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EQUITY FINANCE IN THE CAPITAL STRUCTURE OF GOVERNMENT AND GOVERNMENT AGENCIES: A REVIEW

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Abstract
This paper critically reviews the concept of equity finance as a foundational component of the capital structure of governments and their agencies, positioning it as an analogue to shareholder equity in corporate finance. Unlike debt financing, which entails repayment obligations and interest burdens, equity finance—comprising tax revenues, grants, internally generated revenue (IGR), and retained earnings—represents non-repayable and endogenous resources used to support public expenditures. Drawing from theoretical frameworks including Musgrave's public finance model and the pecking order theory, the review identifies equity financing as essential for fiscal sovereignty, public accountability, and the long-term sustainability of government budgets. The study synthesizes local and international empirical findings, including evidence from Nigerian subnational governments, to show that balanced and strategic use of equity and debt instruments leads to better fiscal outcomes. It critiques the misalignment of financing strategies, such as the use of debt for recurrent expenditure, and highlights the fiscal risks and intergenerational inequities that follow. The review also discusses the role of equity financing in state-owned enterprises and public institutions as a means of reducing dependence on borrowing and enhancing financial autonomy. This paper concludes by recommending policy reforms centred on broadening the tax base, improving compliance, linking grants to performance, and promoting efficient public investment. Emphasizing equity finance is imperative for improving fiscal performance, reducing debt vulnerability, and enhancing governance, especially in resource-constrained economies like Nigeria.

Keywords: Public Finance, Government Budgeting, Fiscal Sustainability, Internally Generated Revenue, Debt Financing and Tax Based Revenue

Introduction
Finance is the lifeblood of all economic units — individuals, firms, and governments. Without access to finance, nations risk stagnation, underdevelopment, and persistent poverty (Amani, 2018). Public finance, like corporate finance, relies on two major sources: equity finance and debt finance. These two constitute the capital structure of governments and their agencies. While debt creates obligations for repayment with interest, equity finance refers to non-repayable contributions — chiefly tax revenues and grants — which underpin a government's ability to plan, execute, and sustain public services and investments (Rosen & Gayer, 2014). In traditional corporate finance, *equity finance* refers to funds raised by a firm in exchange for ownership interests, often characterized by residual claims on profits and the bearing of investment risk. However, in public finance, while governments do not issue equity in the conventional sense, the concept of equity finance is increasingly used metaphorically to describe non-repayable sources of funding — such as tax revenues, grants, and donations — which form the foundational capital for government operations (Musgrave & Musgrave, 1989; Rosen & Gayer, 2014).
In corporate finance, equity refers to funds provided by shareholders in exchange for ownership interest and residual claim on profits. In public finance, however, equity-like finance refers to non-debt, non-repayable sources of funds that provide government with financial capacity to operate and invest in public services. Equity finance in the public sector refers to resources that are not subject to repayment and form the permanent fiscal base of a government. These include revenues from taxation, statutory transfers, and external grants. Unlike debt, equity-like funds do not carry

an obligation for interest payments or principal repayment and thus provide financial flexibility and long-term sustainability (Tanzi & Schuknecht, 2000). In corporate finance, equity is the permanent capital contributed by shareholders who expect returns but do not require repayment. Analogously, in public finance, equity finance refers to non-debt sources. Taxation is the most prominent form of public equity finance. Direct taxes (e.g., personal income tax, corporate income tax) and indirect taxes (e.g., VAT, customs duties) account for the majority of internally generated government revenue (Musgrave & Musgrave, 1989; Rosen & Gayer, 2014). Governments also receive non-repayable funds from supranational bodies (e.g., World Bank, EU) and inter-governmental transfers (e.g., federal to state allocations), which function as equity inflows (Allen, Hemming, & Potter, 2013).

