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Fiscal Subsidy, Institutional Quality and Downstream Sector Performance in Nigeria: A Conceptual Paper

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Abstract
This conceptual paper aims to examine the notion that downstream sector performance in Nigeria is linked to fiscal subsidy through favourable institutional quality. The absence of both direct and indirect research framework for in-depth study of the sector has continuously subjected the sector to flawed assessment and continued abysmal performance. This informed the conduct of the present study. The study initially defines a foundation for downstream sector performance via review of relevant literature, with particular attention to the work of Thurber, Hults, and Heller (2011) in administrative design institutional quality, political competition and oil sector performance in Norway. The paper then offers assessment of the state of the fiscal subsidy. Subsequently, the integration of institutional quality are examined and the basis for theoretical model and propositions. This study argues that the downstream sector performance is associated with fiscal subsidy and that institutional quality has significant mediating effect on the relationship. The paper posits that, for better/improved downstream sector performance, a strategic fit or integration must exist between fiscal policy and institutional quality. A conceptual framework for fiscal subsidy, institutional quality, and downstream sector performance is suggested focusing on the mechanisms through which oil sector performance can be analysed for practical application

Key Words: *Fiscal subsidy, institutional quality, downstream sector, Neo-liberalization theory, institutional theory*

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I. Introduction

The Nigerian downstream sector is an important economic sector with tremendous potentials for national growth and development. Inference from Wapner (2017) suggests that Nigeria's petroleum industry dominates the Nigerian economy and as such the country's economic growth and development is also dependent on the production and consumption of petroleum product, which are the core operations of the downstream sector. The downstream sector is thus said to play an important role in securing better economy as its play host to the nation's oil exploration, production and consumption. Records have shown that Nigeria is ranked the 10^{th} largest oil reserves in the world while oil contributes about 40% to Nigeria's GDP, 70% revenue for the federal government and 92% foreign exchange earnings (Auwal, 2012).

Amidst the aforementioned potentials, the performance of the downstream sector in terms of domestic petroleum product availability and consumption can been described as unsatisfactory. This is due, in part to the incessant cases of product scarcity, hoarding, frequent price increase, considerable loss of refined petroleum products occasioned by high rate of petrol pipeline vandalism and bunkering, all of which ultimately resulted in demand outweighing supply and substantial negative economic costs to the nation (Auwal, 2012). In view of the conceivable potentials and the appertained challenges, developing the downstream sector has become an area of interest for almost every successive administration as several policy measures have been doled out to strengthen the sector for optimal performance.

These measures include: a) the deregulation and privatization policy, which was to give private ownership right to individuals to not only explore and own oil wells, but work against the incessant cases of fuel scarcity in Nigeria (Okafor, 2012); b) oil subsidy, which is aimed at reducing the petroleum product prices to minimize the burden on the citizenry (Ovaga, 2012); and, c) the Petroleum Industry Bill (PIB), which was designed to support local indigenous Nigerian oil and gas companies to participate competitively with their foreign counterpart in the Nigerian oil and gas sector and also to reduce government participation via joint venture operations (Orji, 2013). The concern of this review paper is on oil subsidy which is part of the fiscal policy commitment of the Federal government (Moghalu, 2018). As used here, fiscal subsidy refers to oil subsidy or fuel subsidy or petroleum product subsidy or petrol subsidy. These coinages are based on the statement by Moghalu (2018), that "…The federal government is required by law to secure budgetary approval from the National Assembly to fund its fiscal commitments, including petrol subsidy"

Fiscal subsidy is thus seen as any form of financial assistance that government approves and given out to a sector within an economy to benefit institutions, businesses or individual in order to promote economic and social policy. For this work, fiscal subsidy is financial aids of the Federal Government of Nigeria given to operators of the downstream sector of the Nigerian economy to help in tackling its peculiar perennial challenges such as fuel scarcity, hike in petroleum product prices, product hording, product scarcity/ unavailability etc.; it was at the instance of these that fuel subsidy reform policy was implemented (Akinyemi, Alege, Ajayi, et al., 2017). Suffices it to say that fiscal subsidy to the downstream sector focuses on fuel or petroleum product subsidies or financial aids given to fuel suppliers to increase supplies and reduce importation while generating revenue to government. It is the payment of grants for each unit of fuel produced or imported to keep the prices below market levels for consumers (UNEP, 2008). This implies that a part of the prices that consumers are supposed to pay in order to enjoy the use of petroleum products is paid by government to reduce the price burden of such product on the citizenry. In this light, fiscal subsidy can be seen as citizens' share of the wealth of the nation in addition to many advantages

