

From Dependence to Resilience: Improving Subnational Fiscal Position in Nigeria

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EXECUTIVE SUMMARY

Subnational governments play a critical role in Nigeria's governance structure. However, rising fiscal deficits, driven by both structural and macroeconomic factors, threaten states' capacity to mobilise fiscal resources and build fiscal resilience. Despite the increase in Federation Account Allocation Committee (FAAC) allocation, the subnational fiscal position still exhibits weak fiscal resilience, as over 30 states still derive more than 70 percent of their revenues from FAAC, except Lagos and Ogun, which show a substantial Internally Generated Revenue (IGR) capacity, while Bayelsa, Taraba, and Yobe top the chart of states that are heavily reliant on FAAC. In addition, low capital-to-recurrent expenditure ratios and rising public debts continue to challenge states' fiscal capacity. The critical policy options required to build fiscal resilience at the subnational level in Nigeria include introducing performance incentives for fiscal discipline, implementing reforms to boost subnational IGR, improving the capital-recurrent expenditure ratio, enhancing Public Financial Management (PFM), managing rising public debt, and adopting a responsive budgeting approach to hedge a volatile macroeconomic environment.

Introduction

Nigeria operates a constitution-based fiscal federalism where federal, state, and local governments share responsibilities for public service delivery. Revenues from oil and non-oil sources are pooled into a Federation Account and distributed to the three tiers of government by the Federation Account Allocation Committee (FAAC). While this arrangement guarantees statutory allocations, it, however, creates a fiscal structure that incentivises dependence rather than self-sufficiency, leaving most subnational governments vulnerable to fiscal risks.

According to the National Bureau of Statistics (NBS), over 30 states derive more than 70% of their revenues from FAAC. States like Bayelsa (92.2%), Taraba (81.9%), and Yobe (64.7%) remain heavily reliant on FAAC for FY'2024, while IGR is insufficient to cover basic recurrent expenditure. For example, personnel costs alone in Jigawa exceed the state's IGR by more than 13 times, underscoring the depth of the fiscal imbalance during the period. By contrast, only a few states, such as Lagos (67.7%) and Ogun (55.1%), demonstrated a substantial capacity to generate internal revenue during the same period. Public debt further compounds these risks as subnational domestic and external debts rose by 12.75% from N10.04 trillion as at Dec 31 2023 to N11.33 trillion as at June 30 2025, with many states devoting over 20% of their revenues to debt servicing (DMO, 2025).

Despite the increase in FAAC allocations to states resulting upon the fuel subsidy removal policy, macroeconomic challenges such as high inflation and currency depreciation have tightened the fiscal space, making it more challenging for states to finance critical public expenditures. This fiscal position further shows the level of states' resource management capacities, which affect their abilities to meet statutory responsibilities and execute capital projects that can stimulate better development outcomes. These trends raise a critical policy question: how can subnational fiscal position transition from dependence to resilience? Understanding the subnational fiscal position is essential to deploy the necessary tools to enhance resource mobilisation, debt management capacity, and expenditure efficiency at that governance level.

This policy brief therefore examines the fiscal position of subnational governments in Nigeria and suggests pathways to transition from dependence to resilience. The brief reviews the structure of state governments in terms of the drivers of fiscal risks at the subnational level. The policy recommendations focus on critical pathways to building subnational fiscal resilience in Nigeria and enhancing states' capacity to deliver inclusive development.