Regulatory fees, service charges, and statutory penalties are forms of non-debt income that enhance fiscal autonomy without increasing the government's liability (Tanzi & Schuknecht, 2000). Philanthropic and institutional donations to public agencies, such as hospitals and universities, serve as supplementary equity finance. Retained surpluses from state-owned enterprises (SOEs) and public investments (Tanzi & Schuknecht, 2000).

This form of financing does not carry interest or repayment obligations and provides fiscal space and autonomy for governments to function sustainably. The concept of equity finance in the capital structure of government and government agencies is not typically framed in the same manner as it is in private sector corporate finance. However, the analogy of *equity* is increasingly used in public finance theory to describe non-repayable sources of funding — such as tax revenues, grants, and donations — that do not create liabilities or repayment obligations for the government.

The primary purpose of this review paper is to critically explore and clarify the concept of equity finance in the public sector, particularly as it applies to governments and government-owned agencies. While equity finance in corporate settings is well-defined as shareholder contributions that are non-repayable and risk-bearing (Myers & Majluf, 1984; Frank & Goyal, 2003), its application in the public sector has often been overlooked or misrepresented. In public finance, equity-like financing refers to non-debt, non-repayable sources such as tax revenue, grants, statutory transfers, and internally generated revenue (Musgrave & Musgrave, 1989; Tanzi & Schuknecht, 2000). It also seeks to address the gap in existing literature where discussions on public financing focus disproportionately on debt while underestimating the strategic importance of equity-based revenue (Aregbeyen & Akpan, 2013). To achieve these goals the paper provides a comprehensive conceptual analysis of equity finance in the context of public sector financial management, particularly in contrast with its use in private sector corporate finance (Bhatia, 2021; Bloom, Sadun & Van Reenen, 2015). The paper also analysed the theoretical underpinnings of equity financing using established frameworks such as the Theory of Public Finance (Musgrave, 1959), Allocative Efficiency Theory (Schick, 1998), Pecking Order Theory (Myers & Majluf, 1984), and Budget Theory (Bartle & Shields, 2008). The paper contributes to scholarly and policy discourse on optimal public capital structures that reduce excessive borrowing and promote sustainable development through internally generated resources (Garcia & Alban, 2011; Adebayo & Olanrewaju, 2019).

Empirical Literature

This review paper examines the work of Ifenuaguta (2023). The study provides a novel theoretical interpretation of equity finance in the public sector, a concept typically reserved for corporate analysis. It enriches the body of knowledge on non-repayable public revenue sources by framing them as equity-like instruments and thus broadening the conceptual toolkit for understanding government financial behaviour (Rosen & Gayer, 2014; Ezeabasili et al., 2012). In an era marked by rising debt levels and declining fiscal space in many developing countries, including Nigeria, this study offers alternative fiscal strategies that can enhance budget performance. Empirical evidence shows that states with stronger equity finance bases (e.g., higher tax-to-revenue ratios) are better positioned to deliver infrastructure, social services, and economic development programs without unsustainable debt exposure (Ugwu, 2023; Omodero & Ogbonnaya, 2018). (Adebayo & Olanrewaju, 2019)

The paper sheds light on the relationship between financing structure and expenditure composition. It critically examines how disproportionate use of debt to fund recurrent expenditure can result in fiscal imbalance and intergenerational inequity (Amani, 2018), while strong equity finance can promote more efficient resource allocation and long-term budgetary credibility. Existing studies in Nigeria and other developing countries often focus on debt-financed fiscal performance, leaving the role of equity finance underexplored (Adebayo & Olanrewaju, 2019). This review fills that gap by offering a balanced and theory-driven assessment of both financing modes and proposing new avenues for empirical inquiry.

Ifenuaguta (2023) conducts a focused empirical analysis on the relationship between equity and debt financing and the performance of state government budgets in Nigeria, using Bayelsa and Delta States as case studies. The study spans an 11-year period (2012–2022) and is motivated by growing concerns about rising public debt levels and ineffective budget implementation in Nigeria's subnational entities. The study aims to (1) Examine the degree to which equity and debt financing are applied to both capital and recurrent expenditures (2) Assess the impact of these financing structures on budget performance and (3) Offer policy recommendations for improving fiscal outcomes through optimal financing mix.