Among other advantages, fiscal subsidy has the potential of lowering prices and also serves as anti-inflationary tool especially in the area of fuel prices and particularly during a rise in global oil price. It prevents long-term decline of industries and guarantees greater supply of products. Fiscal subsidy has equally been criticized for causing shortage in supply of petroleum products as lower price can trigger abrupt rise in demand of same products such that many suppliers would hardly meet. Again critics have said that fiscal subsidy has the potential for increasing tax and that measuring its success has some difficulties. The fact that improving access to petroleum product is an important strategy for promoting economic growth and development, the decision to subsidize these products will still remain one of the fiscal policy goals of the present and the government to come. For there to be such influence on the economy, the downstream sector should be a springboard and the cradle for assessing such influence.

In studies involving a sector that is controlled by government, it is usually importance to consider the influence of other factors. Literature suggests that the relationship between fiscal subsidy and downstream sector performance can be influenced by the quality of institutional arrangements in the sector. This was the case in Thurber *et al.* (2011). The authors introduced institutional quality and political competition as mediating forces in the relationship between administrative design and performance of the oil sector in Norway. They found that institutional quality intervene on the result of the association between administrative design and performance of the oil sector. The idea is that the performance of the Nigerian downstream sector can be influence by institutional quality.

The present paper examines the influence of fiscal subsidy on performance of downstream sector and the role of institutional quality in explaining such relationship. The rest of the paper is organized as follows. A review of literature is first presented to identify the conventional definition of key variables of the study, followed by the underlying theory and modeled construct of fiscal subsidy. Then we identify and describe the components of the construct and provide some evidence of fiscal subsidy in different contexts. Subsequently, we build on the work of Thurber *et al.* (2011) and propose a conceptual framework that may provide a better understanding of fiscal subsidy implementation in the downstream sector of economies.

II. Literature Review

Downstream Sector Performance

The Nigerian downstream sector is undoubtedly considered to be the bedrock of survival of our national economy due to its many potential. In addition to creating job, the sector also contributes to gross domestic product (GDP) growth as well as to foreign exchange reserves (Ekwoaba & Ikeije, 2016). Among others, these are some measures by which how well or unwell the downstream sector performance can be assessed. However, the performance of the downstream sector has been described as being volatile (Aigbedion and Iyayi, 2007) given its seemingly truncated revenue to the government and low or complete absence of locally refined petroleum product that has given rise to the perennial product importation with its attendant challenges. For instance, Nigeria has four refineries yet the country still import refined product and pay largely on subsidy (Chidi, 2011). This suggests that the downstream sector may not be performing well in this direction.

Records have it that the volume of imported product has increased in recent time due to the fact that a number of things has gone wrong with the industry, one and, probably the most important problem is the grounding of the four refineries and all efforts toward their resuscitation ended in fiasco (Ekwoaba & Ikeije, 2016). Consequent upon this is a substantial refined products importation to satisfy domestic need. The resulting problem from this importation is the fact that Nigerians have had causes to face civil unrest occasion by increase in the pump price of these imported products as even the Government with the marketers jointly fixed the prices arbitrarily. Statistics reveals that petroleum sector contributes about 90% to the external earnings of Nigeria due to frequent increase in product prices (Bashir, 2016b).

One of the arguments made by every successive government for raising the price of petroleum product is to generate revenue for government. It was on this basis that the petroleum trust fund (PTF) was established to manage such revenue by embarking on some projects across the country (Ekwoaba & Ikeije, 2016). Though such increase had attracted arguments, the government maintained that the prices are appropriate and cheaper compared to what is obtainable in other countries like China, Libya, Egypt, Cuba, Iran, Yemen and Venezuela (Oladoyin, 2013; Nwafor, Ojujiube & Asogwa, 2011). These indices have been argued to have some parasitic association with fiscal subsidy.

