

The Relationship between Fiscal Decentralization and Economic Growth: A Systematic Review

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Abstract

Background: Fiscal decentralization is practiced to improve the governance quality, service efficiency and promote economic growth. The process is concerned with the decentralization of both the revenue generation and expenditure responsibilities. Some regions though experience the benefits of economic growth, other face the challenges hindering its effectiveness.

Objectives: The main objective of this study is to make a systematic review of the journal articles examining the relationship between fiscal decentralization and economic growth.

Methods: The analysis was conducted considering the journal articles based on the quantitative analysis, published in the Google scholar database from 2000 to 2023. Preferred reporting items for systematic reviews and meta-analysis (PRISMA) was adopted as the standard in order to classify the literature into a specific database. The findings were tabulated into themes under the same regions and compared and contrasted under four sub-themes. Moreover, 35 articles focusing their study on various nations and regions were selected from 374 articles identified for the study.

Results: No mutual consensus was found on the relationship between fiscal decentralization and economic growth. The findings reveal that fiscal decentralization can have mixed, linear positive, linear negative, and even non-linear relationships with economic growth.

Conclusion: The effect of fiscal decentralization on economic growth differs across the regions and is shaped by governance as well as institutional quality. In Central and Eastern Europe, the outcomes are mixed. African and OECD nations generally have realized the positive benefits, especially from expenditure decentralization. South Asia and East Asia have mixed effects influenced by governance and institutional factors. In Southeast Asia and Latin America, decentralization though boosts economic growth, faces the challenges of resource inequality.

Keywords: Decentralization, economic growth, governance, quantitative analysis, systematic review

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Introduction

Fiscal decentralization is a process of transferring financial authority and responsibility from the central to the local and regional governments. This multifaceted process comprises the transfer of fiscal responsibility from the central to local administrative bodies through taxation, expenditures, and revenue-sharing mechanisms (Oates, 1972). The underlying rationale of fiscal decentralization is that local governments are more familiar with the necessities and preferences of their communities and design the policies and allocate the available resources effectively and efficiently.

In recent decades, the impact of fiscal decentralization on economic growth has drawn significant attention for the researchers as such, the research regarding fiscal decentralization and economic growth has been a subject of study for economists, scholars as well as policymakers. A considerable number of researchers argue that fiscal decentralization is a mechanism that enables the effective mobilization of resources and enhances efficiency and accountability promoting economic growth. Countries with strong institutional capacity and efficient governance systems generate a higher possibility of attaining benefits from fiscal decentralization as this mitigates the problem regarding the contribution among the administrative bodies and ensures that fiscal decentralization enhances economic growth (Rodden, 2002). Decentralization is a means of empowering the local governing bodies effectively and efficiently regarding the mobilization of resources, stimulation of investment, entrepreneurship and investments as well (Bardhan & Mookherjee, 2006). Fiscal decentralization has long term positive impact on economic growth (Pinilla-Rodriguez et al., 2016). Fiscal expenditure decentralization has a significant contribution in the reduction of poverty (Song et al., 2022). The positive impact of fiscal decentralization on economic growth is usually evident in countries with effective governance and efficient institutions.

However, the realization of the benefits and attainment of efficiency and effectiveness from fiscal decentralization is not a matter of assurance. The impact of fiscal decentralization varies on the basis of country size and government levels (Mali & Malicka, 2021). Critics make the argument that fiscal decentralization also increases the administrative burden, regional disparities, and fragmentation of public service delivery as well. Fiscal decentralization has limited success in reducing the regional disparities, due to the inefficient local budget management and low human capability (Farida et al., 2021). Fiscal decentralization has a negative influence on economic growth due to the weak institutions in Central and Eastern European countries (Mladenovska & Tashevskaja, 2019). The positive outcomes of fiscal decentralization depend upon institutional capacity and governance system as well, however, lack of coordination between and among the administrative bodies leads to regional inequalities and irregular public service delivery (Faguet, 2014). Therefore, fiscal decentralization though holds the potential to enhance economic growth, is subject to efficient institutional structures, and practicable policies that can manage the complexities of decentralized governance.

