, but tighter enforcement of fiscal rules, clearer statutory limits on central bank financing, mandatory transparency on domestic debt composition and maturity, and stronger parliamentary oversight mechanisms. Without these reforms, domestic borrowing will continue to expand within legally sanctioned but institutionally weak frameworks, reinforcing fiscal vulnerability rather than supporting sustainable development.

3.3 Drivers of Domestic Debt Across Africa

Several factors have increased reliance on domestic borrowing in Senegal, Ethiopia, and Kenya. First, persistent and large fiscal deficits, often fueled by development financing needs, post-crisis recovery efforts have led governments to seek accessible and timely funding sources.

Figure 6: Kenya Trends in Expenditure, Revenue and Fiscal Deficit

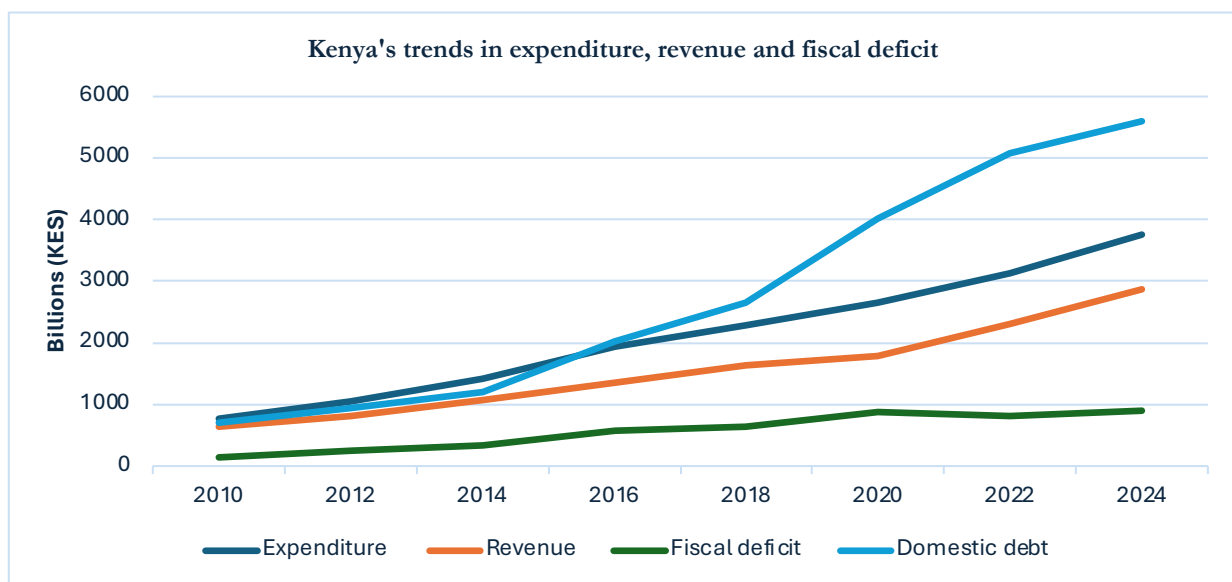


Figure 7: Ethiopia's Trends in Expenditure, Revenue and Fiscal Deficit

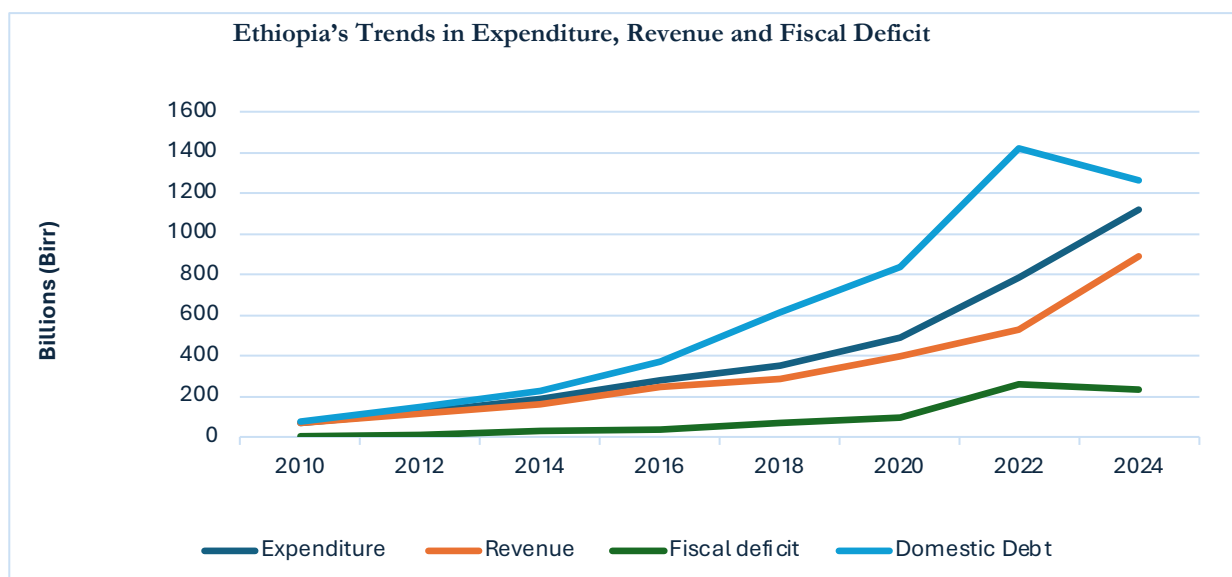


Figure 8: Senegal's Trends in Expenditure, Revenue, and Fiscal Deficit

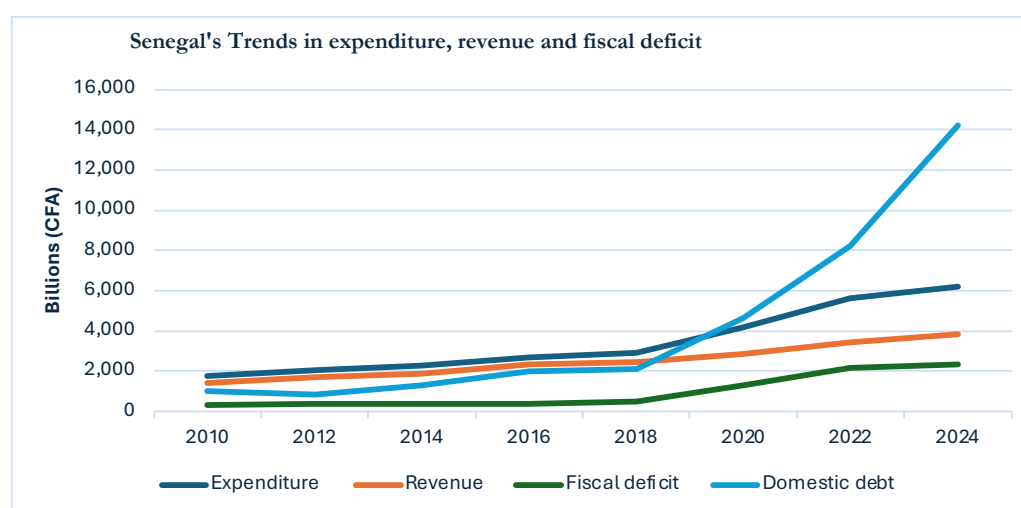
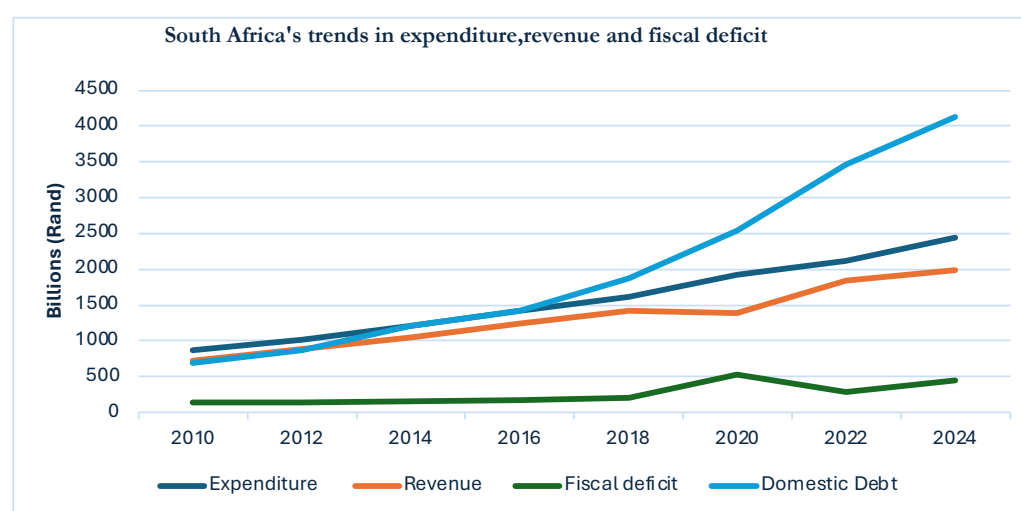


Figure 9: South Africa's Trends in Expenditure, Revenue, and Fiscal Deficit



An analysis of the drivers of domestic debt in Kenya, Senegal, Ethiopia, , under review reveals that rising expenditure, revenue shortfalls, and widening fiscal deficits are key contributors. To take the case of Kenya, domestic debt rose sharply between 2016(26 Percent of GDP) and 2024(34 percent of GDP), increasing by 178 percent (15 percent average annual growth rate) while over the same period, government expenditure nearly doubled, growing by 95 percent (10 percent average annual growth rate). However, compared to expenditure, which averaged KES 2,744 billion, revenue lagged averaging KES 1,975 billion. This consequently created fiscal imbalances that further pushed the deficit upward by 60 percent from KSh 567 billion to KSh 906 billion (6 percent of GDP), representing an 8 percent average annual growth rate). These pressures on fiscal consolidation fueled the country's heavy reliance on domestic borrowing.