Fiscal Subsidy

Hornby (2005:1476) defined subsidy as "money paid by a government or an organization to reduce the cost of producing goods and services so that their prices can be kept low". The author went on to assert that subsidy can be given to any sector including agriculture, housing, petroleum, construction and so on. Similar to the definition of subsidy by UNEP (2008) is Agu's (2009) definition which is that subsidy is a "payment made by government to producers of certain goods and services, to enable them produce and sell at lower prices than they would otherwise". Agu holds the opinion that subsidy programmes help to reduce the market prices of product below the factor costs, so that consumers would have the privilege to pay less for the goods and services than they cost the producer to produce same". From producer's side, Ezeagba (2005:45) defined subsidy "as the payment to producers of some merchandise by the government not to produce at all or supplement their incomes when the prices of their products are less than breakeven point"

According to IMF (2001), producer petroleum product subsidies are current unrequited payment that government units make to enterprises on the basis of the levels of their production activities or the quantities or values of the goods or services they produce, sell, export, or import. In this study, this type of subsidy is referred to as current unrequited payment that government make to enterprises on the basis of the quantities or values of petroleum products import (not produced) and sell to consumers in the domestic market. These subsidies lower prices of these products and at the same time serve indirectly as consumer subsidies which are defined as subsidies given to consumers to aid them in buying and consuming petroleum product. These subsidies are designed to reduce the cost of consuming these products (Burniaux *et al*., 2009). The mechanics of subsidy as illustrated in Fig. 1 shows that subsidy is about government paying marketers the difference between market price called expected open market price (EOMP) of petroleum product and government-approved retail price for the product.

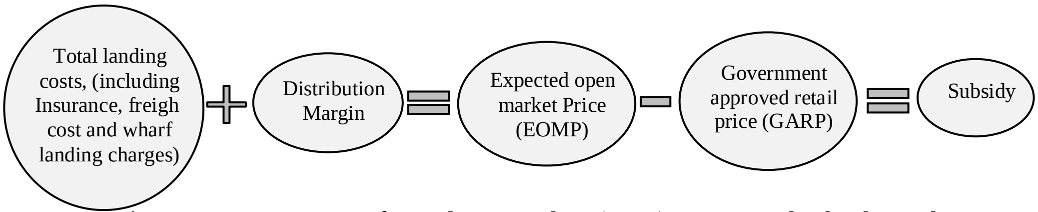

Figure 1: Components of petroleum product (PMS) pricing and subsidy per liter
Source: Adapted from Petroleum Pricing Regulatory Agency (PPPRA)

Mathematically therefore, fuel subsidy could be expressed as the difference between the actual market price of fuel and the amount final consumers pay for the commodity (Soile, *et al.*, 2014). Generally, fiscal subsidy can be seen as a fiscal policy tool used by government to incentivize important sector in their economy such as education, aviation to enable citizens mostly the poor enjoy what the sector offers. For instance, Todaro (1980) conceptualized subsidy as a tool that can be used in education sector to make education affordable to the people, especially the less privileged in the society. The author argued that by this, low income groups are given sufficient subsidies so they can contend with the substantial costs of education. As the author explained further, the penultimate aim is to encourage the poor to avail themselves the opportunity of gaining from the generosity of the government as the costs of schooling is reduced. From another perspective, earlier scholars like Ruffin and Gregory (1983) considered subsidy as a vital instrument for the growth and development of a nation.

In similar thinking, Bazilian and Onyegi (2012) have argued that subsidies for consumers are used by many developing countries to achieve some social, economic and environmental goals such as redistribution of wealth and resources, correction of externalities, reduction of poverty and inflation control. The authors submitted that since substantial foreign earnings are derived from crude oil exportation, this has enable citizens to benefit from resource endowment of the country as government has had to subsidize petroleum product prices. This has led to improvement in industrial growth, wealth distribution and expansion of domestic consumption (World Bank, 2010).