The main objective of this study is to systematically review and analyze quantitative research on the relationship between fiscal decentralization and economic growth and also identify the trends and variations across regions. In the Nepalese context, no significant literature has been comprehensively analyzed considering the quantitative data, as such the impact of fiscal decentralization on the economic growth of Nepal remains under-explored.

Review of Literature

Systematic review of included literature

Out of the 374 identified journal articles on the topics under study, 35 journal articles were thoroughly assessed and categorized under several regions. Moreover, the studies across various regions were compared and minutely assessed, creating the sub-themes generated from the journal articles themselves.

Table 1

The themes of the eligible papers from various regions

Year	Authors	Theme of the paper of the nations/regions
Central and Eastern European Countries		
2023	Kaneva, Karpenko, Nasibova Tabenska, and Tomnyuk	Revenue decentralization constrains economic growth, and expenditure decentralization relatively boosts economic growth in 15 Central and Eastern Europe.
2022	Slavinskaite et al.	Fiscal decentralization does not enhance economic growth in the absence of influence of central government in Baltic states.
2020	Onofrei et al.,	Fiscal autonomy promotes economic growth in Central and Eastern European countries.
2019	Tashevskva	Fiscal decentralization has a negative influence on economic growth due to the weak institutions and large public sectors in Central and Eastern Europe.
2017	Malicka, Sulikova and Soltes	Fiscal decentralization has a non-linear, inverted U-shaped relation with the economic growth in European Union countries.
African and OECD Nations		
2023	Amin et al.	Revenue decentralization has a limited influence on economic growth in comparison to expenditure decentralization in Nigeria.
2023	Sima, Liang and Qingjie	Fiscal decentralization has a positive influence on the economic growth, especially stronger in the omit nations African and OECD nations.
2023	Mosikari and Stungwa	Fiscal decentralization has a positive impact on the economic growth in South Africa.
2021	Mose	Fiscal decentralization has positive effects on economic growth through recurrent expenditures in Kenya.
2021	Atan and Esu	Fiscal decentralization does not have a direct influence on economic growth but omit rather through better governance in Nigeria.
2016	Ewetan et al	Fiscal decentralization has a long-term positive impact on the economic growth in Nigeria.
South Asia		
2022	Hussain et al.	Fiscal decentralization has a positive impact on the economic growth in Pakistan.
2019	Faridi et al.	Expenditure decentralization has a positive influence, but revenue decentralization has a negative influence in the case of India.
2018	Ganaie et al.	Expenditure decentralization positively influences the economic growth of India, however, revenue decentralization has a negative impact.
2015	Adil and Anwar	Fiscal decentralization has a positive impact on the economic growth in Pakistan.
2012	Kang and Arshad	Fiscal decentralization has a positive influence on the economic growth in Pakistan.
East Asia		
2019	Ding, McQuoid and Karayalcin	Fiscal decentralization (the tax sharing/ revenue decentralization) has the positive impact on the economic growth especially in case of China.
2017	Sun et al.	Fiscal decentralization has an inverted the U-shaped relationship with the economic growth in China.