In Ethiopia, domestic debt growth has been persistent since 2010, with especially noticeable sharp peaks between 2016 and 2023, accounting for 21 percent of GDP. During this period, domestic debt surged by a staggering 386 percent, accounting for a 24 percent average annual growth rate. On the other hand, the trends in in expenditure show growth of 236 percent (20 percent average annual growth rate) while revenue lagged behind, only expanding by 190 percent (18 percent annual growth rate) As in Kenya, these fiscal strains have shown to intensify Ethiopia's dependence on domestic debt.

Senegal on the other hand had its domestic debt grow gradually between 2010(13 percent of GDP) and 2018(16 percent of GDP), before accelerating sharply through 2024(71 percent of GDP). Over this seven-year period, debt increased by a staggering 573 percent, accounting for a 30 percent annual growth rate from CFAF 2,110 billion to a historic CFAF 14,195 billion. Government expenditure on the other hand expanded by 114 percent (13 percent annual growth rate), but revenue growth lagged significantly at 59 percent (7 percent annual growth rate). The mismatch widened fiscal deficits by nearly 400 percent, from CFAF 470 billion (4 percent of GDP) to CFAF 2,339 billion (12 percent of GDP), further entrenching reliance on domestic debt financing.

Figure 10: Senegal's debt trends against infrastructure needs

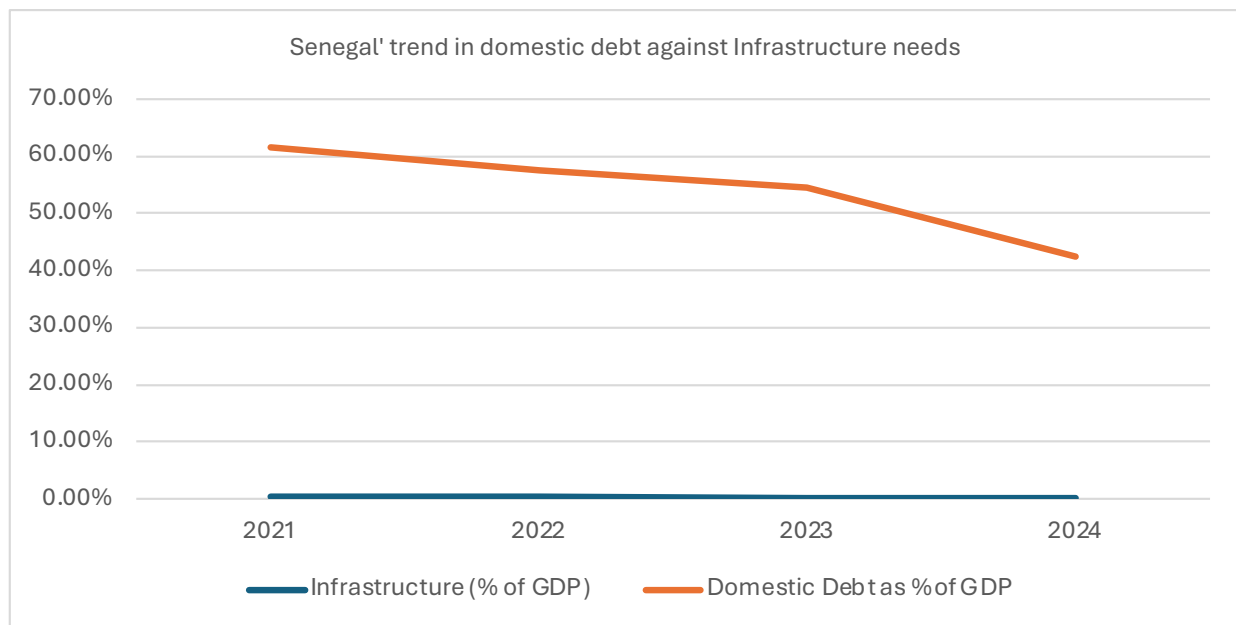


Figure 11: Ethiopia's debt trends against Infrastructure needs

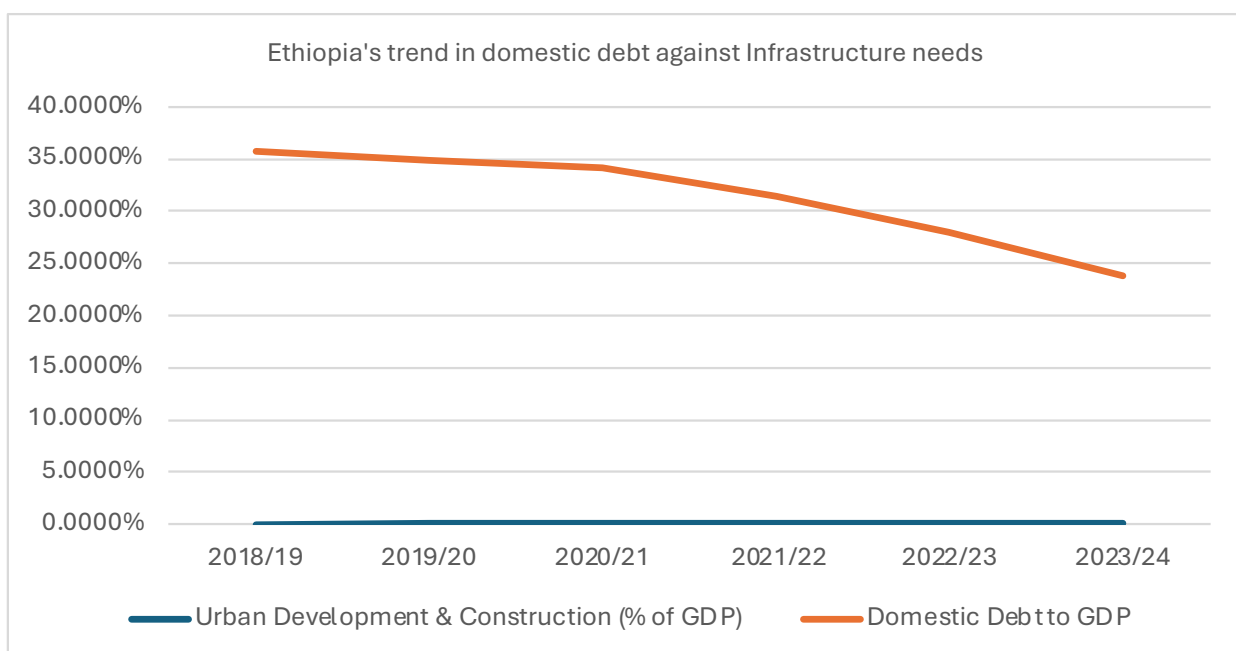
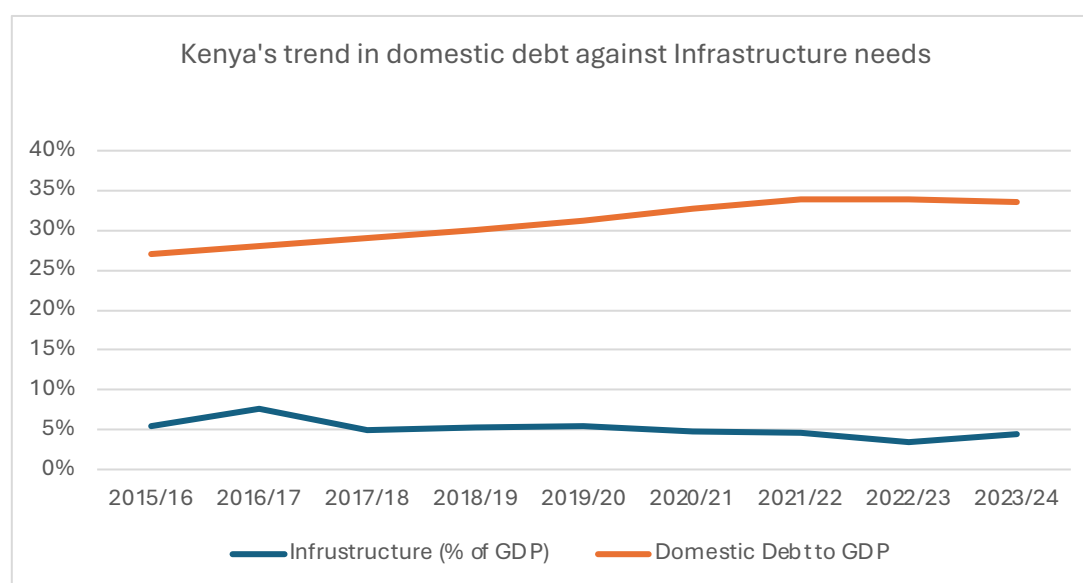