Institutional quality

The role of institutional complexities the attainment of desired corporate performance has attracted a lot of consideration in recent literature. Institutions can be seen as humanly concocted requirements that structure political, financial, and social collaborations (North 1990). Institutional quality is an expansive idea that catches law, individual rights and astounding government direction and administrations and generally clarifies pathways for corporate operations. Institutional quality helps in improving and developing potentials of corporate workforce at all levels (Boscheck, 2007). Institutions react to issues coming from social connection in an indeterminate world, where operators take non-coordinated choices under a structure of flawed information (Boscheck, 2007).

In this specific situation, institution constitutes an instrument to lessen discretional practices and undue interference in its operations. Also, since they shape social practices, institution cultivates collective activity and diminishes coordination costs (Alonso, 2010). In other words, institutional quality is a pattern of connections and model for supervisors to accomplish administrative objectives through organizing, planning, controlling, and directing (Mabey *et al*., 2001). Thus, it can be a significance force in the attainment of better corporate performance. Along these lines, with respect to downstream sector, it can be reasoned that good institutional quality could make the downstream sector operations more efficient and effective and ultimately lead to improved performance.

The impact of institutional quality has been established through different dimension. According to Nifo & Vecchione (2015), there are five dimensions of institutional quality namely i) rule of law, ii) Government effectiveness, iii) Control and corruption, iv) Voice and accountability, v) Regulatory quality . These dimensions were used by Nifo & Vecchione to measure institutional quality in Italian provinces. Since research questions could be raised in any study seeking to know the intervening role of this variable, a construct for answering such question could also be built around these dimensions. Voice is usually described as the citizens' ability to express their choices and to be given a listening ear by the state through form of communication while accountability is defined as the process which involves holding organizations and individual actors to give account of their actions (Menocal, & Sharma, 2008).

Government effectiveness encapsulates the perceptions of "the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies" (World Bank, 2010:7). Rule of law involve the use of state power guided by written and published standards that govern and regulate social values, interpersonal relations and norms that eschews particularism and are widely accepted and enjoyed broad-based public support as guiding principles of living in a society or nation. Regulatory quality entails individual's perceptions of the ability of the government to formulate and implement standard policies, rules, and regulations without any prejudice and biasness. Control and corruption is a pointer, which measures the degree to which public power is used for personal gain including "petty and grand forms" of corruption (World Bank, 2010).

Theoretical model and hypothesis development

Theoretical model

Figure 2 depicts our proposed theoretical model. We argue that fiscal subsidy implementation has direct effect on performance of downstream sector of Nigerian economy. Further, we argue that the relationships between fiscal subsidy and downstream sector performance are mediated by institutional quality. We draw on the work of Thurber *et al.* (2011) to make a case for the interactive research framework to be adopted in studying and understanding of Nigeria's downstream sector in order to know how best to reposition the sector for optimal performance from the perspective fiscal subsidy programme. Our decision on fiscal subsidy variables or dimensions as independent variables and institutional quality as mediating variable are based on the following considerations: first, fiscal subsidy to operators of the downstream sector is targeted at improving the services of the sector in terms of product availability, affordability and revenue generation by reducing importation. This is so because, importation is argued to lead to a loss in revenue that should otherwise have accrued to the Federation Account if petroleum products were sold to consumers at prices above the cost of refining or importation of products, including distribution charges" (Igbikiowubo, 2011).

Second, fiscal subsidy is solely governmental and is highly likely to be manipulated to achieve desired results on the responsive sector – the downstream sector. Ellis (2010) showed that the amount of consumption-related petroleum product subsidies is in excess of 2% of GDP for many countries, especially for in developing countries whose GDP per capita is considered low. The countries and their percentage to GDP are Turkmenistan (15.2%), Ecuador (8.7%), Egypt (8.4%), Ukraine (3.3%) and Bangladesh (3.0%). The author explained further that "in many of these countries expenditures relating to the subsidization of petroleum sector (fossil-fuel) were as large as or larger than health or public (health sector) education (education sector) budgets or both in some cases".