2016	Yang	Fiscal decentralization and economic growth have inverted the U-shaped relationship in China.
South-East Asia		
2023	Sirojuzilam	Decentralization has a positive impact on economic growth through there exist the challenges of unequal distribution of resources especially in Indonesia.
2022	Azizah et al.	Decentralization has a positive impact on economic growth through there exist the challenges of unequal distribution of resources especially in Indonesia.
2022	Hung and Thanh	Fiscal decentralization has positive impact on the economic growth as it reduces the poverty through improved local service delivery especially in Vietnam.
2020	Nantharath et al.	Revenue decentralization has a positive impact while expenditure decentralization has a negative impact especially in Thailand.
2020	Thanh and Canh	Fiscal decentralization enhances economic growth with strong public governance in Vietnam
2019	Sasana	Fiscal decentralization enhances local growth when combined with private investment and labour dynamics, especially in Indonesia.
2016	Nugraha	Fiscal decentralization has a negative impact on the economic growth in Indonesia.
Aggressively Developing Economies		
2022	Jin and Rider	Fiscal decentralization has a positive impact on the economic growth where institutional quality and regional disparities are the key determinants in case of China and India.
2022	Arif and Chishti	Strong institutions are necessary for realizing the benefits of fiscal decentralization and attaining higher level of economic growth (Considering the data from 43 countries).
Other Regions		
2017	Miri and Mohamed	Fiscal decentralization has long tern positive impact on the economic growth despite short term reduction in growth in case of Morocco
2015	Yushkov	Fiscal decentralization has mixed effect in the economic growth: Expenditure decentralization has negative impact while fiscal transfers have positive impact in Russia
Cross-Regional / Global		
2022	Jin and Rider	Fiscal decentralization may hinder the short-term economic growth of India but offers the long-term benefits. However, no significant long-term effects are observed in case of China.
2020	Arif and Ahmadt	Fiscal decentralization enhances the economic growth in case the macroeconomic conditions are stable (Considering the data from 53 countries).

The existing literature explored the relationship between fiscal decentralization and economic growth. However, a gap was identified in the comprehensive systematic review specially emphasizing the quantitative analysis in terms of regional variations, comparing and contrasting the themes, and categorizing into specific sub-themes.

Materials and Methods

The systematic and transparent review process, PRISMA guidelines was adopted with relevant studies

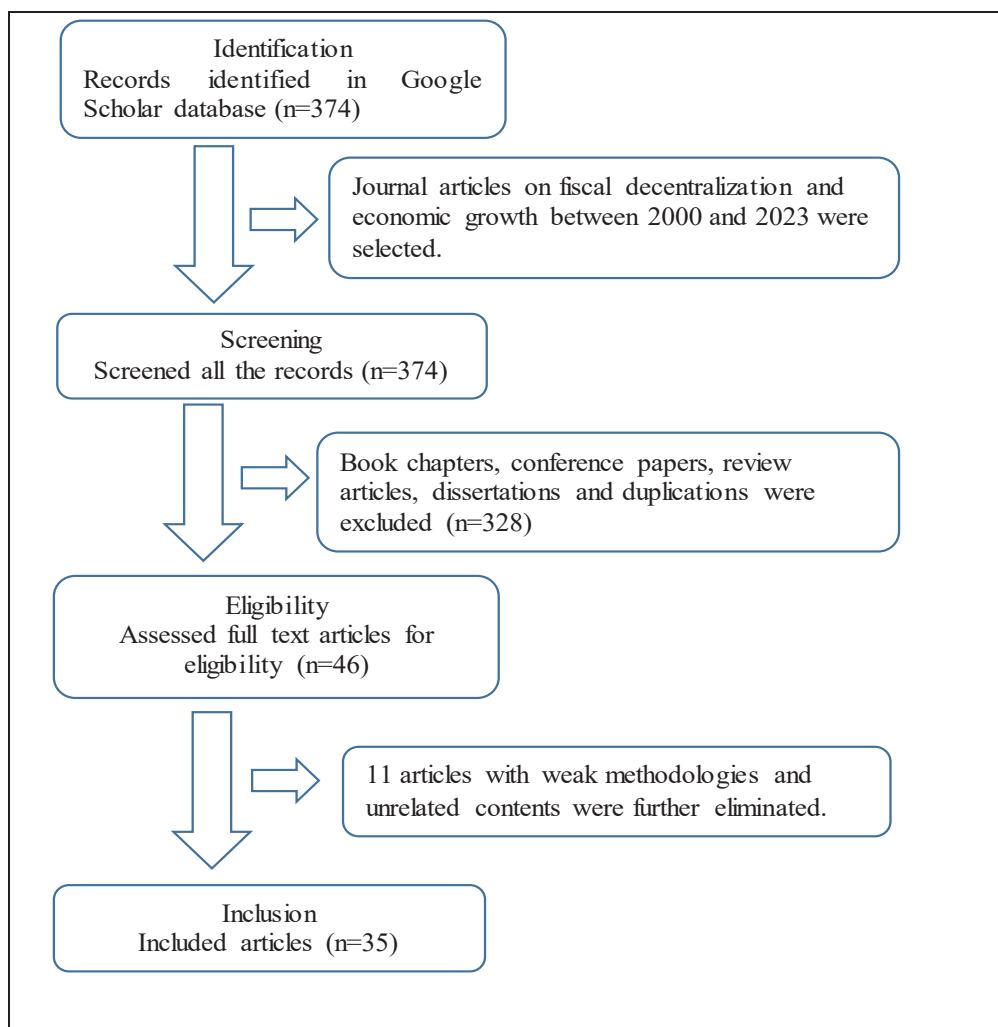
identified through the comprehensive Google scholar database. Moreover, eligible studies were identified, screened, and synthesized into themes and sub-themes. The journal articles in the Google Scholar database, based on quantitative data analysis, published in peer reviewed journals in English languages, from 2000 to 2023, entitled fiscal decentralization and economic growth imply the main resources for the study. A search string of (“fiscal decentralization”) AND (“economic growth”) was developed and 374 journal articles were identified and screened, out of which, 328 articles were excluded employing the inclusion and exclusion criteria set. Though 46 articles were found to be eligible for the study based on the study criteria, only 35 articles were included for the study which fulfilled the entire criteria set such as quantitative data analysis, peer-reviewed journal articles, published in Google Scholar, from 2000 to 2023 and in the English language.