Figure 12: Kenya's domestic Debt trends against infrastructure needs



For Kenya, Senegal, and Ethiopia, debt stock is shown to be rising consistently, even as infrastructure development spending remains almost unchanged. This would imply that for all three countries, infrastructure development needs contribute very little to growth of domestic debt. Some of mega projects which have been financed with debt in Kenya include: The Standard Gauge Railway which was financed by two loans from China Exim Bank, whereby one was concessional (US\$1.63 billion, 2% interest, 20-year term) and one commercial (US\$2 billion, ~LIBOR+3.6%, 15-year term). In Senegal, the Bus Rapid Transit and Dakar Express Train were financed by concessional World Bank financing while Diass Solar Power Station was financed with funding from the German Development. Ethiopia has the Grand Ethiopian Renaissance Dam, which was largely funded through domestic debt, and Awash-Weldiya Railway funded using loans totaling US\$1.165 billion.

South Africa does provide a useful benchmark for other African countries, illustrating how deep domestic financial markets, a large and liquid investor base, and relatively stronger debt-management institutions can support domestic borrowing while ensuring that fiscal and market risks are mitigated. The IMF highlights that South Africa has the capacity to issue domestic-currency debt in the context of deep domestic financial markets and also observes that the country's large and liquid domestic investor base helps reduce asset-price volatility during periods of stress.²⁵

Notably, **the reclassification to lower-middle-income has affected countries such as Kenya and Senegal has reduced access to highly concessional finance, which thus pushes governments toward costlier domestic borrowing.** This raises debt-service burdens relative to revenues, which in turn narrows fiscal space for social and development spending. By contrast, South Africa's relatively deeper financial markets and more diversified economy have allowed the country to manage this shift more effectively, though domestic debt has significantly grown.

3.4 Debt Profiles in Kenya, Ethiopia, Senegal and South Africa

The trajectory of public debt in Kenya, Ethiopia, Senegal and South Africa between 2010 and 2024 reflects divergent historical contexts, borrowing strategies and levels of domestic market maturity, while also revealing notable points of convergence.

Kenya's debt history is closely connected to the structural changes in its economy and the country's development goals since independence. After gaining independence in 1963, Kenya mainly relied on concessional loans from bilateral and multilateral partners to finance infrastructure and service delivery.²⁶ Kenya began facing macroeconomic imbalances in the 1970s and 1980s, resulting from falling commodity prices and deteriorating terms of trade. To address rising fiscal and current account deficits, the government depended on external borrowing through Structural Adjustment Programs (SAPs) supported by the IMF and World Bank. As Kenya's external borrowing escalated, its debt-to-GDP ratio increased, setting the stage for long-term fiscal vulnerabilities. Kenya was ineligible for debt relief under the Highly Indebted Poor Countries (HIPC) Initiative or the Multilateral Debt Relief Initiative (MDRI).²⁷ Still, it benefited from a general shift in donor support and renewed fiscal discipline in the early 2000s. Through improved public financial management and stronger economic growth, Kenya's debt levels decreased to sustainable levels, with the debt-to-GDP ratio also decreasing.²⁸

The launch of Kenya Vision 2030 in 2008, aimed at transforming Kenya into a newly industrializing middle-income country, significantly increased public investment needs. To finance large infrastructure projects such as roads, energy infrastructure, ports and railways, the government increased its reliance on commercial and non-concessional borrowing such as the issuance of Eurobonds in 2014, which raised USD 2 billion from international capital markets.²⁹ In the same year, a statistical rebasing of GDP elevated Kenya to lower-middle-income status,³⁰ effectively locking it out from most concessional financing available to low-income economic countries and pushing the government towards more costly debt from commercial and domestic sources to meet its development needs. Constrained access to concessional external financing coupled with global financial tightening has pushed Kenya to rely more heavily on the domestic market in recent years. Between 2013 and 2016, Kenya's domestic debt consistently exceeded external debt rising from Ksh 696 billion (19% of GDP) in 2012/13 to Ksh 1.64 trillion (24% of GDP) in 2015/16, compared to external debt at Ksh 1.51 trillion (22% of GDP). After reaching parity with external debt at about 27% of GDP in 2018, domestic borrowing accelerated sharply, climbing to 34% of GDP (Ksh 5.59 trillion) by 2024/25 against external debt at 32% of GDP (Ksh 5.20 trillion).³¹

The Kenyan Government, under the 2026 Medium-Term Debt Strategy (MTDS), prefers an 84/16 mixture of domestic and external financing in line with an intention of shifting towards domestic financing. This is in line with the current trends which saw domestic borrowing rising to 50% target to 73 and 83 in FY 2023/24 and FY 2024/25 respectively. The change is accompanied by an increase in the debt risk indicators, including the decline in the Average Time to Maturity (ATM) of 11.5 years in June 2022 to 8.3 years in June 2025, which implies faster rollovers and higher refinancing risk. The composition of the domestic debt holders has also shifted, with non-bank investors becoming the largest holders, increasing by FY 2024/25 to Ksh 4.0 trillion as compared to FY 2020/21, with bank holdings moderately increasing between Ksh 1.9 trillion and 2.4 trillion, as shown in Table 1. A diversifying investor base is reflected in new classes of investors such as parastatals (Ksh 874 billion), households (Ksh 382 billion), and non-residents (Ksh 280 billion) and in changes in pensions and insurance companies. Domestic borrowing, however, takes place in a high-interest rate environment, with the yields on the securities going up to approximately 17% in 2023/2024, meaning that the cost of extra dependence on domestic

financial resources is high. Although this approach mitigates exchange rate risk, it increases risks within the country and increases refinancing pressures, particularly in case of significant redemptions like Ksh 735 billion in FY 2026/27, such as which would have to be rolled over under prevailing market conditions.

Table 2: Holders of Domestic Debt in Kenya

Ksh Million	FY 2020/21	FY 2021/22	FY 2022/23	FY 2023/24*	FY 2024/25*
Banks	1,900,876	2,103,687	2,294,332	1,769,829	2,366,785
Central Bank of Kenya	87,575	85,141	198,108	170,109	172,637
Commercial Banks	1,813,301	2,018,546	2,096,223	1,599,720	2,194,148
Non-Banks	1,796,015	2,185,521	2,537,929	3,648,760	3,959,224
Government (Parastatals)	-	-	-	930,704	874,246
Households	-	-	-	333,743	382,411
Non-Residents	-	-	-	325,268	279,636
Pensions	1,133,453	1,403,175	1,583,455	751,870	894,493
Insurance Companies	246,004	309,904	345,796	689,684	799,140
Others	416,558	472,442	608,678	617,490	729,299
Total	3,696,891	4,289,208	4,832,260	5,418,589	6,326,009

Between 2010 and 2024 the total public debt expanded more than eight times from KSh 1.32 trillion (37% of GDP) to KSh 10.78 trillion (66% of GDP). The debt trajectory was largely upward, with a clear peak in 2023 at KSh 11.04 trillion before easing slightly in 2024, signaling the beginning of fiscal restraint. Domestic debt followed a similar path, rising from KSh 696 billion (19% of GDP) in 2010 to KSh 5.59 trillion (34% of GDP) in 2024. The steepest increases occurred between 2015 and 2021, when domestic borrowing nearly tripled as the government increasingly turned to local markets to cover persistent budget gaps. As of August 2025, Kenya's domestic debt stood at KSh 6.38 trillion, having more than tripled from KSh 1.82 trillion in FY 2015/16.³² Kenya's debt composition remained broadly balanced, with domestic liabilities making up 52 percent and external debt 48 percent of the total, compared to less than 45 percent domestic share in the early 2010s. The surge in Kenya's public debt coincided with significant spending on infrastructure projects such as the Standard Gauge Railway, road expansion and energy investments under Vision 2030, as well as rising recurrent expenditure driven by devolution, a growing public wage bill and mounting interest payments.³³ The near-equal reliance on both domestic and external markets distinguishes Kenya from its peers.

