

Investigating the relationship between Decentralisation of Economies and Economic Growth

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Abstract— *Decentralisation is considered an important avenue to gain efficiency making a direct association between local taste and provision of goods and services. Since the provision is as per the taste of consumers, it is expected that this will result in faster economic growth. The association between decentralisation and economic growth has been identified by many studies in the past using data of different nations associated with GDP. However, empirical literature reviews on the association but found that there is no consensus among past researchers over the topic. The state which provides more power to the local government can grow faster in comparison to those having centralised power. There may be spillover impact from decentralisation at the local level including tasks linked to crime prevention or public infrastructure investment. They highlight the probability of adverse economic effects from decentralisation due to local government expenditure spillovers.*

I. INTRODUCTION

A political economy can be either centralised or decentralised however, it has become common in the current world that economies are moving towards decentralised system. This is the system where the central government gives some of its power to local government so it can manage organisations in its domain. Decentralisation has become common due to its efficiency since it results in the efficient provision of products and services and quick economic growth [1]. This pace of increase in economic growth is the question to be answered as to how economic growth is affected by decentralisation and how centralised authority cannot work as efficiently as decentralised. This research paper puts light on the concept and system of decentralisation and why economies have moved towards decentralisation. The paper includes a review of many papers in the past to include support as well as a critical material. The paper includes a background of the topic, objectives of the study, literature review, discussion, and future implications. The paper has discussed the association between decentralisation and economic growth to depict how decentralisation may help in or slow down the economic growth along with reasons.

A. Background

Decentralisation is a complex system having few dimensions; fiscal, political and managerial. Political decentralisation is employed in the shape of elections to elect individuals for local government. On the other hand, fiscal decentralisation contains two aspects where local or regional states are obliged for services on the expense side, responsibility and authority for the collection of tax can be shifted to a regional level [2]. The level of decentralisation of fiscal revenue and expenditure may reflect the value of interstate income relocation by the central government. Decentralisation has been viewed as an important avenue to gain efficiency so that economic growth can also be enhanced. Nations that give more authority to local government grow faster than those where the government is centralised [3]. This is because the local government has a limited area of control and monitoring while the central government has to look at overall issues on the national and international levels. Hence, decentralisation shares the burden of government so that operations can be handled with limited burden since only one thing can be achieved out of quality or quantity so decentralisation believes that quality should be focused. The central government may fail to look at both quality and quantity therefore, efficiency is ensured when quantity is lowered. Decentralisation shares quantity of work or control so that quality can be achieved therefore, many of the states focus more on quality to ensure economic growth [4].

There are few criticisms on decentralised system as well such as the view that giving power to more people means more chances of misuse of power. This indicates that the local government may use its authority for its benefit rather than the benefit of the region for which it is responsible [5]. This is an important and useful point raised regarding decentralisation and its impact. Although decentralisation ensures efficiency but resources may be wasted or misused by those possessing them or having authority to allocate. Fair and honest resource allocation for economic efficiency and growth is mandatory however, such fair and honest allocation depends upon those in power. The central government is responsible to ensure that it has resided power in hands of responsible and honest government.

B. Aim and Objectives

The major aim of the study is to depict the association

between decentralisation and economic growth. For the purpose, the study includes different studies associated with the same or similar topic from which important variables have been extracted and discussed along with their impact on economic growth. Following are the objectives of the study;

- To explain the concept of decentralisation as an economic and political system.
- To identify the reasons why decentralised system is being preferred around the world.
- To depict the association between decentralisation and economic growth.

C. Research Questions

Does decentralisation of economic growth strengthen or weaken the state?

What is the association between decentralisation and economic growth?