Overview of Subnational Fiscal Position in Nigeria

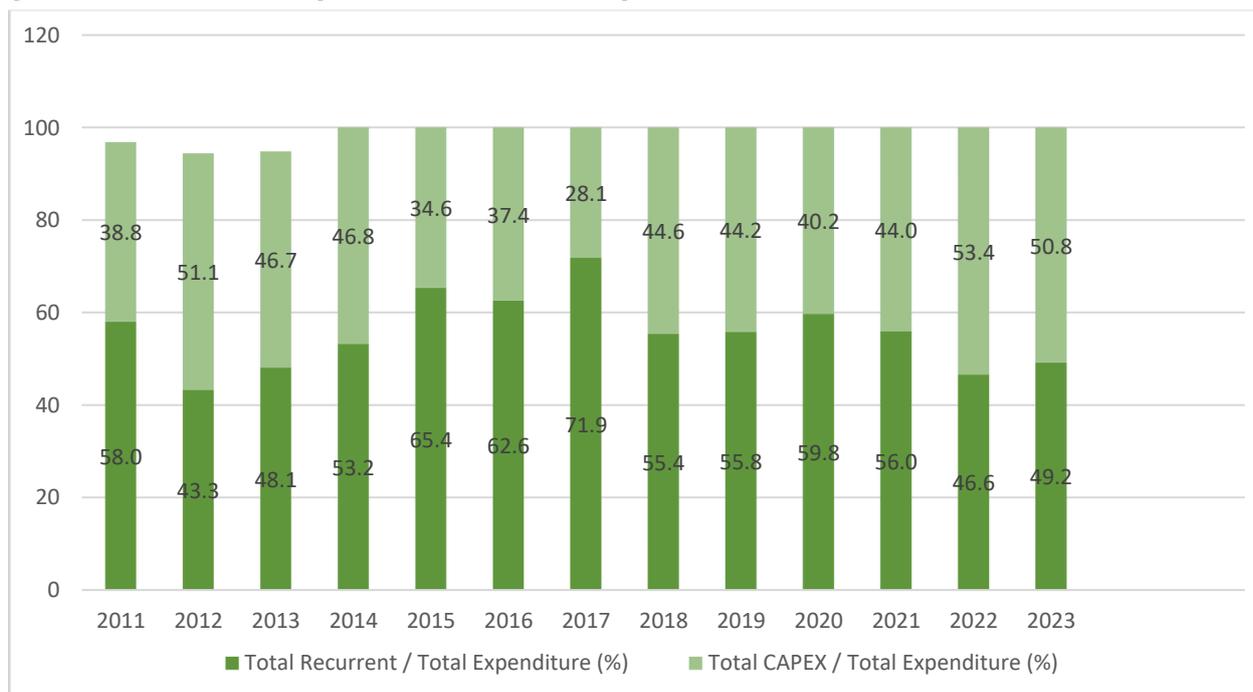
Subnational fiscal position in Nigeria exhibits substantial macro-fiscal risks driven by various factors discussed below:

Low IGR: There is heterogeneity in subnational fiscal structures, which underscores why states are at different stages of administrative capacity, tax base formality, and the scale of their urban economies. For instance, over 90 percent of subnational governments depend on FAAC allocations for more than 70 percent of total revenue. Meanwhile, Lagos State's IGR accounted for roughly one-third of Nigeria's total IGR, with a record N1.26 trillion in FY'2024. Rivers State followed with N317.3 billion, while Ogun State came third with an IGR of N194.93 billion, driven by manufacturing and industrial taxes. Enugu came next with an IGR of N180.5 billion, reflecting rising commercial activity in the southeast. States at the bottom end of the IGR spectrum for the same period include Yobe, Ebonyi, and Kebbi, which recorded the lowest revenues of N11.08 billion, N13.18 billion, and N16.97 billion, respectively. Other states in the bottom tier include Taraba (N17.46 billion) and Adamawa (N20.3 billion) (NBS, 2025).

This dependence on federal allocation makes states' finances highly vulnerable to oil price volatility, disruptions in crude production, and fluctuations in federal revenue mobilisation. Furthermore, states' weak tax administration, low levels of formalisation of businesses, limited enforcement capacity, and political reluctance to broaden the tax base exacerbate the revenue challenge. However, volatility in global crude oil prices and subsequent revenue shortfalls make states susceptible to fiscal crises, such as the inability to meet basic fiscal obligations, including salary payments, without accumulating public debt. This underscores the urgent need for lagging states to strengthen fiscal resource management capacities and leverage relevant tax reforms to broaden revenue bases.