Figure 13: Debt Composition Trends in Kenya

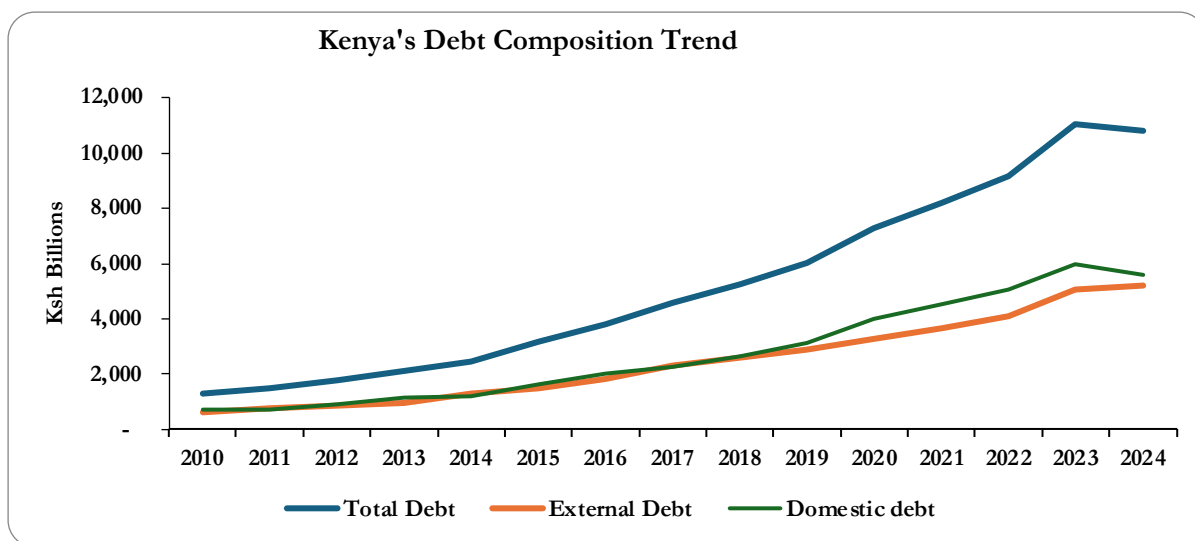


Figure 14: Debt Composition Trends in Ethiopia

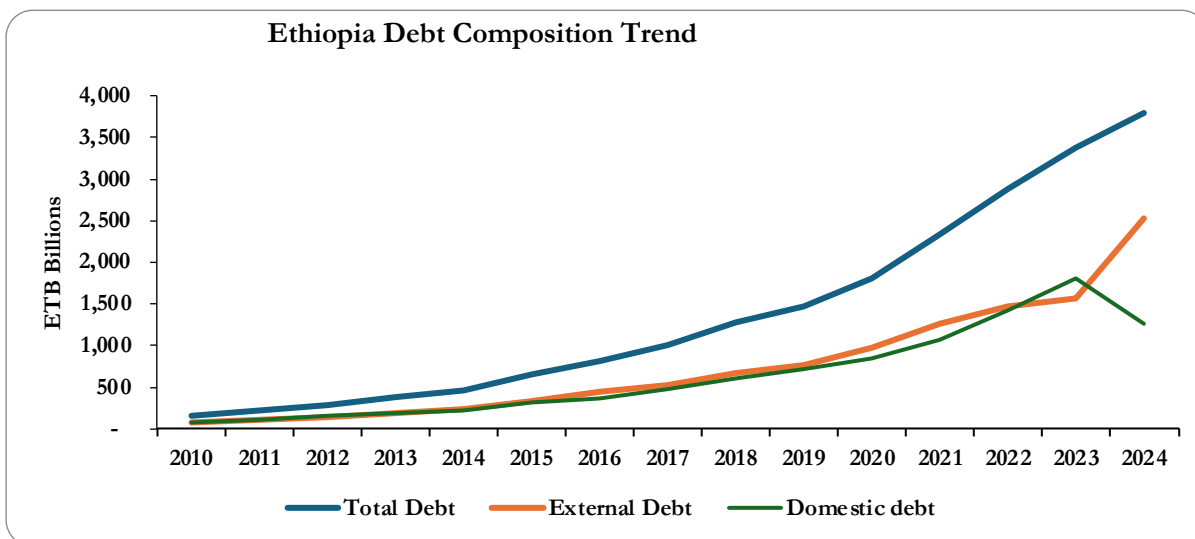


Figure 15: Debt Composition Trends in Senegal

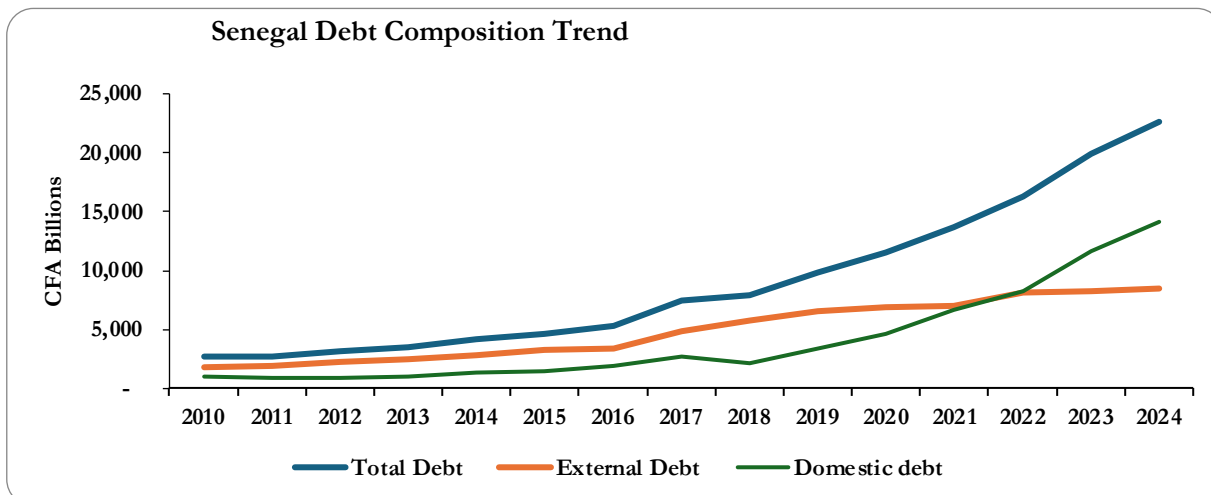
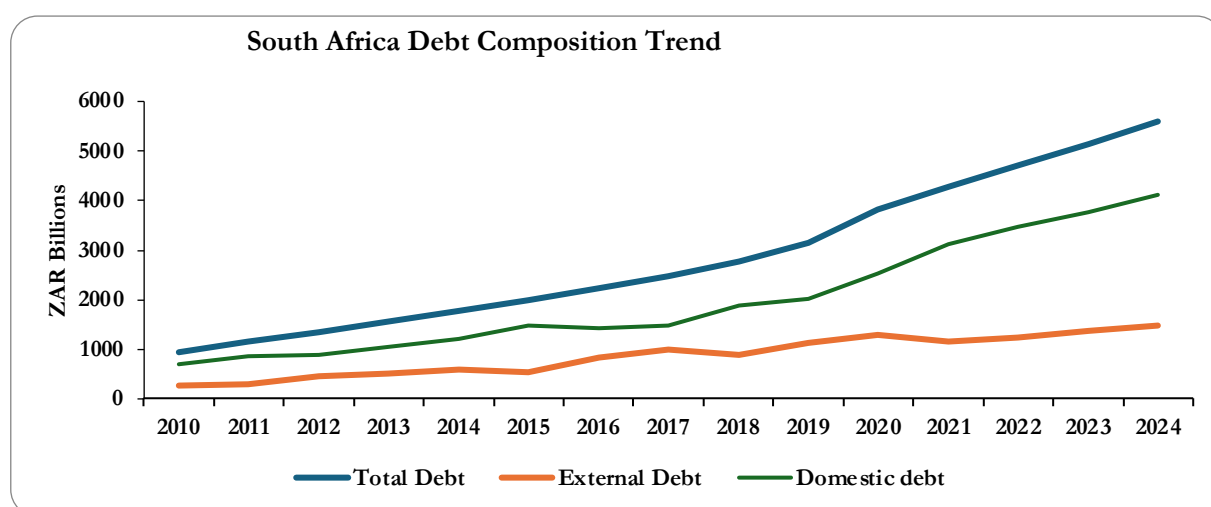


Figure 16: Debt Composition Trends in South Africa



Ethiopia's debt dynamics, by contrast, stand out for their scale and volatility. Its public debt trajectory mirrors its broader political and economic shifts, transitioning from post-conflict recovery to government-led development. Following the fall of the Derg regime in 1991, the new government prioritized reconstruction and growth, primarily financing these efforts through concessional external loans from international and bilateral partners.³⁴ By the late 1990s and early 2000s, Ethiopia became eligible for debt relief under the Heavily Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI), which significantly reduced its external debt and increased its short-term fiscal space. The country's total debt grew almost twenty-five times, from ETB 152 billion (39% of GDP) in 2010 to ETB 3.80 trillion (32% of GDP) in 2024. Domestic debt grew significantly from ETB 75 billion (19% of GDP) in 2010 to ETB 1.27 trillion (11% of GDP) in 2024. This reversal marked a turning point in 2023, whereby for the first time, domestic debt (ETB 1.80 trillion accounting for 21% of GDP) overtook external debt at 53 percent of the total. Nevertheless, in 2024 external liabilities accounted for two-thirds of the total. Ethiopia's debt profile is therefore characterized by volatility, with sharp swings in composition reflecting both external financing constraints and the limited depth of domestic markets. These swings underscore Ethiopia's vulnerability to shifting access to concessional and non-concessional financing as well as the limits of its underdeveloped domestic markets.