The study employs an ex-post facto research design using secondary data obtained from the Central Bank of Nigeria (CBN), the Debt Management Office (DMO), The National Bureau of Statistics (NBS) and, the Annual financial statements from Bayelsa and Delta State governments. The data is analyzed using multiple regression analysis, enabling the researcher to estimate the individual effects of equity and debt financing on capital and recurrent expenditure performance. The dependent variables include indicators of budget implementation efficiency, while the independent variables are disaggregated into equity-based (e.g., IGR, grants) and debt-based (loans, bonds) financing.

Ifenuaguta (2023) finds that equity financing has a statistically significant and positive effect on recurrent expenditure performance in both states. Specifically she found that States with a higher proportion of tax revenue and statutory allocations (e.g., FAAC) were more effective at funding salaries, pensions, education, and healthcare programs and that Internally Generated Revenue (IGR), though relatively low, served as a stabilizing factor during periods of oil revenue shocks. This finding supports the Optimal Matching Principle that recurrent expenditure should be funded through equity finance, as it is more predictable, less risky, and better suited for covering ongoing operational costs. The study also shows that debt financing positively correlates with capital expenditure, but only when debt is strategically managed. Capital projects such as road construction, water supply systems, and public buildings were largely debt-funded, particularly in Delta State. However, delays in project execution and cost overruns were observed when debt service obligations crowded out capital outlays. Furthermore, instances where debt was used to finance recurrent expenditure were linked to poor budget performance and increased fiscal distress.
This reinforces the theoretical expectation that debt should be applied to long-term capital projects where returns (economic or social) can justify future repayments (Tanzi & Schuknecht, 2000; Amani, 2018). Misalignment between debt and recurrent expenditure leads to fiscal mismatch and rising debt service burdens.

One of the most critical insights from Ifenuaguta (2023) is the identification of fiscal mismatches in the budgeting practices of Bayelsa and Delta States. The study highlights situations where equity funds (taxes, grants) were directed toward capital projects with long gestation periods, despite not being backed by repayment mechanisms. It also highlights the misuse of debt to cover salary arrears, travel expenses, and political patronage, which generated future liabilities without corresponding long-term benefits. This contributes to what was terms "intergenerational fiscal inequity", where future taxpayers are saddled with obligations that funded past or current consumption.

The study provides actionable recommendations that align with broader literature. It recommends the strengthening of internal revenue generation to build a more sustainable equity finance base (Aregbeyen & Akpan, 2013) and the adoption of strict debt governance frameworks to ensure borrowings are tied only to bankable capital projects (World Bank, 2022). It also recommends the promotion of fiscal discipline by enforcing the principle of matching revenue sources to the nature of expenditure (Bloom, Sadun & Van Reenen, 2015).

Ifenuaguta (2023) fills an important empirical gap by operationalizing the theoretical concept of equity finance in a subnational Nigerian context and provide evidence for the differential impact of financing types on budget performance. The study introduced the idea of fiscal alignment, which strengthens the conceptual argument made in this review regarding the optimal matching of financing structures to expenditure types. The empirical findings of Ifenuaguta (2023) provide strong support for the conceptual framework outlined in this review. They affirm that equity financing is better suited for recurrent expenditure, ensuring fiscal stability and accountability and that Debt financing, if prudently managed, can drive capital development, but misuse leads to deficits and future liabilities. It further confirms that fiscal mismatches significantly undermine budget performance, suggesting the need for a strategic and disciplined approach to financing. The work thus serves as a critical evidence base for advocating a balanced and aligned public capital structure for state governments in Nigeria.