Low Capital-To-Recurrent Expenditure Ratio: A divergent expenditure mix with a low capital-to-recurrent expenditure ratio usually characterises a state's budget. In several states, capital expenditure accounts for less than 30 percent of the budget, far below the levels required for sustained growth and service delivery. For most states, recurrent spending, particularly on personnel, overheads, and political appointments, dominates the budget, leaving little room for capital investment. In terms of the capital and recurrent expenditure ratio relative to total expenditure, Figure 1 shows a mixed priority among the States. The ratio of capital expenditure to total expenditure fluctuated over the period 2011 to 2023. It averaged about 65 percent during 2014 - 2017, with the highest ratio recorded in 2022 and the lowest in 2017. However, states with smaller budgets face the challenge of balancing development initiatives with recurrent expenses. This imbalance is fiscally risky because it reduces the growth-enhancing potential of public expenditure, limits infrastructure development, weakens the productive capacity of the State's economy, and limits the potential for revenue generation. This underscores the need to tailor fiscal policies to address specific economic issues of each State to accelerate sustainable development.

Figure 1: Subnational Capital and Recurrent Expenditure Ratio (%)



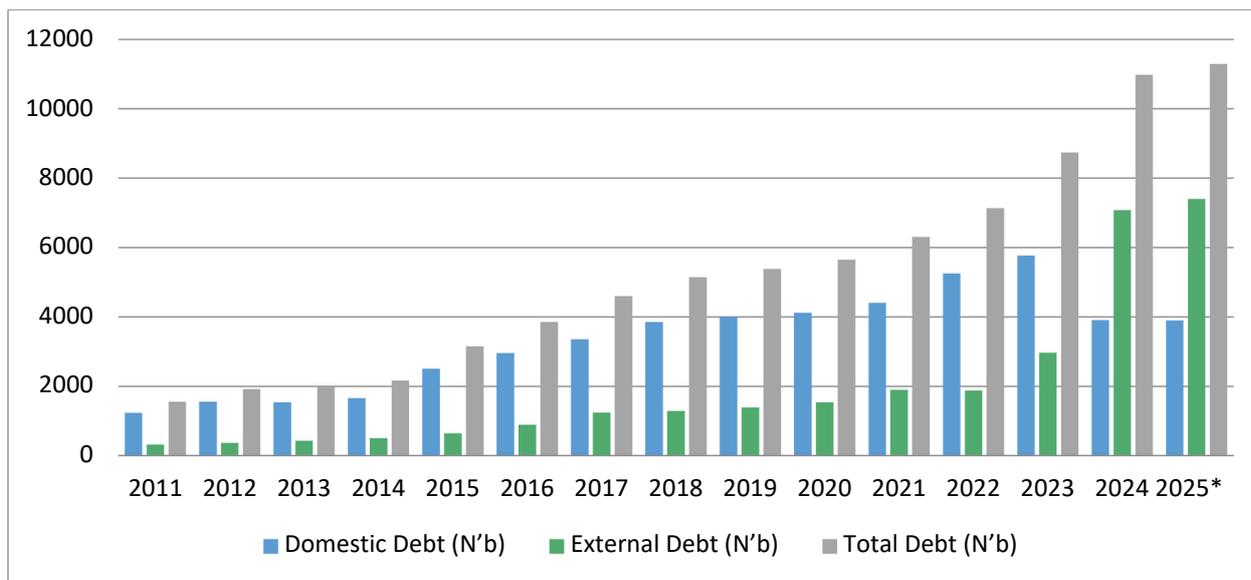
Source: CBN Statistical Bulletin, 2023

Bloated Public Debt: According to the Debt Management Office (DMO), the subnational total debt grew significantly between 2011 and 2025. As depicted in Figure 2, subnational total debt increased by approximately 96.07 percent between 2020 and 2024, from N5.6 trillion to N10.98 trillion. When disaggregated into domestic and external components, Figure 2 further shows that subnational total domestic debt rose from N1.55 trillion in 2012 to N3.99 trillion in 2019. Induced by the COVID-19 pandemic, subnational total domestic debt later rose from N4.11 trillion in 2020 to N5.77 trillion in 2023. Despite the slight easing in 2023 to N3.90 trillion, driven by gains from fiscal policy reforms, subnational domestic debt resumed its upward trend, with domestic debt of N3.96 trillion accumulated as at June 30, 2025. However, the domestic debt portfolio was highest in the 2022/23 due to the pre-election year effect, which increased public spending.