Senegal's trajectory reflects a seemingly deliberate structural transition to domestic borrowing, anchored in the deepening of the WAEMU regional market and a conscious strategy to reduce exposure to volatile global financing conditions.³⁵ Senegal's public debt history shows a steady rise in public borrowing to support long-term transformation plans. Senegal received significant debt relief under the HIPC and MDRI frameworks in the early 2000s, lowering its external debt burden and creating space for increased public investment. However, after the HIPC and MDRI, the country's public debt began growing again.³⁶ The launch of the Plan Sénégal Émergent (PSE) in 2014 by the Senegalese government aimed to promote structural transformation through large-scale investments in energy, transportation, and digital infrastructure, relying on both external and domestic borrowing. Senegal has seen a steady increase in both external and domestic borrowing since 2010. Just like the other countries, Senegal re-entered international capital markets with Eurobond issuances in 2011, 2018 and 2021, signaling confidence but also increasing vulnerability to global financial shocks.³⁷ At the same time, it also sped up its shift to domestic instruments, and by 2021, when global interest rates rose and refinancing conditions tightened, the move accelerated. Domestic funding comes mainly from the

West African Economic and Monetary Union (WAEMU) regional market, through Treasury bills and bonds issued in CFA francs.³⁸ Unlike Kenya and Ethiopia, where central banks dominate issuance, Senegal's domestic debt, being anchored in WAEMU, leverages the broader regional market while allowing for deeper investor participation and shared liquidity.

Nonetheless, contrary to Kenya and Ethiopia, this domestic market is under a monetary system which limits the capability to generate liquidity on its own. The central bank providing the region must have foreign exchange reserves to keep the fixed peg to the euro and therefore the growth of the domestic debt market eventually depends on the supply of foreign currency. Practically, this forms a vicious cycle where foreign borrowing, like the issue of Eurobonds is used to fund the reserves required to maintain the domestic liquidity as seen in 2018 when member countries borrowed foreign funds to stabilise the local financial system. This means that the domestic borrowing in Senegal although regionally diversified, does not entirely mitigate the external susceptibility but instead internalises it in the structure of WAEMU.³⁹ This means that the liquidity of the domestic bond market will be dependent on the balance of payment processes and foreign exchange access, which constrain the monetary policy autonomy and capacity of the central bank to serve as a lender or market maker of last resort. This is unlike in other countries like Kenya, where the cost of domestic borrowing is not structurally limited to foreign exchange support, as it is in Kenya.

Senegal's total debt expanded from CFA 2.76 trillion (35% of GDP) in 2010 to CFA 22.67 trillion (114% of GDP) in 2024. Domestic debt rose from CFA 1.02 trillion (13% of GDP) in 2010 to CFA 14.20 trillion (71% of GDP) in 2024 while external debt rose from CFA 1.74 trillion (22% of GDP) to CFA 8.47 trillion (42% of GDP) over the same period, but its share of the total dropped markedly from 63 percent in 2010 to just 37 percent in 2024. The most dramatic increases occurred in 2016–2017 when domestic borrowing more than doubled in a single year and again between 2020 and 2024, when it nearly tripled. A pivotal shift came in 2022, when domestic debt for the first time surpassed external debt, reaching 50 percent of the total and by 2024 it accounted for 63 percent. This structural transition underlines Senegal's growing reliance on local financial markets to finance development, contrasting sharply with the external-debt-heavy profile of the early 2010s. Unlike Ethiopia's temporary reversal, Senegal's shift from external to domestic financing was sustained, reflecting deeper regional market integration and a structural rebalancing away from external dependence.

South Africa provides a contrasting benchmark of stability and maturity. South Africa exemplifies the broader history of domestic debt trends across Africa. Unlike most nations on the continent, South Africa's domestic debt market has been well-established since the apartheid period, when the government increasingly relied on local borrowing due to global sanctions. After South Africa's democratic transition in 1994, it grappled with the inherited substantial public debt.⁴⁰ The new government introduced macroeconomic reforms, including the Growth, Employment and Redistribution (GEAR) strategy, along with improved debt management and fiscal consolidation. These measures temporarily lowered public debt to below 30 percent of GDP in the early 2000s. However, the global financial crisis of 2007–2008 led to a shift back towards expansionary fiscal policies. The country's public debt has been on a steady rise in recent years rising from 54% of GDP in 2018.⁴¹

South Africa presents a markedly different picture with the maturity of its domestic financial markets and consistent reliance on domestic borrowing. Its total public debt rose from ZAR 953 billion (31% of GDP) in 2010 to ZAR 5.60 trillion (76% of GDP) in 2024. Domestic debt remained the dominant component, increasing from ZAR 691 billion (23% of GDP) to ZAR 4.13 trillion (56% of GDP) and consistently accounting for between 60 and 74 percent of total liabilities. External debt grew steadily, rising from ZAR 262 billion (9% of GDP) in 2010 to ZAR 1.48 trillion (20% of GDP) in 2024. Its share peaked at 40 percent in 2017 but gradually declined to 26 percent by 2024. Unlike Kenya, Ethiopia or Senegal, South Africa's debt composition has mostly been stable and anchored by domestic dominance throughout the period. This steadiness highlights the stabilizing role of South Africa's deep and liquid domestic capital markets, which contrast sharply with the volatility in Ethiopia and the structural pivot in Senegal.

Taken together, these debt trajectories illustrate the interplay of fiscal policy, financing choices and market development. Ethiopia experienced the steepest surge, with total debt multiplying nearly twenty-five times, but also the most significant volatility in composition as domestic and external dominance alternated between 2010 and 2024. Kenya and Senegal both recorded an increase of almost eight times between 2010 and 2024, though Kenya maintained a balanced structure while Senegal transitioned decisively from external to domestic reliance after 2022. South Africa's debt expanded more moderately, six times over the period, but remained consistently anchored in domestic markets. Kenya's peak at 40 percent of GDP in 2023 was followed by a decline to 34 percent of GDP in 2024, reflecting a stabilizing adjustment not observed in its peers, while Ethiopia's reversal underscores its fragility. Senegal's post-2022 transformation illustrates a structural deepening of local markets, and South Africa's trajectory demonstrates how maturity and liquidity can anchor stability. Viewed comparatively, South Africa provides a benchmark of compositional steadiness, Senegal a case of structural rebalancing, Kenya an example of persistent stability in debt composition, and Ethiopia an illustration of volatility and vulnerability. These patterns together illustrate fiscal strategy, market depth and access to external capital jointly shape divergent debt trajectories. The maturity and depth of South Africa's domestic financial markets have enabled it to rely consistently on domestic borrowing and maintain a stable debt composition, in contrast to the volatility of Ethiopia, the structural rebalancing of Senegal and the balanced but shifting profile of Kenya. Beyond the trends and composition of public debt in these countries, it is also important to understand drivers of debt and more importantly why they shift to domestic debt.