Theoretical Framework

This review paper is underpinned by the Theory of Public Finance, Allocative Efficiency Theory, the Pecking Order Theory and the Budget Theory which are elucidated below:

The Theory of Public Finance

The theory of public finance was advanced by Richard A. Musgrave in his seminal work, *The Theory of Public Finance* (1959). Musgrave identified three core functions of government in economic management: resource allocation, income distribution, and economic stabilization. According to Musgrave, public finance plays a central role in correcting market failures, ensuring a fair distribution of income, and maintaining macroeconomic stability. These functions are guided by two overarching principles: fiscal efficiency and equity. Through taxation and public expenditure, governments are expected to maximize social welfare by allocating resources to sectors that may be underprovided by the market, redistributing wealth to reduce inequality, and stabilizing the economy during periods of inflation or recession (Musgrave, 1959).

Allocative Efficiency Theory

The theory of allocative efficiency emphasizes the government's responsibility to distribute resources in a manner that maximizes societal welfare. It reflects the government's ability to prioritize and direct public resources toward projects and programs that yield the highest social and economic returns (Schick, 1998). Allocative efficiency is achieved through a transparent and strategic budgeting process where funds can be shifted from less effective programs to more impactful initiatives. As Amayo (2019) suggests, this requires governments to be both forward-looking in setting development priorities and reflective in evaluating past performance. The essence of allocative efficiency is to ensure that every unit of public spending contributes meaningfully to national development objectives.

Pecking Order Theory

The pecking order theory, initially introduced by Donaldson (1961) and later formalized by Myers and Majluf (1984), explains the hierarchy of financing preferences within organizations. This theory posits that firms prefer to finance their operations and investments first through internal funds (retained earnings), then through debt, and finally through external equity when other sources are exhausted (Al-Najjar, 2013). The rationale lies in information asymmetry—managers possess more information about the firm’s value than external investors. Issuing equity may be interpreted as a negative signal about the firm’s valuation, leading to adverse selection. Therefore, debt is considered a preferable second option, as it imposes fewer informational costs and is less dilutive (Frank &

Goyal, 2013; Harford et al., 2012). While developed in the corporate finance context, this theory provides insights into public finance, where governments also show a preference for internal equity-like sources (taxes, IGR) before resorting to debt, to preserve fiscal credibility and autonomy.

Budget Theory

The budget theory, as articulated by Bartle and Shields (2008), focuses on the political, managerial, and economic underpinnings of public budgeting. It integrates concepts from incrementalism, principal-agent theory, organizational process models, and punctuated equilibrium theory to explain how budgets are formulated, implemented, and evaluated. At its core, the theory identifies three central purposes of budgeting:

- Control, ensuring financial discipline and proper stewardship of resources;
- Management, facilitating the alignment of resources with organizational or governmental goals; and
- Planning, enabling the optimal use of resources to achieve policy outcomes (Schick, 1966).

Hildreth (2002) further elaborates that budgets not only reflect economic inputs and outputs but also embody the intentions and commitments of government. In essence, a public budget is more than an accounting document—it is a strategic policy tool for articulating and delivering the will of the people. It provides a framework for monitoring government performance, enforcing fiscal responsibility, and allocating public resources to maximize societal benefit.

METHODOLOGY

The methodology for this **review paper** which is focused on the concept of equity finance in the capital structure of governments and government agencies, particularly in comparison with corporate finance and enriched by empirical and theoretical insights are as follows:

This study adopts a **narrative review design**, which is appropriate for synthesizing existing conceptual, theoretical, and empirical literature about equity and debt financing in public sector financial management. The narrative review approach enables the researcher to critically analyse, interpret, and integrate diverse bodies of knowledge from both **public finance** and **corporate finance**, to develop a comparative framework that explains how equity finance functions in governmental contexts and how it differs or converges with private sector practices.