II. LITERATURE REVIEW

Decentralisation is considered an important avenue to gain efficiency making a direct association between local taste and provision of goods and services. Since the provision is as per the taste of consumers, it is expected that this will result in faster economic growth. The association between decentralisation and economic growth has been identified by many studies in the past using data of different nations associated with GDP. However, empirical literature reviews on the association but found that there is no consensus among past researchers over the topic. The state which provides more power to the local government can grow faster in comparison to those having centralised power. There may be spillover impact from decentralisation at the local level including tasks linked to crime prevention or public infrastructure investment. They highlight the probability of adverse economic effects from decentralisation due to local government expenditure spillovers [6].

A study used similar factors to depict two important indicators of growth i.e. income and population but the findings of individual indicators were different; central city population share showed positive in population regression but negative in income regression. The literature was further extended to depict the association between regional decentralisation and regional economic growth using data of 314 US statistical metropolitan areas. The study found a significant but negative association between the number of governments per metropolitan area population and area residents and capital real income growth. This study showed proof of a strong and positive association between local decentralisation and economic growth of the area [7]. A simple correlation was created to reflect that fiscal decentralisation is associated with quality of governance positively which accelerates economic growth and development. The contribution of decentralisation towards economic growth has been assessed theoretically using data of single country covering different periods than researches conducted in China and the USA. However, a key

econometric issue of endogeneity problem has not given much attention [8].

Decentralisation of fiscal growth can be classified into the following three kinds i.e. deconcentration, devolution, and delegations. Some country's governments have used all three kinds simultaneously while other governments have used certain combinations of the categories [9]. Deconcentration is the process of giving up power and authority to the lower levels by the government to give the authority to the lower levels to enable them to make their own decisions. Devolution is the process of strengthening the lower level of authorities by the government what is not directly under the control of the government. Thus, the central or the main body authority may only practice power over the units indirectly. The process ensures that the declaration is the process of transferring administrative authorities to the lower level government. According to Bodman (2011) [10], these are the best-known process of fiscal decentralisation which can result in the efficiency of the government [11]. Decentralisation also profits the government during the stages when the government is not economically stable and decentralisation also empowers lower-level authorities and increases interaction and trust level which ultimately contributes to the government's performance. The central government is not capable of solving every lower level's solution, and therefore the poorer regions within the company suffered due to delayed solutions to their problems.

Decentralization of economies have transformed several underdeveloped countries into developing economies and with the devolution of economic powers and decisions, every sector is open to experience growth as per it's own progress agenda [12]. These economies have particularly helped agriculture and industrial sector simultaneously, elected governments have separate ministries for the promotion and growth of these sectors. Although there's one finance ministry in every governmental setup economic decisions with regards to funds allocation, yield anticipation, export and import decisions, production cost management – all these factors are determined and sorted out regardless of their impact on other sectors [13]. With decentralised system, industries have been set free to explore new vistas of progress, similarly, consumers or customers have the opportunity to express their feedback, making it easier for both to reach a sweet spot. Customization of products and flexibility have further pepped up economies with compatibility features. Governmental policy decisions are no hurdles in decentralized economies, therefore it gives room to competition and breaks monopolies, resultantly, products are available at cheaper rates. Countries are less likely to be vulnerable to the wheat shortage crisis or inflation issues because every dedicated unit keeps working to meet customer demands. They are free to conduct surveys and increase or decrease production with regards to the anticipated demand. Furthermore, at the organisational level, every section in a production or services unit is tasked with a different job to execute, making them all answerable for their jobs simultaneously [14]. Shutdown in one part of the unit doesn't necessarily halt production in the other

section while giving enough leverage to resolve the ongoing crisis in that particular section before the whole procedure is disrupted.