4.0

Impacts of Domestic Debt on National Development Plans and Fiscal Consolidation

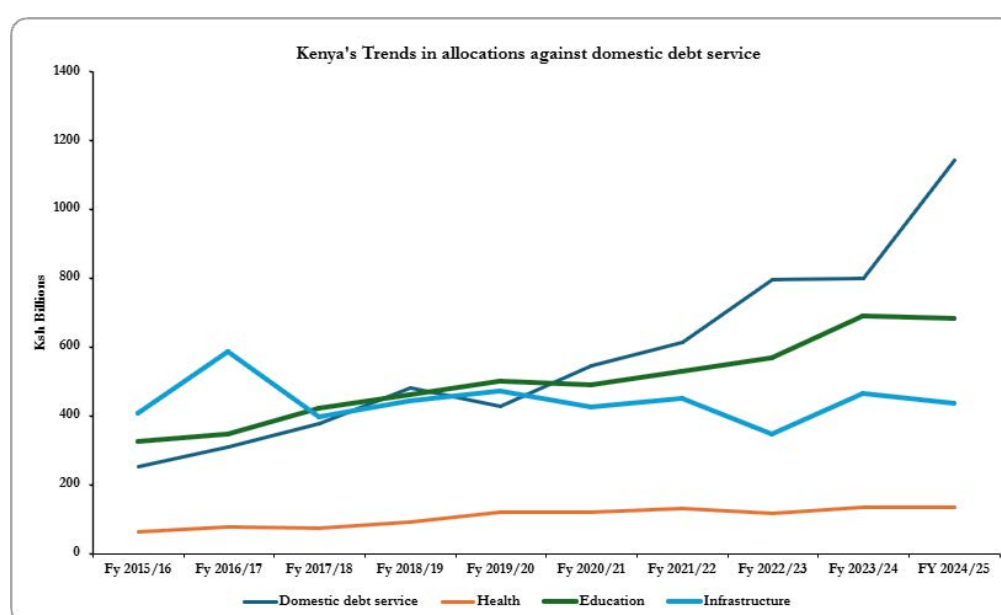
While the rising cost of domestic debt service is an important constraint in the progress and full implementation of national development plans, it is however important to note that sectoral underfunding cannot be attributed to debt service alone. Whether budget allocations are increasing or decreasing is dependent on a combination of factors such as revenue performance, political prioritization, expenditure rigidity, and the efficiency of public spending. Therefore, this section that investigates the relationship between domestic debt service and sectoral allocations should be understood not as a direct causal link, but as part of a broader set of fiscal trade-offs that influence how limited public resources are distributed.

As mentioned, this section discusses how domestic debt impacts national development plans for the three countries particularly delving on the impact on the health sector, education sector and infrastructure sector. Across Kenya, Ethiopia, and Senegal, national development plans have set significantly ambitious goals for the three critical sectors but rising domestic debt servicing has consistently undermined progress. In Kenya, Vision 2030 identifies universal health coverage, education reform, and infrastructure expansion as priorities. However, the high cost of debt servicing reached KES 797.07 billion in FY 2022/23 (up from KES 612.11 billion the previous year) has mostly exceeded allocations to health, education, and infrastructure. Notably, these sectors have grappled with underfunding such as underfunded hospitals, education budget shortfalls, and stalled infrastructure projects valued at close to KES 700 billion, almost equivalent to that year's debt service bill. Similarly, Ethiopia's Ten-Year Plan has likewise been constrained, with domestic debt repayments absorbing fiscal space, with funds that would have been otherwise used to cater for the underfunding in health, education, and urban development. Between FY 2020/21 and FY 2023/24, domestic interest payments rose by over 186%, absorbing 75% of total public interest costs in 2023/24. This has slowed efforts to rehabilitate conflict-damaged facilities, expand schools, and invest in urban infrastructure. On the other hand, schools and hospitals have inadequate infrastructure, delayed housing and road projects, and worsened fiscal imbalances. Overall, while each country has outlined clear social and economic priorities, ballooning domestic debt and the high cost of servicing has limited the fiscal space needed to achieve this objective.

4.1 Impact of domestic borrowing on Kenya's development plans and fiscal consolidation

Kenya's growing reliance on domestic borrowing has continually strained its fiscal position as debt service is now shown to be competing directly with critical social and development priorities. This mismatch between rising debt costs and minimal sectoral allocations has thus exposed health, education, and infrastructure to persistent underfunding. Worth mentioning is that while reduced debt service would not automatically translate into higher allocations to these sectors, it could significantly create more fiscal room for the government to strengthen investment in them, depending on budgetary priorities and policy choices.

Figure 17: Kenya's Trends in allocations against domestic debt service



It is important to note that from FY 2020/21 to FY 2023/24, **Kenya consistently spent significantly more on domestic debt servicing than on health**. Domestic debt service has risen steadily reaching 1.1 trillion billion KES in FY 2024/25.⁴² This is seven times higher than the allocations toward health which have stagnated at below 140 billion KES since FY 2019/20. Owing to the significant needs in the health sector, whereby Kenya Vision 2030 has identified UHC as a key component of its social pillar, it is thus noted that the sector would benefit significantly if allocations which would have been otherwise used for domestic debt service were channeled to the health sector. Consequently, the high cost of domestic debt service is thus expected to negatively impact allocations to Ministry of Health, particularly in preventive and curative health programs. While the education sector in Kenya has normally received the largest share, the funding allocated to learning institutions is often insufficient. Notably, according to the Auditor General's reports, capitation is not adequate to cover operational costs of the schools leading to shortages of essential resources such as teaching materials and dilapidated infrastructure, for example in 2025 the office flagged a shortage of Kshs.2,145,001,872.⁴³ The argument here is that funds being used to cater for domestic debt servicing would be significant in bridging these financing gaps across the health and education sectors, strengthening the delivery of essential services, and advancing social outcomes envisioned under Vision 2030. Nevertheless, allocation of resources to these critical sectors will not be merely solved by reducing debt service obligation but also necessitate a change in policy choices, fiscal rules, and expenditure priorities.

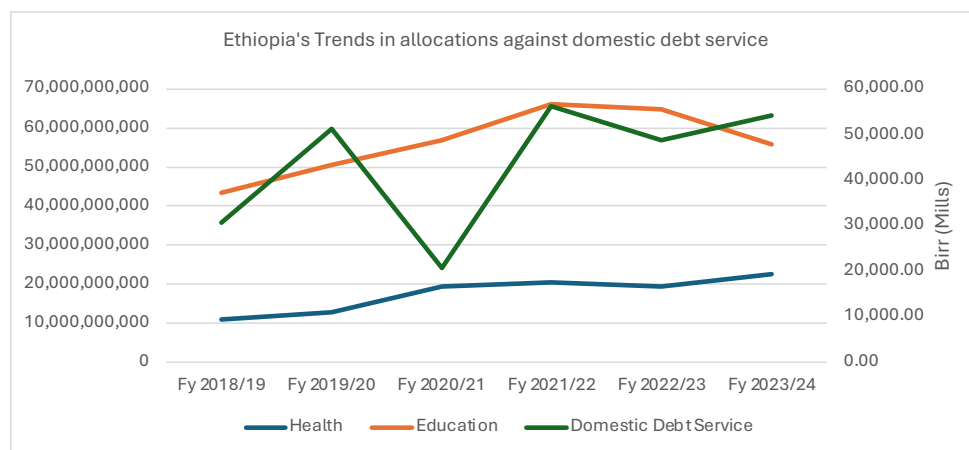
In achieving the Kenya Vision 2030, there is need for the country to invest heavily in roads, rail, and energy.⁴⁴ However, domestic debt service has been shown to negatively affect expenditures towards infrastructure. For example, in FY 2022/23, expenditure towards infrastructure decreased to 344 billion from 447.9 billion in the previous financial year. This same period experienced a sharp increase in domestic debt service from 612.11 billion to 797.07 billion. The implication here would be that though debt is normally intended to pursue infrastructural development, debt service is consuming a significant amount of the budget, thus constraining infrastructure's budget. This consequently leads to stalled infrastructural projects, which according to the IMF, nearly half of over 1000 government implemented projects had stalled by 2024 and would require Ksh. 1 trillion (6 percent of GDP) to revive. It is worth noting that any funds that were spent on stalled projects normally become sunk costs, however the loans used to finance them would still require repayment. Maintaining the similar argument, social sectors such as health, education, and social protection remain underfunded, and would have greater potential to meet their financing needs if the fiscal space currently absorbed by domestic debt service were available to support them.

However, it is worth mentioning that the divergence between rising debt service and declining infrastructural expenditure may also reflect shifts in government priorities, project implementation challenges, or revenue constraints during the period. It is notable that since FY 2021/22 Kenya has used over 26 percent of its revenue to service domestic debt (Interest and Principal), with the highest being 33 percent in FY 2022/23. While the country's revenue collections have continually risen, so have debt service payments, whereby from FY 2020/21 to FY 2024/25 it rose by approximately 109 percent. These amounts have deterred fiscal consolidation efforts by draining revenues towards debt servicing expenditures which as at 2023/24 accounted for approximately 21 percent.

4.2 Impact of domestic borrowing on Ethiopia's development plans and fiscal consolidation

Ethiopia's Ten-Year Development Plan has set its priorities on health, education, and urban infrastructure as drivers of growth. However, as is the case of Kenya and Senegal, the rising cost of domestic debt service has further eroded fiscal space and limited the government's ability to expand social investments, modernize infrastructure, and address conflict-related reconstruction needs.