The study relies exclusively on secondary sources of data that are published in Peer-reviewed journal articles from recognized finance, economics, and public policy databases such as JSTOR, Elsevier, ScienceDirect, and Google Scholar and Books and academic texts on public finance, fiscal policy, and financial management (e.g., Musgrave & Musgrave, Rosen & Gayer). Other sources are Official publications and reports from global institutions such as the International Monetary Fund (IMF), World Bank, Organisation for Economic Cooperation and Development (OECD), and Central Bank of Nigeria (CBN). Other sources of data are from Empirical theses and dissertations, particularly those focusing on subnational finance in Nigeria

To ensure relevance and academic rigor, the review focused on materials that directly address equity and debt financing, capital structure, and government budget performance. Others are materials that explore fiscal sustainability, public investment efficiency, and financial accountability and those that provide comparative insights from both corporate and public finance literature. Emphasis was placed on materials published within the last 15–20 years, with seminal texts included for foundational theory. Articles that were opinion-based articles or blog posts lacking academic credibility were excluded.

The analytical method used is qualitative thematic synthesis. The conceptual definitions of equity finance in public and corporate contexts and the theoretical underpinnings such as Musgrave's theory of public finance, allocative efficiency theory, pecking order theory, and budget theory has been briefly addressed above. The characteristics of equity and debt financing, the role of Equity Finance in Public Governance and Fiscal Sustainability and the implications of Equity Finance for fiscal performance and macroeconomic stability were also discussed. Each of these themes were

critically examined and triangulated across sources to identify patterns, gaps, areas of convergence/divergence, and implications for policy.
This review is conceptual and exploratory in nature and does not involve empirical statistical testing. While efforts were made to include cross-country and global literature, the paper focuses primarily on insights applicable to developing economies, with specific emphasis on subnational government financing in Nigeria (Bayelsa and Delta States). Therefore, findings may not be generalizable to high-income or unitary political systems without contextual adjustments.

Comparison of Equity Finance in the Context of Public and Corporate Finance
Below is a comparative description of the key characteristics of equity finance as applied in public finance (governments and public agencies) and corporate finance (private firms), highlighting how each characteristic manifests and differs in both sectors.
Table 1: Equity Finance Characteristics in Public and Corporate Finance Contexts

Characteristic	Public Finance Context (Government)	Corporate Finance Context (Private Sector)	Comparison Insight
1. Non-repayable	Equity finance in public finance includes taxes, grants, and other non-debt revenue sources. These are not repaid to the taxpayers or donors.	Equity finance (shares) involves investor contributions that are not repaid like debt. Shareholders receive dividends but not principal repayment.	In both contexts, equity capital is not contractually repayable, but in the private sector, shareholders expect returns (dividends, capital gains); taxpayers do not.
2. Low Financial Risk	Public equity financing reduces exposure to interest rate volatility and repayment pressures, unlike debt which increases fiscal risk.	Equity financing avoids interest and default risk, especially when compared to debt. However, it dilutes ownership and control.	Both use equity to lower financial risk. In public finance, the government avoids debt service strain; in corporate finance, the firm avoids insolvency risk.
3. Flexible and Endogenous	Equity financing in government (taxes, internally generated revenue) is sourced domestically, and its use is largely under sovereign control.	Firms can use retained earnings (internal equity) flexibly without external approval. External equity (IPO) is less flexible and subject to market conditions.	Public equity is often more flexible in usage, but more politically constrained; corporate equity is flexible when internal, but market-sensitive when external.
4. Publicly Owned and Accountable	Taxes and grants are public funds. Government is accountable to citizens and legislative bodies on how they are used (social contract).	Shareholders "own" equity in corporations. Managers are accountable to them through governance structures (AGMs, financial disclosures).	Both require accountability, but public finance accountability is to citizens and political institutions; corporate is to shareholders and financial regulators.
5. Supports Fiscal Sovereignty	Equity finance (e.g., taxes) underpins fiscal autonomy. Governments can fund policies without dependency on foreign or private creditors.	Internal equity enhances strategic independence. Firms are less constrained when using retained earnings than when taking on loans from creditors.	In both cases, equity enhances autonomy. For governments, it supports fiscal sovereignty; for firms, it supports strategic freedom and reduces creditor control.