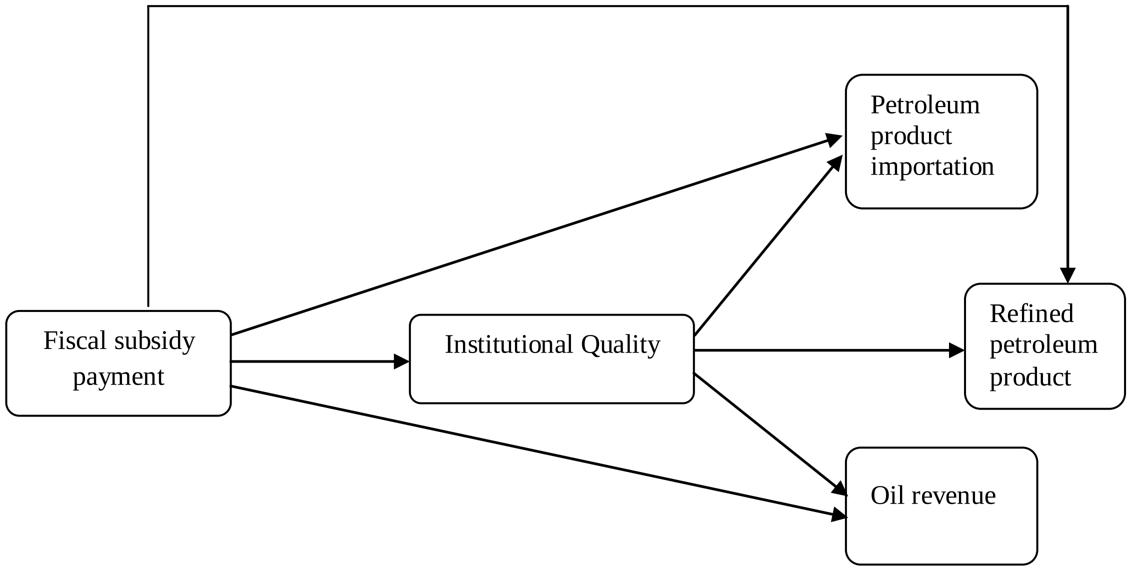

Fig. 2.1 Conceptual framework for the research
Source: Researcher

Third, fiscal subsidy relates directly to consumers and producers/suppliers of petroleum product whose services return the gains of the subsidy to the people and the government. Morgan (2007) stated that in many nations subsidies lower petroleum product prices for the final consumers.

The inclusion of institutional quality as mediating variables follows the research paradigm of multidimensional or indirect analysis of a cause and effect relationship rather than a one-dimensional or simple and direct relationship analysis between variables. The environment in which operators of the downstream sector work is entangled with several institutional bottlenecks that needs to be dealt with in order to make judicious use of the subsidy fund allocated to them. Such bottlenecks constitute organizational environment for the operators and are bound to affect organizational structure, processes, and management decision making of the operators (Duncan, 1972; Keats and Hitt, 1988 cited in Stonebraker and Liao, 2006). The inclusion of institutional quality is also in continuation of the streams of researches that has studied organizational environment as a multidimensional concept as suggested by past scholars (Aldrich, 1979; Dess and Beard, 1984; Keats and Hitt, 1988).). This being so is because institutional quality relate to a larger extent to the complexity of operational environment of businesses.

Environmental complexity is concerned with the heterogeneity and concentration of environmental elements and is thought to have direct impact on the form of organization structure. As opined by Boscheck (2007), institutional quality which relate with environmental complexity is an expansive idea that catches law, individual rights and astounding government direction and administrations and generally clarifies pathways for corporate operations.

Institutional quality helps in improving and developing potentials of corporate workforce at all levels (Boscheck, 2007). Institutions react to issues coming from social connection in an indeterminate world, where operators take non-coordinated choices under a structure of flawed information. Institutional quality is a pattern of connections and model for supervisors to accomplish administrative objectives through organizing, planning, controlling, and directing (Mabey *et al*., 2001). It defined institutional quality to be bureaucracy which offer the kind of regulatory and policy check on the activities of the national oil company. It can also be refer to a broad concept that captures law, individual rights and high quality government regulation and services (Bruinshoofd, 2016). In this study, consideration of definition from Thunders (2011) was necessary; it defined institutional quality to be bureaucracy which offer the kind of regulatory and policy check on the activities of the national oil company. It can also be refer to a broad concept that captures law, individual rights and high quality government regulation and services (Bruinshoofd, 2016)

Hypotheses development

The development of hypotheses that guides the conduct of this study is based on the theoretical positions on the relationship between fiscal subsidy and downstream sector performance. The prediction of the neo-liberalization theory is that deregulation would improve the economy. This it does through a free market system and competition which guarantees effectiveness, productivity, and efficient service as opined by Ugorji (1995). By this theory, fiscal subsidy as a type of economic liberalization policy and reform is capable of strengthening market forces with some degree of economic liberalization, wage relaxation and price controls and can also eliminate any hindrance and interference by government in the free market economy and drive efficiency in the economy.