III. DISCUSSION

A. Does decentralisation of economic growth strengthen or weaken the state

Decentralisation of economy effects the government in four key aspects such as authority over a certain territory, policy autonomy, accountability of service and social learning [15]. The state is made up of various ethnic groups each possessing its own culture, norms, and languages. Many citizens feel that the government does not represent them and that they only accommodate their kinfolk and district and fail to pay attention to all the citizens alike. The process of decentralisation can aid and bring the government closer to people by providing the government a wider presence throughout the state and enable the citizens to feel closer to the government and have an impact on the policymaking and public services [16]. The government can give the residents and the different groups the right to elect their government that represents them and makes decisions in their interest. History has shown that decentralisation has been a success in Spain and Canada, and has helped the states in keeping the Quebec and Catalunya provinces from seceding from the states [17]. The UK also decentralised the state authority and gave the local Northern Ireland Assembly the power to rule over locals and make their own rules while holding some authority and control hence decentralisation of authority has been a success in the past. Decentralised local levels also provide better opportunities for solving problems of the locals as the subunits are more aware of the concerns and issues of their communities and groups [18]. They can also strengthen the government by providing a deep insight into the needs and current situations of the locals which can help the state in understanding the demands and needs of the people and hence assist the government in taking appropriate steps. Decentralisation can strengthen the government in participation in making decisions in which they did not have a say in previously during centralised government system [19]. Decentralisation of our financial system can also improve the individual's financial state. This is among the missing elements in the existing systems, but the recent dynamic changes in the market have resulted in the development of platforms that have prioritised decentralisation over other aspects. One of the markets leading decentralisation can be represented in the form of Virie, which has digitised transaction instrument that the traditional banking system has failed to do. The banking system for years has controlled our financial system and has exploited its power and controlled profitable derivatives. Virie market offers an opportunity of decentralised market that obliterates financial vulnerability. Virie market is a decentralised functional free market that involves no centralised third party and is bound to government regulations. Banks have played a major role in financial recessions and when the bank's collapse, the entire population collapses economically because people have

been so dependent on the banking systems. Therefore, Virie project has combined several technologies and has created a decentralised financial system and gives the people the control back over their transactions. People do not have to be affected by the financial collapses and they are not affected by any centralised third party. Virie is a full-proof payment method that aims to diminish the monopoly of the banking system and people's reliance on their bank accounts. Virie market has diversified their payment methods and has provided an alternative for people. Virie involves no third party shareholders and is a completely full-proof and provides a no strings attached transaction system, free of the centralised economic system [20]. Virie system is also always functional and never fails to operate. It also offers numerous currencies to trade such as (Dollars, Yen, Pounds, Euros, Bitcoins, etc.) because if one currency loses its value, another currency can be used, if one cannot find a particular product it can be found on Virie market in another country. Thus, Virie market decentralises our economic condition and if the country is in economic disaster, it will not affect the user. Another example of decentralised payment method is ARAW Pay. ARAW allows the users to pay the vendors in crypto currency. ARAW has created a decentralised ecosystem that also offers cashback options which protects their clients from fraud. Through ARAW Pay, merchants can use the ARAW tokens anywhere they wish. The main goal of ARAW is to build an online decentralised ecosystem that allows ordinary people to have access to cryptocurrencies from every corner of the globe [21]. Hence, devolution can not only improve the overall performance of the government but also benefit the individuals economically.

However various case studies have shown that the participation of the public in the state affairs may differ from state to state. The devolution of centralised government does not certainly result in the engagement of citizens as the local government can further provide strict watch over the locals which can affect their participation and put further constraints upon the locals. In 1994, Bolivia's local government was non-existent but after Bolivia's Law for Popular Participation (LPP) passed in April 1994 the government created 198 municipalities, it created a substantial impact upon the performance of the government [22]. The devolution process made it possible for the public to participate in the political affairs of the state and generated the omission of local government by civil society. But with certain advantages, the process also had its drawbacks and demerits because the LPP law states that the local municipality has the power to dethrone the mayor if they get the majority votes. With this power, the corruption started as the mayors were deposed not because of transgressions but rather due to shifting political coalitions. This lack of accountability and decentralised power caused political stability in Bolivia and wreaked havoc [23].