The generated search string was executed in Google Scholar advanced search. The search was limited to “with the exact phrase” of the search string, where my words occur in “the title of the article”. Besides, the themes of the literature were synthesized and were further categorized under four major sub-themes namely: mixed, linear positive, linear negative, and non-linear and analyzed.

A multi-step process of PRISMA was followed for the transparency of the study. A flow diagram is presented detailing each stage and reasons for the exclusion of the articles along with the final number of the literature included.

Figure 1

The process of selecting articles



Results and Discussion

Research from various regions of the globe has made an attempt to assess the relationship between fiscal decentralization and economic growth and reported the diverse impact emphasizing the contextual factors as well. The findings were categorized into four major sub-themes: Moderate and mixed, linear positive, linear negative and non-linear relationship between fiscal decentralization and economic growth.

Moderate and mixed relation

The studies based on the relationship between fiscal decentralization and economic growth have also concluded their moderate and mixed relations. Kaneva et al. (2023) found that though revenue decentralization hindered, expenditure decentralization benefited the economic growth in the 15 Central and Eastern European countries from 1996 to 2020. Amin et al. (2023) considering the annual time series data from 1993 to 2021 found that revenue decentralization has a limited influence on economic growth relative to expenditure decentralization. Slavinskaite et al. (2022) found that fiscal decentralization alone did not have a beneficial impact on the economic growth in the Baltic States from 1996 to 2019 without the involvement of the central government. Azizah et al. (2022) in Indonesia and Jin and Rider (2022) in China and India, emphasized the varied effects of fiscal transfers, growth dynamics, and expenditure policies highlighting the role of government policy frameworks. Hung and Thanh (2022) assessing the data from 18 countries from 2011 to 2017 noted the positive relationship between fiscal decentralization and economic growth, however, expenditure based decentralization must be carefully managed in order to avoid the adverse impact.

Mali and Malicka (2021) found that fiscal decentralization had a significant influence on the economic growth in the EU nations between 1995 and 2018, with results varying depending upon the country size and structure of the government. In contrast, Atan and Esu (2021) found that fiscal decentralization in Nigeria between 1980 and 2018 had no direct influence on economic growth, rather it could be fostered through an improved management system and efficiency. Taranco (2020) examined the data between 2007 and 2018 in Peru and found that though current expenditures boost economic growth, the spending on education and health did not benefit the economy.