Source: The Author based on insights the literature.

From the date presentation above it can be observed that Equity finance plays a stabilizing role in both systems — minimizing debt-related financial risks and enhancing long-term capacity to fund operations. In public finance, equity finance strengthens democratic accountability, macroeconomic sovereignty, and intergenerational fairness. In corporate finance, equity finance balances risk and reward, trading off ownership dilution for financial stability and growth capacity.

Characteristics of Equity Finance vs. Debt Finance in Government

In the Table 2 below is a comparison of the qualities and characteristics of Equity Finance and Debt Finance in Government Capital Structure.

Table 2 Characteristics of Equity Finance and Debt Finance in Government

Characteristic	Equity Finance (Taxes, Grants)	Debt Finance (Loans, Bonds)	Comparison Insights
Repayment Obligation	None. Funds are not repaid; contributions are made by taxpayers or donors.	Repayment of principal and interest is obligatory.	Equity finance reduces fiscal pressure by avoiding repayment commitments; debt adds future obligations.
Fiscal Risk	The public bears risk indirectly through political accountability and tax changes.	The government bears direct financial risk, including risk of default or rising debt service costs.	Debt introduces vulnerability to external shocks and interest rate changes; equity spreads risk broadly.
Long-term Sustainability	High, especially if the tax base is broad, efficient, and predictable.	Sustainability depends on debt management, revenue growth, and favorable economic conditions.	Equity finance provides greater long-term stability; debt requires careful planning and repayment ability.
Political Cost	High, due to the unpopularity of taxation and need for accountability.	Lower initially, as borrowing delays public scrutiny; but can rise sharply if debt becomes unsustainable.	Debt may appear more politically convenient but becomes risky over time; equity is transparent but unpopular.
Autonomy	High. Domestic revenue sources support policy independence and sovereignty.	Can be constrained by lender conditionalities, credit ratings, or IMF/World Bank programs.	Equity financing preserves decision-making autonomy; debt can limit policy options and invite oversight.

Source: Author's Compilation based on insights from OECD (2014)

As highlighted by the OECD (2014), excessive reliance on debt weakens fiscal sustainability, while a robust and diversified tax system — a form of equity finance — enhances sovereign control over fiscal outcomes. A healthy fiscal structure entails a strong reliance on equity-like revenue sources to finance core public services and capital investments, while debt is reserved for strategic, high-return infrastructure that can stimulate economic growth and potentially repay itself. For government agencies and parastatals, the equity component typically includes statutory budget allocations, internally generated revenue (IGR), and external grants. Their debt components, if applicable, may include development finance loans or infrastructure bonds. As Musgrave & Musgrave (1989) note, the prudent mix of both sources is necessary to fund public services and stabilize macroeconomic conditions.

Equity Finance Applications and Imperatives in Government Owned Agencies

Government Owned agencies are often granted the status of Semi-autonomous government entities. Such agencies include public universities, teaching hospitals, regulatory agencies, and development commissions such as the Niger Delta Development Commission (NDDC). They often combine **budget allocations (public equity)** with **self-generated income** (e.g., tuition fees, consultancy services). Some of these agencies also enjoy special allocations earmarked by acts of parliament such as the Tertiary Education Trust Fund (TETFUND). These agencies require table and sustainable funding to carry out their statutory mandates. Where permitted, they may access **grants and endowments**, strengthening their equity base (Allen et al., 2013). These agencies are encouraged to build **reserves or retained surpluses**, akin to **retained earnings in corporations**, to buffer against fiscal shocks and fund internal capital development. Unlike private corporations that can raise funds via the capital market through equity issuance, most public institutions rely on **non-debt, non-repayable financing mechanisms**. These sources are considered **forms of equity finance** within the context of public financial management because they do not incur interest, do not require repayment, and are ultimately derived from public ownership and contributions (Musgrave & Musgrave, 1989; Rosen & Gayer, 2014).