Figure 18: Ethiopia's Trends in allocations against domestic debt service



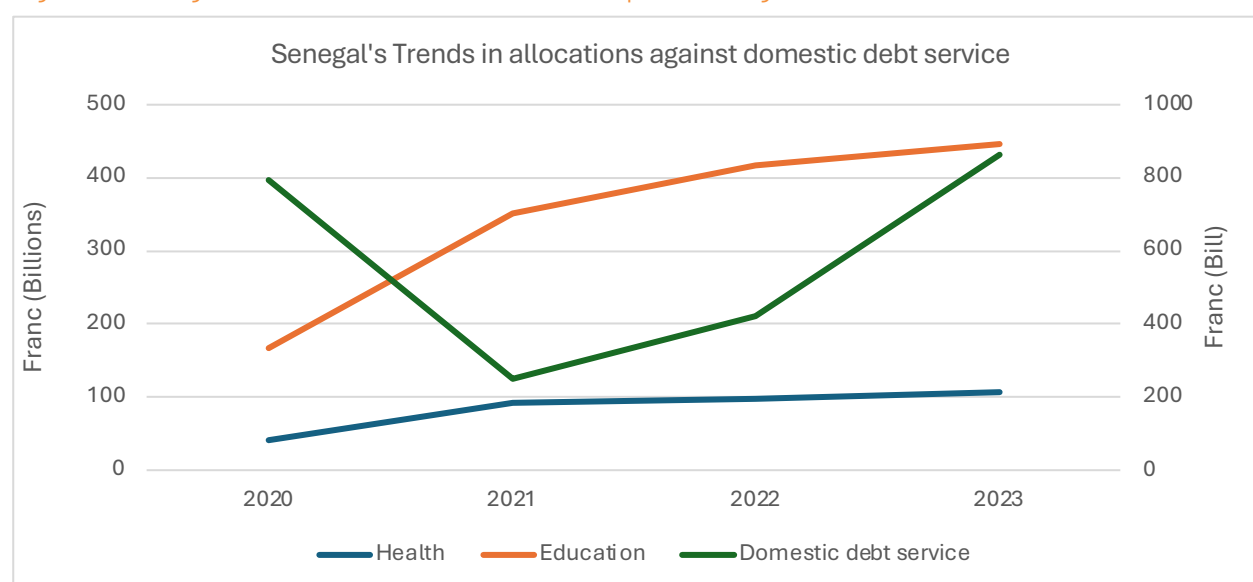
Ethiopia's ten-year plan on health intends to improve health access, quality, and outcomes. However, the country's domestic debt service has greatly constrained fiscal space for the achievement of the health sector's objectives. Though the share of the national budget to health rose to 8.3 per cent, the sector faces a low human resource at a ratio of 22.2 per 10,000 which is far below the WHO standard of 44.5 necessary for achieving UHC. Additionally, Ethiopia's health professional-to-population ratio remains one of the lowest globally, at 1.63 per 1000 people, reflecting the need for more tailored, resource-sensitive approaches to health workforce development. Additionally, while it is notable that the government has managed to raise Ethiopia's capital expenditure on health, it still falls short of the intended amount to rehabilitate health facilities damaged by conflict and expand service coverage. This demonstrates that despite increased allocations, the health sector remains underfunded relative to its needs, and the pressure of high domestic debt service further limits the fiscal space required to achieve the sector's objectives under the ten-year plan

The education sector is critical in the achievement of Ethiopia's Ten-Year Plan Perspective Development Plan. The government seeks to improve quality education, upgrade infrastructure, conduct teachers' recruitment, and develop vocational training centers. Despite these goals, the sector faces significant financing challenges under rising domestic debt pressures. For example, in FY 2023/24, the sector saw a decline in allocation from 64,763,384 million in the previous financial year to 55,774,746 million ETB. Yet, domestic debt service, particularly to state-owned banks, absorbed 54,058 million ETB of public resources. Notably, limited investments in capital have strained the expansion of facilities and the intended modernization of educational infrastructure. Again, constrained recurrent spending has slowed down the recruitment and retention of qualified teachers. Consequently, the education sector has struggled to fulfill its role as a driver of human capital development under the Ten-Year Perspective Development Plan.

4.3 Impact of domestic borrowing on Senegal's development plans and fiscal consolidation

Under the Plan Sénégal Emergent, the government has also committed to making advancements in education, health, housing, and infrastructure. However, rising domestic debt service, further amplified by high interest costs, has constrained fiscal space, limiting capital spending and slowing progress on key PSE goals while weakening fiscal consolidation efforts.

Figure 19: Senegal's Trends in health and education expenditure against domestic debt service

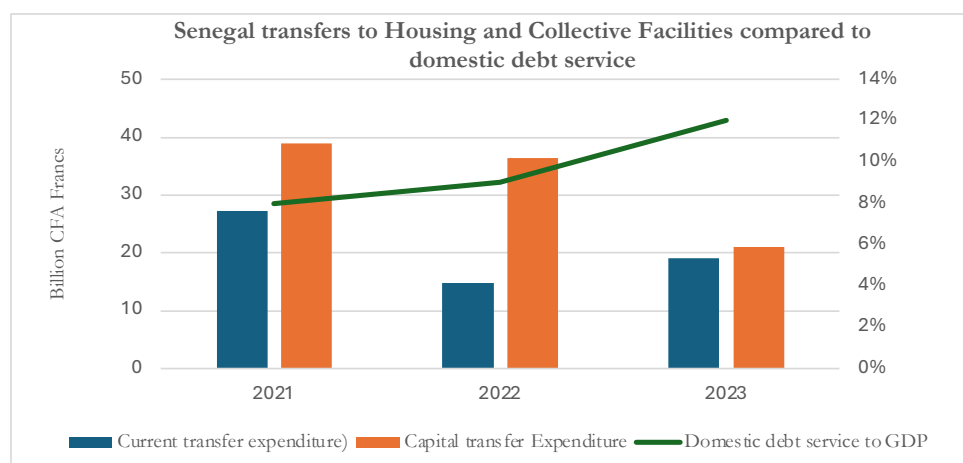


Worth noting is that while there are high expenditures in recurrent spending, learning poverty remains high, with 69% of children unable to read age-appropriate texts by the age 10. ⁴⁵ This further exemplifies the need to lower debt serving payments and redirect them to improving education. According to the IMF if current trends underfunding to education and high debt payments persist, Senegal will not only find it challenging to achieve the PSE but also the SDG 4 of which it is a signatory. The government needs to create more fiscal space.⁴⁶ Reports from the International Budget Partnership also notes that due to growing public debt, Senegal is recording historical and significant budget deviations in education. For example, the Ministry of Health and Social Action posted budget deviations of 31 percent in 2018, -50 percent in 2019 and -34 percent in 2020⁴⁷. The United Nations notes that a minimum of at least 20% tax to-GDP ratio is needed to deliver on the Sustainable Developments Goals.⁴⁸ Therefore, by the Senegalese government allocating just 20% of new tax revenues towards achievement of the SDGs, the education budget would increase by US\$1.5 billion which is approximately about 80% of the current budget allocation to education.⁴⁹ This is unachievable with current high debt payments.

From financial year 2021 to 2024 in figure 20, expenditures towards current transfers have exceeded capital transfers by over 80 percent. This deviation further increased in FY 2024 to 414 percent when capital expenditures dropped to 10.36 billion CFA francs. Notably, from financial year 2021 to financial year 2023, domestic debt service as a percentage of GDP increased from 8 percent to 12 percent. While expenditures towards capital expenditures increased during this period, it remained significantly low as compared to current expenditures. This is critical owing to the need from the Plan Sénégal Emergent (PSE) to increase capital expenditures, whereby the State of Senegal has a key focus on the health of populations, which includes building new health infrastructure. Senegal's high domestic debt servicing costs amplified by elevated interest rates (e.g., 6.9% on 3-year bonds) have constrained fiscal space, leaving fewer resources available for health investments. Notably, the high domestic debt servicing costs are structurally driven by the country's membership in the CFA franc zone, where the currency is pegged to the euro and monetary policy is effectively anchored to the European Central Bank (ECB).⁵⁰ As the Banque Centrale des États de l'Afrique de l'Ouest (BCEAO) must align its policy stance with European Central Bank (ECB) tightening to preserve the peg, domestic interest rates in the WAEMU region have risen irrespective of Senegal's domestic macroeconomic conditions. Consequently, translating into elevated yields on government securities, including rates of approximately 6.9 percent on three-year domestic bonds.⁵¹ The Ministry of Health has faced budget deviations exceeding 30% annually, undermining planning and delivery.⁵² UHC efforts are structurally vulnerable due to low investment in health infrastructure and human resources.