In the same vein, the subnational total external debt follows a similar trajectory during the same period. Rising from US\$2.13 billion in 2011 to US\$3.53 billion and US\$4.75 billion in 2016 and 2021, respectively. However, external debt eased slightly to US\$4.43 billion in 2022, but this could not be sustained as external debt rose to US\$4.79 billion as of Q2-2025. Given its magnitude, the public debt profile appears high, and little effort has been made to mitigate debt accumulation or improve non-debt revenue streams. Although the subnational government's total public debt portfolio rose significantly, evidence shows that subnational governments preferred domestic liabilities to external debt because of the opportunity to hedge against currency volatility.

State governments resort to borrowing to fill fiscal deficits, fund ambitious projects, or meet contingent liabilities arising from litigation and judgment debts. Some states rely heavily on short-term commercial loans with high interest rates, which not only crowd out developmental spending but also creates refinancing risks. The lack of stringent debt management frameworks and limited transparency in loan acquisition processes further compounds the problem. While borrowing remains a legitimate fiscal tool, it increases debt service liabilities, which can offset the efforts of subnational governments to achieve fiscal resilience.

Figure 2: Public Debt Portfolio of Subnational Governments in Nigeria



Source: CBN Statistical Bulletin, 2025

Note: Public debt values for 2025 Q2.

Macroeconomic Risks: Subnational fiscal position is highly influenced by the national macroeconomic environment. Persistently high inflation erodes the real value of revenues and inflates the cost of public service delivery. Exchange rate volatility and frequent foreign exchange policy adjustments raise the prices of imported goods and services, thereby increasing the cost of inputs for state capital projects. Similarly, high interest rates, a result of the Central Bank of Nigeria's (CBN) monetary tightening, raise borrowing costs for states, further constraining fiscal space. Because state governments depend heavily on the broader macroeconomic environment for revenue generation and expenditure execution, adverse macroeconomic shocks often translate directly into fiscal stress at the subnational level.

Policy Options for Building Subnational Fiscal Resilience in Nigeria

Achieving fiscal resilience at the subnational level is essential for Nigeria's broader economic stability and development. In a federal system where states are constitutionally entitled to statutory transfers from the Federation Account, the pervasive dependence on these allocations has created weak incentives for fiscal discipline, limited innovation in revenue mobilisation, and chronic vulnerability to oil market volatility. Building fiscal resilience, therefore, requires a multifaceted approach that combines reforms in revenue generation, expenditure discipline, debt management, and macroeconomic alignment. Below are actionable directions:

1. Introduce Performance Incentives for Fiscal Discipline

A central weakness in Nigeria's subnational fiscal framework is the absence of meaningful rewards or sanctions for fiscal behaviour. States receive statutory FAAC transfers regardless of their efficiency or accountability in resource use. Introducing performance-based grants and fiscal incentives tied to spending efficiency, transparency, and outcomes would transform this trend. For instance, states that demonstrate improved compliance with relevant fiscal laws, reduce variance between budgeted and actual expenditures, or publish timely budget implementation reports should be incentivised to do more. Performance incentives would encourage states to adopt global best practices in Public Financial Management (PFM), foster peer competition, and gradually build a culture of fiscal responsibility.

To achieve this, subnational governments must move from manual, opaque systems to digital platforms for budget preparation and execution, thereby improving efficiency and reducing leakages. Transparency can be enhanced by publishing budgets and quarterly implementation reports in open data formats accessible to citizens and civil society. Equally important is the establishment of robust monitoring and evaluation frameworks that ensure resources are not only spent but also deliver measurable outcomes. Enhancing capacity within budget ministries and legislative oversight committees will further ensure accountability and effective fiscal governance.