Furthermore, this theory says that the liberalization and deregulation of the downstream sector (which can be through fiscal subsidy) would open up the sector for foreign investments, and, the incidents of petroleum products smuggling and inefficiencies in the sector would be eliminated. By this theory, fiscal subsidy can be positive by encouraging foreign investment in the sector and can also be negative by encouraging smuggling and breeding inefficiencies in the sector. The assumption is that, if it encourage foreign investment, the sector is highly likely to perform better in terms of high revenue generated to government, low product importation, and high volume of domestically refined petroleum product otherwise the opposite would be that fiscal subsidy effect on the downstream sector is negative. Based on this analysis, three sets of hypotheses are developed to be tested as follows:

Ha1: There is a significant relationship between fiscal subsidy payment and downstream sector performance.
Ha1a: There is a significant relationship between fiscal subsidy payment and petroleum product importation.
Ha1b: There is a significant relationship between fiscal subsidy payment and refined petroleum product.
Ha1c: There is a significant influence between fiscal subsidy payment and oil revenue.

The fourth hypothesis of this study is based on the prediction of the institutional theory. This theory has been employed by scholars to explain institutional complexities as they affect corporate performance (Scott, 2001; Wicks, 2001). The theory stressed that for any policy or reform to be successful, the industry factors must be properly addressed as part of the firm (Volberda et al., 2012). By the dictates of the institutional theory, institutions are creations of human beings and without them, firms and its assets including economic sectors and its operators could never have existed and transactions could not have been consummated. This shows how powerful the institutions and its complementarities are in many sectors. This signifies the intervening power of institutional qualities in performance analysis. Sequel to the above, another dimension by which institutional theory could explain the mediating role of institutional quality in the relationship between subsidy and downstream sector performance is through the various form of isomorphism identified earlier under discussion of institutional theory. Consequently, the hypothesis below is stated for investigation.

Ha2: There is a significant influence of mediation effects of institutional quality on the relationship between fiscal subsidy payment and downstream sector performance.
Ha2a: There is a significant influence of mediation effects of institutional quality on the relationship between fiscal subsidy payment and petroleum product importation.
Ha2b: There is a significant influence of mediation effects of institutional quality on the relationship between fiscal subsidy payment and refined petroleum product.
Ha2c: There is a significant influence of mediation effects of institutional quality on the relationship between fiscal subsidy payment and oil revenue.

Guided by prior researches and theory, a study should apply the research framework shown in Fig 3 to explain the interrelationship among fiscal subsidy, institutional quality and performance of downstream sector. This framework is developed basically based on the tenets of the theories that can be applied in studying downstream sector performance in response to fiscal subsidy in the presence of institutional quality. The framework has three dependent variables which are refined petroleum product, petroleum product importation, and oil revenue all of which represent downstream sector performance; one independent variable which is fiscal subsidy payment to the downstream sector; and, one mediating variables which is institutional quality.