Similarly, Nantharath et al. (2020) indicated that revenue decentralization has contributed to regional growth in Thailand between 1997 and 2017, though excessive expenditures in the metropolis limit local investment. Arif and Ahmad (2020) analyzing the data from 53 nations from 1996 to 2014, found that fiscal decentralization has an indirect effect on economic growth dependent upon macroeconomic stability and governance quality. Faridi et al. (2019) concluded that expenditure decentralization supports growth but revenue decentralization has unfavorable effect in South Asia from 1990 to 2016. Ganaie et al. (2018) in 14 Indian states from 1981 to 2014 found that expenditure decentralization though stimulate revenue decentralization hindered economic growth emphasizing the importance of balanced fiscal management. Yushkov (2015) in Russia from 2005 to 2012 found that excessive expenditure decentralization, without revenue decentralization, has a negative impact on economic growth, and while fiscal transfers from the central have a positive impact. Adil and Anwar (2015) in Pakistan employing the data between 1972 and 2010 noted that fiscal decentralization positively influences economic growth in the long run while the short-run effects are insignificant. These studies suggest that benefits from fiscal decentralization can be realized by maintaining the balance between revenue, expenditure, and transfer management.

Linear and positive relation

A significant number of researches have been conducted regarding the relationship between fiscal decentralization and economic growth around the globe considering different time frames and concluded their linear and positive relation. Sima, Liang, and Qingjie (2023) found the positive impact of both the revenue and expenditure decentralization in the economic growth of 23 African and OECD countries

employing the data from 1980 to 2018 and noted a relatively stronger impact in the developing nations than the developed ones. In consistent, Mosikari and Stungwa (2023) also reported the positive influence of fiscal decentralization measured in terms of provincial expenditure on the economic growth in South Africa by using the data from 1994 to 2018. Similarly, Sirojuzilam (2023) also noted that fiscal decentralization on the one hand improved the regional economic performance and also reduced economic disparities in Nias Islands Indonesia between 2004 and 2020. Alves et al. (2023) found a strong association between fiscal decentralization and economic growth in industrial and service sectors in Brazil from 2000 to 2019. Arif and Chishti (2022) reported the strong and sustainable impact of fiscal decentralization on economic growth in a cross-country analysis between 1990 and 2018, across 43 countries, given the strong institutions and efforts of the governments. Hussain et al. (2022) noted the positive impact of fiscal decentralization over the period of 1980 to 2020 in Pakistan. Enriquez and Espinoza (2021) reported that fiscal decentralization in Ecuador has a positive impact on economic growth considering the data from 200 to 2018. Mose (2021) reported that fiscal decentralization through the increased recurrent expenditures boosted economic growth in Kenya between 2000 and 2015.

Similarly, Onofrei et al. (2020) noted that fiscal decentralization had a positive impact on the economic growth of 11 Central and Eastern European countries between 2000 to 2015 subject to the degree to fiscal autonomy and structure of decentralization. Thanh and Canh (2020) demonstrated that in Vietnam, fiscal decentralization has a positive impact on economic growth analyzing the data spanning 2006 to 2015. Ding, McQuoid, and Karavalcin (2019) considering the tax sharing system as a form of fiscal decentralization, using the data from 1980 to 1999 of China, found a positive influence in the economic growth of an economy. Likewise, Sasana (2019) noted a positive relationship between fiscal decentralization and economic growth in Central Java, Indonesia, between 2009 and 2017, considering the crucial roles of private investment and labour. Meanwhile, Miri and Mohamed (2017) in Morocco, Pinilla-Rodriguez et al. (2016) in Latin America and Lozano and Julio (2016) in Colombia emphasized the long-term growth benefits from the increased fiscal autonomy, with positive spillover effects. In consistent, Ewetan et al. (2016) in Nigeria employing the data from 1970 to 2012 confirmed the long-term positive relationship between fiscal decentralization and economic growth. Similarly, Kang and Arshad (2012) in the study of Pakistan over the period between 1972 and 2009 found the long run positive relationship between fiscal decentralization and economic growth. These studies reveal that fiscal decentralization can stimulate economic growth, however, is dependent upon the balance between revenue generation, expenditure management, and institutional context as well.