2. Implement relevant Fiscal Reforms to boost IGR

The long-term sustainability of state finances depends on robust and diversified IGR systems. Currently, most states rely heavily on Pay-As-You-Earn (PAYE) tax from formal sector workers, neglecting the vast informal economy. Strengthening tax administration by digitalising tax records, improving compliance monitoring, and automating collection processes can help curb leakages. Expanding the tax net to capture informal enterprises through simplified presumptive taxes and market levies is equally critical. Beyond taxation, states must improve sectoral productivity by strategically investing in agriculture, tourism, and technology. For instance, agricultural value-chain development not only enhances food security but also expands taxable activities in processing and logistics. Similarly, tourism and creative industries can generate service taxes, while tech-driven startups broaden PAYE and consumption tax bases. Thus, IGR growth should be anchored on creating productive economies rather than simply imposing higher tax rates.

3. Improve the Capital-to-Recurrent Spending Ratio

Nigeria's states consistently spend disproportionate amounts on recurrent expenditure, especially personnel costs and overheads. This undermines the capacity to finance infrastructure and long-term development. Enforcing fiscal rules mandating a minimum percentage of budgets for capital expenditure, for instance, not less than 40%, would create a legal and institutional safeguard for investment spending. States should also conduct payroll audits, rationalise subsidies, and adopt technology-driven payroll systems to curb recurrent spending and reduce costs of governance. By reallocating expenditure towards physical infrastructure, health, education, and industrial development, states can stimulate growth, expand their tax bases, and build fiscal resilience.

4. Manage Rising Public Debt

Rising subnational debt is a significant fiscal risk, with many states borrowing to finance recurrent rather than capital expenditure, which has the capacity to stimulate economic activities. A sustainable path requires enforcing debt sustainability frameworks that tie borrowing strictly to revenue-generating or growth-inducing projects. States should establish sinking funds to manage contingent liabilities and ensure timely repayment, while also securitising debt where feasible to reduce rollover risks. Importantly, states must limit borrowing to clearly defined debt-to-GDP or debt service-to-revenue thresholds and publish annual debt sustainability analyses. By aligning debt accumulation with productivity, states can ensure that today's borrowing does not compromise tomorrow's development.

5. Adopt Responsive Budgeting to Hedge the Volatile Macroeconomic Environment

Macroeconomic volatility, particularly high inflation, erodes the real value of state budgets. To build resilience, states should institutionalise inflation-responsive budgeting mechanisms, such as indexing key expenditure items to inflation and building fiscal buffers for shocks. Ministries of Budget and Planning must strengthen their economic intelligence units to conduct regular macroeconomic monitoring, produce development updates, and recommend adaptive strategies. This approach ensures that states anticipate and mitigate inflationary pressures rather than simply reacting to them. States should also align fiscal policies with monetary policies by prioritising efficient procurement processes, cutting non-essential expenditures, and embedding realistic macroeconomic assumptions in their Medium-Term Expenditure Frameworks (MTEFs). By doing so, deviations between budget forecasts and outcomes can be minimised, and fiscal stability maintained even under restrictive monetary conditions.

In addition, states should adopt currency risk mitigation strategies, particularly by limiting exposure to foreign currency-denominated debt. Leveraging export-oriented industries, such as agro-processing and creative industries, can help states earn foreign exchange locally and cushion the adverse effects of external shocks. Equally, promoting local content policies reduces import dependency, strengthens domestic value chains, and insulates state budgets from exchange rate volatility.

Conclusions

Building subnational fiscal resilience in Nigeria requires a deliberate shift from dependence on statutory transfers towards diversified, efficient, and transparent budgeting systems. Incentives for discipline, productive investment in IGR sources, stronger capital orientation, prudent debt management, and proactive macroeconomic alignment are essential. Only through these integrated approaches can Nigerian states build their fiscal resilience, promote inclusive growth, and achieve long-term economic development.

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