The most prominent source of equity financing for government agencies is budgetary allocation from federal, state, or local governments. These allocations are typically made through annual appropriation acts and are treated as capital contributions from the state to its agencies, rather than as repayable funds. As noted by Adebayo and Olanrewaju (2019), these allocations are essential for ensuring that public agencies can fulfill their social mandates, especially in sectors such as health, education, and infrastructure where cost recovery is low or politically sensitive. Budget allocations represent the public's collective investment in the agency and confer an obligation of public service delivery and accountability, not financial return.

Many agencies generate internally generated revenue (IGR) through service charges, licensing fees, inspection levies, or certification processes. These revenues are akin to retained earnings in the corporate world and can be reinvested into operations without the need for external borrowing. According to Ezeabasili, Mojekwu, and Herbert (2012), when well-managed, IGR can provide a stable source of equity-like financing for government entities, reducing dependence on volatile budget transfers or debt. Examples include Universities charging tuition and professional certification fees, Transport authorities collecting tolls, Regulatory agencies earning fees from industry oversight. These revenues are non-repayable and directly tied to the agency's operational capacity, creating a feedback loop of performance and sustainability.

Grants from development partners, foundations, or CSR-based contributions from corporations are an increasingly important source of non-debt financing for public institutions. These funds are often earmarked for specific projects such as capacity building, infrastructure support, or research and development. The World Bank (2022) emphasizes the need for governments to integrate donor support into their equity financing strategies to enhance long-term fiscal resilience and avoid unsustainable debt accumulation. Because these funds do not require repayment, they serve as a soft equity injection that enhances the financial base of the institution and supports the delivery of capital-intensive or socially beneficial programs. In the case of revenue-generating SOEs such as power authorities, transport corporations, or commodity boards, retained earnings represent a critical form of equity finance. These earnings may result from operational surpluses, which are then reinvested into the agency for modernization, expansion, or diversification. According to Aregbeyen and Akpan (2013), SOEs with stronger retained earnings tend to exhibit greater operational independence and lower exposure to sovereign debt risks. Rather than distributing profits to shareholders (as in private firms), public enterprises typically reinvest earnings to enhance service delivery or expand public access to infrastructure.

The literature catalogues the imperatives for equity finance in government owned agencies. Reliance on equity-like finance reduces the need to borrow from external or domestic creditors, thereby avoiding future debt service obligations that can crowd out service delivery (Tanzi & Schuknecht, 2000). Agencies with reliable equity financing sources — such as robust IGR — can exercise greater financial autonomy, enabling quicker response to public needs without waiting for delayed budget disbursements (Omodero & Ogbonnaya, 2018). Because these funds originate from the public or donors, there is a higher expectation of transparency, efficiency, and performance-based governance, aligning with modern public sector management principles (OECD, 2019). Equity financing enhances long-term institutional resilience, as it provides a stable capital base that allows public entities to withstand economic downturns, changes in political leadership, or fluctuations in federal transfers (Garcia & Alban, 2011).

Also, Equity financing provides stable and predictable funding, essential for realistic and enforceable budgets (Cheruiyota et al., 2017). Heavy reliance on debt may erode public sector independence, whereas equity financing ties performance to taxpayers, reinforcing the **social contract** (Garcia & Alban, 2011). As Amani (2018) points out, borrowing enables governments to regulate macroeconomic variables, but equity finance anchors long-term fiscal sustainability. Governments with stable, predictable equity finance — primarily through taxation — exhibit more credible and disciplined budgets (OECD, 2014). Taxation, as a form of equity contribution from citizens, reinforces the social contract: "no taxation without representation". It strengthens the demand for transparency and effective governance (Tanzi & Schuknecht, 2000). Countries that rely on equity-like revenue are less vulnerable to donor conditionalities and foreign debt burdens, thereby maintaining policy sovereignty (Bahl & Bird, 2008). Public equity finance enables governments to allocate resources toward long-term socio-economic development rather than debt servicing (Rosen & Gayer, 2014).