Linear and negative relation

Contradicting the presumption that fiscal decentralization has a positive impact on economic growth, several studies have concluded the negative impacts, especially in developing nations. Tashevskaja (2019) in the study of Central and Eastern European (CEE) countries between 1992 and 2012 found that fiscal decentralization has a negative impact on economic growth, indicating that without favorable conditions, decentralization does not yield expected benefits in the developing economies. Nugraha (2016) in Indonesia examined the data between 2005 and 2014 from 33 provinces and found a negative relationship between fiscal decentralization and economic growth considering the expenditure pattern of the local governments. These findings suggest that fiscal decentralization can enhance economic growth but the benefits depend upon the allocation and management of resources

Non-linear relation

Studies have also shown that the relationship between fiscal decentralization and economic growth also follows the inverted U-shaped implying that the benefits of growth increase to a certain level before diminishing. Sun et al. (2017) found an inverted U-shaped relationship between fiscal decentralization and economic growth between 1995 and 2014 in China, indicating that though decentralization

enhances growth, there remains an optimum level that most provinces have yet to achieve. Malicka, Sulikova, and Soltes (2017) found that fiscal decentralization and economic growth have an inverted U-shaped relationship in 26 EU countries between 1997 and 2015, indicating that the benefits of fiscal decentralization diminishes beyond a certain level. Yang (2016) also noted the inverted U-shaped relationship in China, revealing that excessive decentralization could be unfavorable, especially for the high-growth regions. These findings indicate that though fiscal decentralization promotes economic growth only to a certain level then after begin to diminish.

The impact of fiscal decentralization on economic growth varies across economies. In case of the developing nations, expenditure management can enhance economic growth. Whereas, in the case of the developed nations, excessive decentralization can hinder economic growth. However, the outcomes largely depend upon the institutional capacity and governance as well.

Conclusion and Suggestions

The major intent of this paper was to examine whether there exists a mutual consensus regarding the impact of fiscal decentralization and economic growth. Research on fiscal decentralization and economic growth found the diverse outcomes shaped by institutional efficiencies, fiscal policies, and regional contexts as well. The findings reveal that decentralization can have moderate and mixed, linear positive, linear negative or even non-linear effects on economic growth, depending on the economic and governance conditions of each region. The impact of fiscal decentralization on economic growth is multifaceted and the outcomes depend upon various factors such as regional contexts, economic conditions and structures, and policy measures as well. The researches indicate that though fiscal decentralization boosts economic growth by empowering local governments and enhancing resource allocation and distribution mechanisms, the result is not universally accepted. The strategies of sound revenue generation mechanisms, efficient expenditure management, and effective institutions support to reap the benefits of fiscal decentralization.

Some studies focusing on the economies of developing countries found that poor resource management or excessive practice of decentralization, may hinder to grasp of the positive aspects of decentralization turning to the negative by increasing the operation cost and management cost of the governance. Moreover, several studies also found an inverted U-shaped relationship between fiscal decentralization and economic growth suggesting that decentralization has an optimum threshold. Accordingly, once the economic benefits are maximized, the level of advantages and benefits diminish with the extension and practice of decentralization. This also highlights the importance of regulating and revising the fiscal policies in order to avoid the negative consequences arising from the excessive decentralization.

Finally, the efficiency of the decentralization is embedded in the careful practice and execution of the prevalent fiscal policies considering the governance quality, socioeconomic and political factors as well. Therefore, for the effective implementation of fiscal decentralization, there arises the necessity of efficiency in revenue generation, expenditure management, and policy mechanisms as well.

Author contribution statement

The author solely conducted conceptualization, data collection, analysis, writing tasks, addressing the comments of reviewers, and finalizing the manuscript.

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The authors declare no conflict of interest.

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