Housing and Collective Facilities

Figure 20: Senegal's Housing and collective facilities expenditure transfers against domestic debt service



Notably, in FY 2023, Senegal experienced a rise in domestic debt servicing from 9 per cent to 12 per cent.⁵³ This was accompanied by a drop in capital transfers by approximately 45 percent. While the PSE has also set key priority in infrastructure, domestic debt has crowded out the country's investments in roads, housing, and energy. Overborrowing has also caused a shift in the priority of investments, pushing social infrastructure projects to the sidelines and creating delays and challenges in the construction of rural roads and utility expansion. Fiscal space for new housing and collective facilities projects is shrinking, and investment efficiency is diminishing due to rising costs and administrative bottlenecks. Overall, the evidence across Kenya, Ethiopia, and Senegal points to a pattern in which rising domestic debt service coincides with constrained sectoral spending. However, it is best to understand this relationship reflects broader fiscal trade-offs rather than a simple one-to-one causal mechanism. While it is indeed true that Debt service obligations, especially when large, short-term, and high cost do reduce fiscal flexibility and increase the rigidity of public spending, it is equally true that allocation outcomes are also shaped by revenue performance, political priorities, institutional capacity, and the efficiency of public expenditure. Therefore, the impact of domestic debt on development outcomes operates through its interaction with these broader fiscal dynamics, rather than as an isolated driver of underfunding.

Fiscal Consolidation

Senegal's fiscal consolidation measures particularly in raising more revenue has been significantly affected by growth in domestic debt and domestic debt service. In 2022, total domestic debt as a percentage of revenue accounted for 104 per cent, which further increased to 127 per cent in 2023. While the country's revenue collections have continually risen by approximately 30 percent from 2847 billion CFA franc in 2021 to 3725 billion in 2023, debt service payments during the same period have risen by approximately 245 per cent. This has deterred fiscal consolidation efforts as expenditure has increased significantly, caused by a growing domestic debt.



5.0

CONCLUSION

The comparative analysis of Kenya, Ethiopia, and Senegal shows that domestic debt has increasingly shifted from a developmental financing instrument to a mechanism for managing fiscal stress. While all three countries have legal authority to borrow domestically, the quality of governance, market depth, and fiscal-monetary coordination differs significantly. These differences explain why domestic borrowing in some contexts amplifies vulnerability, while in others it functions as a strategic risk-management tool. It is notable that there is possible role that electoral cycles and short-term political incentives play in the accumulation of domestic debt, as governments facing competitive elections often prioritize visible public spending such as infrastructure projects, wage increases, and subsidies while postponing politically costly revenue measures.

South Africa provides a critical counterfactual within Sub-Saharan Africa. Despite high public debt levels, domestic borrowing in South Africa is underpinned by a deep and liquid capital market, a diversified investor base, transparent auction systems, predictable issuance calendars, strong coordination between the National Treasury and the central bank, and robust parliamentary and audit oversight. Domestic debt is largely long-term, market-priced, and issued within a clearly structured Public Finance Management framework. As a result, rollover risks are lower, interest-rate shocks are absorbed more gradually, and fiscal-financial sector spillovers are better managed.

In contrast:

Kenya faces high rollover risk due to shorter maturities and elevated domestic interest rates, combined with a narrow investor base heavily concentrated in commercial banks and regulated institutions.

Ethiopia struggles with shallow markets, opaque institutional arrangements, and past reliance on central bank-linked financing, weakening market discipline and heightening inflationary pressures.

Senegal, though benefitting from the WAEMU regional market framework, faces constrained monetary flexibility and exposure to externally driven interest-rate movements under the CFA peg.

The divergence is therefore not about the level of domestic borrowing alone, but about the institutional architecture governing it. South Africa demonstrates that domestic debt can be sustainable where legal clarity, transparency, maturity management, and fiscal credibility are entrenched. The policy challenge for Kenya, Ethiopia, and Senegal is not to eliminate domestic borrowing, but to reform the governance structures that determine its cost, risk profile, and developmental impact.



6.0

RECOMMENDATIONS

While the proposed reforms are technically feasible and consistent with good international practice, their implementation depends on addressing underlying political economy constraints. In Kenya, Ethiopia, and Senegal, domestic debt management is often shaped not only by fiscal necessity but also by short-term political incentives, institutional fragmentation, and vested interests that benefit from opaque and short-term borrowing practices. Reforms may fail where executive discretion overrides fiscal rules, parliamentary oversight remains weak, or financial sector actors continue to benefit from concentrated sovereign exposure. Accordingly, debt reforms must be sequenced around institutional strengthening, political commitment, and incentive realignment.

(i) Cross-Cutting Reforms

Institutionalize predictable, market-based issuance systems:

South Africa's benchmark bond auctions and structured primary dealer system work because they are supported by strong institutional credibility and rule-based fiscal governance.

Kenya, Ethiopia, and Senegal should strengthen transparent auction calendars, formalize primary dealer frameworks (where absent or weak), and avoid ad hoc issuance that increases risk premiums.

Lengthen maturity profiles and reduce rollover exposure: South Africa's domestic portfolio is skewed toward longer maturities, reducing refinancing pressure. Kenya should accelerate reprofiling away from short-term Treasury bills; Ethiopia should develop medium-to-long tenor instruments as market reforms deepen; Senegal should prioritize longer-dated regional instruments to smooth refinancing cycles.

Strengthen fiscal-monetary coordination with clear limits on central bank financing: In South Africa, the separation between fiscal authority and monetary operations enhances credibility. Ethiopia should formalize and tighten constraints on direct monetary financing; Kenya should maintain disciplined overdraft rules; Senegal should improve coordination within WAEMU structures to manage liquidity shocks.

Diversify the investor base to reduce sovereign-bank nexus risk: South Africa's broad investor participation (pension funds, asset managers, non-residents) reduces systemic concentration. Kenya and Ethiopia should incentivize broader institutional participation and reduce overconcentration in

commercial banks; Senegal should deepen pension and insurance market engagement to balance regional bank exposure.

Enhance transparency and parliamentary oversight: South Africa's reporting, audit scrutiny, and legislative engagement improve accountability. All three countries should publish granular domestic debt data (maturity ladder, holder composition, cost metrics), strengthen parliamentary review of borrowing plans, and institutionalize annual debt-risk statements.

Political and electoral impact on debt: Further research is needed to examine the political and electoral incentives that may shape domestic debt accumulation. This is with the intention of establishing clearer causal evidence on whether borrowing decisions are driven by short-term political expediency or by prudent fiscal and development considerations.

(ii) Country-Specific Recommendations

Kenya

Near-term political feasibility depends on strengthening fiscal discipline incentives.

- ☞ Adopt a formal domestic debt reprofiling strategy, anchored in legally enforceable medium-term debt targets to reduce rollover risks and smooth the maturity structure of domestic obligations.
- ☞ Introduce an independent fiscal risk disclosure framework insulated from executive manipulation to improve transparency around contingent liabilities, debt servicing costs and fiscal pressures associated with off-budget commitments.
- ☞ Strengthen parliamentary enforcement of debt-service thresholds to limit politically driven short-term borrowing and reinforce legislative oversight of fiscal sustainability.

These reforms may face resistance where short-term borrowing remains politically expedient for managing expenditure pressures. Building bipartisan support around fiscal sustainability will be essential.

Ethiopia

Reform depends on broader institutional liberalization.

- ☞ Deepen domestic capital markets before expanding domestic debt issuance to reduce reliance on captive financing arrangements and improve the absorptive capacity of local investors.
- ☞ Consolidate SOE and contingent liability reporting to improve transparency around quasi-fiscal obligations that may ultimately migrate onto the sovereign balance sheet.
- ☞ Gradually phase out central bank financing and other forms of state-directed lending to strengthen market-based debt pricing and reduce distortions associated with financial repression.

However, implementation requires political willingness to reduce state-directed financial control and accept greater market discipline.

Senegal

Reforms must align with regional political and monetary realities within WAEMU.

- ☞ Improve issuance planning and debt maturity management to reduce refinancing pressures arising from the rapid expansion of short-term domestic debt instruments within the WAEMU market.
- ☞ Introduce debt-smoothing mechanisms including staggered maturities and a more balanced mix of Treasury bills and longer-term bonds, to limit rollover risks during periods of external monetary tightening and constrained regional liquidity.
- ☞ Strengthen disclosure of contingent liabilities and quasi-fiscal risks associated with state-led infrastructure investments under the Plan Sénégal Émergent (PSE), particularly where borrowing obligations may migrate onto the public balance sheet,
- ☞ Deepen coordination between national debt management authorities and regional WAEMU institutions to mitigate the structural dependence of domestic liquidity on external capital inflows and foreign exchange availability.

Success depends on coordination across regional institutions and political commitment to transparency despite fiscal pressures.

The lesson from South Africa is not simply that governments should borrow domestically, but that domestic borrowing is sustainable only where technical reforms are supported by credible institutions and political incentives aligned with long-term fiscal discipline.

For Kenya, Ethiopia, and Senegal, the central challenge is therefore not merely adopting better debt management tools but building the governance and political conditions that allow such tools to function. Without confronting the political economy drivers of short-termism, domestic debt reforms risk remaining aspirational rather than transformative.

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