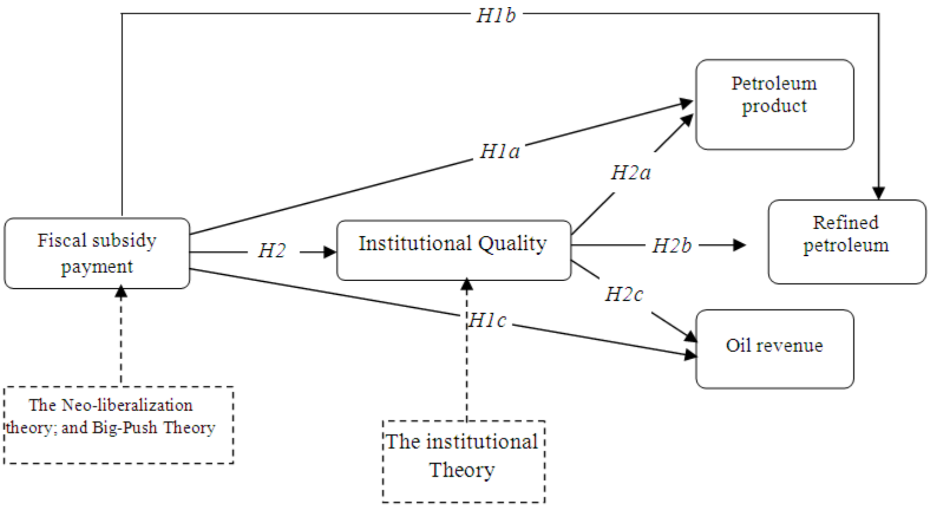

Fig. 3. Conceptual framework for the research

As illustrated in Fig. 3, the relationship between fiscal subsidy and performance of downstream sector represented by petroleum product importation, refined product and oil revenue is explained by the Neo-liberalization theory whereas the mediating effect of institutional quality on the relationship between fiscal subsidy and performance of downstream sector is explained by institutional theory. Applying this framework and testing the appertained hypotheses could offer better explanation of the downstream sector. This framework provides an example of how the issue of downstream sector performance may be enhanced using fiscal subsidy through institutional quality / complexities.

III. Conclusions and implications

This paper has pursued the notion that, for better/improve downstream sector performance, a strategic fit or integration must exist between fiscal policy and institutional quality. We have argued that the downstream sector of Nigeria has not performed desirably in terms of the revenue generated tot e government, volume of refined petroleum product, and volume of product importation. On the strength of the Neo-liberalization theory, it is argued that fiscal subsidy can led to improvement in this important sector of Nigerian economy. And that institutional quality can also mediate the effect of fiscal subsidy on downstream sector performance based on the prediction of the institutional theory.

To enable a robust and guided investigation of these conjectured relationships, the present researchers have proposed a model that can be applied in the analysis. It is mediated research framework that integrates fiscal subsidy, institutional quality, and downstream sector. Many researches have been done on fiscal subsidy; however, the present study did not find prior studies that have addressed either the direct effect of fiscal subsidy on performance of downstream sector or institutional quality as mediators of the relationship between fiscal subsidy and downstream sector performance. Therefore, in the proposed framework, this study has suggested and 'dimensionalizes' the relationship of the mediating variable to the primary independent and dependent variables.

This study does have some notable limitations. Of course, this paper has focused on the model building, 'dimensionalization', and hypothesis-positing activities only. There is no statistical test of the hypothesized relationships. Thus, evidence-based conclusions on the existence of significant effect or not among the variables of the study cannot be claimed in the present investigation. Given that the currently available research focuses primarily toward qualitative and descriptive analysis, with some measurement of integration (mediating) variable, the present study is an initial step to provide a theoretic foundation and model of fiscal subsidy and the downstream sector performance. It has however, not developed, or operationalized a high-confidence test of the model. That study is yet to be undertaken.

Certainly, none decomposition of several variables, such as fiscal subsidy into the specific types of subsidy (consumer subsidy or producer subsidy etc) and institutional quality into specific dimensions (rule of law, government effectiveness, control and corruption, voice and accountability, and regulatory quality) also detract from the overall scope of the model. These specific variables are likely entwined differently with the generic variables used in the present study and they should be pursued, both separately and in concert in future research efforts. The more variables that are included, the greeter the number of potential hypotheses, and, as the study moves toward empirical testing, the larger and more complex survey, the sampling processes, and the method.

This study is an example of in-depth multidimensional and complex or interactive research framework that is increasingly relevant to the more dynamic and integrated operational environment of businesses. It establishes the foundation for numerous future conceptual and empirical research efforts. The generic independent variables – fiscal subsidy and the mediating variable - institutional quality should be decomposed or 'dimensionalized' and be made focus of further research to establish the nature and strengths of their interrelationships with current variables.

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