CONCLUSION

This review has critically examined the concept of equity finance within the capital structure of governments and their agencies. Drawing parallels from corporate finance, where equity represents the permanent capital base that sustains operations and growth, the study interprets tax revenues, grants, internally generated revenue (IGR), and donor funds as the government's equity. These sources are non-repayable, flexible, and publicly accountable — making them crucial for maintaining fiscal sustainability and operational autonomy.

In the context of public finance, equity finance serves as the foundational layer that ensures the delivery of public goods, supports fiscal sovereignty, and reduces vulnerability to debt shocks. Governments and government-owned enterprises (SOEs) that prioritize equity over excessive borrowing enjoy greater legitimacy, policy flexibility, and long-term sustainability.

Furthermore, the review finds that equity finance is most suitable for funding recurrent expenditures and public service operations, while debt finance should be prudently reserved for productive capital investments with long-term returns. When this balance is not observed, fiscal rigidity, budget underperformance, and intergenerational burdens arise — especially in contexts like Nigeria, where debt servicing pressures have intensified in recent years. Therefore, this review concludes that repositioning equity finance at the heart of government capital structure is not only conceptually sound but empirically justified.

Policy Implications

The findings from this review carry significant implications for fiscal policy, especially for subnational governments and government-owned agencies in developing economies. Redefining Public Capital Structure: There is a need to recognize and institutionalize equity finance as the core of the government's capital base. Budgeting frameworks should distinguish clearly between equity-like funds (non-repayable) and debt liabilities. Fiscal Sustainability and Autonomy: Overreliance on debt financing undermines fiscal sovereignty. A strong equity base enables governments to make independent policy choices, free from the constraints of conditionalities and debt obligations. Accountability and Public Trust: Since equity finance derives from public contributions (e.g., taxes, fees), its utilization demands higher transparency and accountability. This can strengthen the social contract and promote civic engagement in budgetary processes. Efficient Resource Allocation:

Understanding the role of equity finance can guide more strategic budget allocation — aligning financing sources with appropriate expenditure types (e.g., using IGR for operations and targeted borrowing for infrastructure).

Recommendations

To entrench a robust equity-based capital structure in government finance, the following recommendations are proposed. There is need to strengthen equity finance mechanisms by broadening the tax base through formalization of the informal economy and reduced dependence on volatile natural resource revenues (Rosen & Gayer, 2014); enhance IGR performance at the subnational level by leveraging technology, administrative reforms, and cost-recovery mechanisms in service delivery and, by promoting performance-based grants to ensure that intergovernmental transfers reward efficiency and outcome-based planning (Bahl & Bird, 2008).

Furthermore, it is imperative to institutionalize fiscal matching principles. Governments should apply the optimal matching principle, aligning equity financing to recurrent expenditure and debt to capital projects with clear economic or social returns (Ifenuaguta, 2023; Amani, 2018). Also, improve budget governance in SOEs and Agencies by requiring SOEs and public institutions to maintain clear equity-to-debt ratios, using retained earnings, donor funds, and budgetary allocations as permanent capital and limit borrowings to capital expansion projects, with strict oversight and measurable performance targets. And finally, there is need for increase transparency and civic engagement by mandating public disclosure of how equity finance is used in budgets and creating participatory budget forums to deepen citizen trust and oversight, especially in tax-based financing.

Positioning equity finance as the cornerstone of the government's capital structure is not merely an academic reclassification. It is a strategic imperative for building resilient, sovereign, and accountable public finance systems. For countries like Nigeria — facing mounting debt and fiscal pressures — emphasizing equity finance at all levels of government is not just desirable, but essential for sustainable development and democratic legitimacy.

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