The state transparency can also be influenced by the process of decentralisation as the process breaks up the government and bring the authorities closer to the public which enhances their performance and also satisfies the local's needs [24]. Since the locals will be given the power

to elect their leaders, it will also increase the efficiency of the elected governments for if the officials performed poorly, they will face the risk of getting dismissed from the office by the locals [25]. In contrast to the decentralised government, the previously centralised system lacked this accountability and increased corruption as well. Although studies have been ambiguous about the corruption rate after the implementation of the process of decentralisation of government for the lack of evidence. Decentralisation has proven to be an effective tool within countries such as India, Canada, Spain, and Belgium but has been proven to be unsuccessful in countries such as Yugoslavia. Decentralisation allows the shift of power between the administrations which bring a balance within the government. This design of decentralisation enables the government to implement the policies and more effectively [26]. The more involvement of individuals in the process of policymaking can lead to more successful policymaking and result in policy stability. On the other hand, decentralisation process can cause the government to lose a certain level of power and control over the local authorities [27]. This can also lead to the weakening of centralised government's power to put forth fiscal policies over to the local administrators and can, therefore, be at the risk of macro-economic complications. The centralised government system is simpler and less convoluted and can the commands and policies are passed down easily onto the local government, however, the centralised government can cause issues and weaken the central government's authority [28].

B. What is the association between decentralisation and economic growth?

Decentralisation of government also provides the local government with an insight into the prospective problems or issues that the government may face and enable them to take quick actions against and regulate those problems. The local governments would be closer to the public and therefore be able to devise solutions to their problems that may be better suited to their issues [29]. The decentralisation of government also provides the government with an opportunity to tend to the problem of minorities and the underprivileged localities and it can affect their lives positively. They tend to work closely with the local and marginalised groups of the society and work closely to address their concerns which will increase the satisfaction of the public with the government. Hence, this process of decentralisation strengthens the government of the state. Decentralisation also encourages dynamism in the public as it allows the practice of power at certain different levels of the government which can promote dynamism and pluralism [30]. The creation of a local government in the state can also foster a better division of management that will cater to public problems. It will improve the efficiency of the government and will enable the central government to focus and cater to the higher-level issues of the states.

Fiscal decentralisation is the handover of the liability of fiscal policies from the central level to the sub-national level. It gives the local government some level of autonomy

in making their own financial or expenditure programs. The sharing of finances and revenues is not always effective and can lead to economic issues. Decentralisation also brings higher threats of seizure of power by the elites of society [31]. Without effective control over the local government, they run a risk of utilisation of power by the privileged for their benefit and profit. This exploitation of authority and power due to the deficiency of accountability can posit a threat to the process of devolution within the state. The centralised government is running the risk of losing control or power over the local government due to a lack of attention and accountability to the locals. The creation of a decentralised government can create complexities in the functions of the government and can cause issues related to financial and monetary policies. In the 1990s, in Ethiopia the decentralisation of power to the locals allowed the government to empower previously neglected local authorities and this transferral of power has helped the government in making healthy decisions with regards to public wellbeing [32]. Fiscal indolence is another negative outcome of decentralisation process which must be addressed by the centralised government to retain its stability and firmness [33].

IV. CONCLUSION

From the above discussion, it can be concluded that the process of decentralisation of the government can enhance the efficiency of the government and the economic growth of the state. The economic autonomy of the process can provide solutions to the financial problems of the country as the centralised government will allocate certain funds to the local government and they are held accountable. The decentralisation process of the state also gives more authority to the locals and the public that will enable them to dethrone the authorities who perform poorly. The devolution of government also brings the public closer to the government and therefore allows them to be voice their opinions and concerns and help the government take decisions keeping the public's issues and concerns in regard. Decentralisation of authority also empowers women and other minority groups to work closely with the authorities. This process strengthens the governments as the local authorities in contrast to the central government is more aware of the problems and issues of the locals as they represent them and are close to the people. This will solve the issue of the locals. However, the decentralisation process of the government also posits a threat on the macroeconomics of the state if the revenues and fiscal policies are not strictly monitored by the central government. It has also been concluded that fiscal decentralisation also impacts income distributions. The allocation of funds can lead to corruption as well, as there is a significant threat that the local elites can utilise all the funds.

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