



### Impact of Fiscal Decentralization on Economic Growth: Empirical Evidence from Pakistan

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**Abstract:** This study aims to investigate the impact of the fiscal decentralization on economic growth in the context of Pakistan. Focusing on key factors such as revenue decentralization, expenditure decentralization, own-source revenue, and fiscal balance, the study employs empirical analysis to unravel the impact of decentralization mechanisms on the country economic growth. While plugging in the Eviews, the Augmented Dickey-Fuller (ADF) test indicated that, in the beginning, all variables demonstrated non-stationary characteristics at the integrated of order zero (I(0)) level. However, through first differencing (I(1)), the variables became stationary, setting the stage for further analysis. Based on time series data set spanning the years 2000 to 2022, following the Pooled OLS estimation technique, the research reveals a positive correlation between revenue decentralization and economic growth, advocating for a judicious distribution of revenue-raising authority. Similarly, a moderate positive relationship is identified between expenditure decentralization and economic growth, emphasizing the potential benefits of local autonomy in resource allocation. The study underscores the importance of fostering self-sufficiency at the subnational level, as evidenced by the positive correlation with own-source revenue. However, a cautionary note is sounded on the negative relationship between fiscal balance and economic growth, urging policymakers to maintain fiscal discipline. The findings contribute nuanced insights and actionable recommendations for policymakers seeking to navigate the intricate dynamics of fiscal decentralization in Pakistan, providing a foundation for informed decision-making in the pursuit of sustainable economic development.

**Keywords:** Fiscal decentralization, Economic growth, Sustainable economic development

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## 1. Introduction

### 1.1 Background of the Study

Fiscal decentralization is the process through which power over a region's economy is delegated to its constituent municipalities. To do this, it is necessary for different tiers of government to articulate their respective financial responsibilities. To that end, these monetary mechanisms and procedures are designed to expand access to public goods (Bahl, & Bird, 2018). Fiscal decentralization, as defined by Nursini (2019) is giving decision-making authority to a lower governmental authority. According to the Sanogo (2019), "Transfer of obligation associated with the accountability to the sub-national governments" is what fiscal decentralization means. Therefore, it is defined as the ability of the local governments to levy taxes and distribute the proceeds to different programs in the

bounds of the law. Some individuals think fiscal decentralization encourages economic growth, despite the fact that it may lead to a shift of resources. Goals of fiscal decentralization include fostering economic growth and development, increasing efficiency in government operations, and fostering competition among subnational governments in the provision of public services (Park, Park, & Nam, 2019). Pakistan's fiscal policies have undergone substantial transformations in recent years, prominently characterized by a discernible shift towards decentralization. This strategic restructuring of fiscal responsibilities has materialized through the devolution of revenue and expenditure obligations to subnational entities, signifying a paradigmatic change in the fiscal architecture of the country. As Pakistan contends with the multifaceted challenges and opportunities ushered in by this decentralized fiscal framework, a critical imperative emerges—the need for a comprehensive and empirical examination of its impact on the nation's economic growth (Ahmed, Hussain, & Bhatti, 2022).

Revenue decentralization involves the transfer of revenue-raising authority from the central government to subnational entities. In the context of Pakistan, there has been a shift towards increased authority of local governments and provinces in terms of income generation strategies. The purpose of devolving tax collection, grants, and other revenue streams to subnational levels is to increase fiscal autonomy and improve the ability to address local needs. The impact of revenue decentralization on economic growth is contingent upon the efficient management and utilization of these resources by subnational entities. The decentralization of expenditure obligations is closely associated with revenue decentralization (Bushashe & Bayiley, 2023). The term "own-source revenue" pertains to the financial resources that are generated by subnational bodies autonomously, without relying on transfers from the central government. The government of Pakistan has advocated for local governments and provinces to enhance the diversification of their revenue sources, thereby diminishing their reliance on central grants. Own-source revenue encompasses many sources of money created at the subnational level, such as municipal taxes, fees, and other forms of revenue (Z. Khan, Ali, Dong, & Li, 2021). Financial decentralization may affect the monetary turn of events by making subnational substances more active in terms of income age and use share. In any case, researchers have not yet pinpointed the exact mechanisms that implement this impact (Zahra and Badeeb, 2022).

## 1.2 Research Problem

A number of studies have shown that central government has fallen short of meeting expectations in terms of economic development, income distribution, poverty reduction, and the provision of public goods and services (Bahl, & Bird, 2018). Since local governments have more control over the mix of public goods and services they supply, every family should be able to choose a place where they can get the public goods and services they want. The responsibility of developing policies and executing programs is now considerably higher at lower levels of government than it was before due to the increased emphasis on fiscal decentralization (Ding, McQuoid, & Karayalcin, 2019).

While the majority of research on fiscal decentralization has been done at the state level, there are a few notable exceptions. However, these investigations must also be conducted at the county level. Studies conducted at the county level are crucial since county governments now play a major role in redistribution of resources and in welfare reform-related services. Despite the growing significance of county governments little study has been done at this level particularly in the context of Pakistan (Amin, 2018). Since fiscal decentralization measures are marked by the Shoufeng (2017) — Revenue decentralization, expenditure decentralization, own-source revenue and fiscal balance — this study will fill the research gap resulting by the inconsistent results of the existing empirical results for the impact of the fiscal decentralization on economic growth in the context of Pakistan.

## 2. Literature Review and Development of Hypotheses

### 2.1 Theoretical Review

Below theories provide theoretical support to the current study.

#### 2.1.1 Neoclassical Growth Theory

The neoclassical model of Solow serves as the foundational framework for economic growth theories. According to this model, a stable equilibrium is established, wherein a constant long-term growth rate of income is dictated by the augmentation of factor endowments and technological advancements (Mankiw et al., 1992). The initial focus of

this model was on an economy that operates in a closed system, wherein the production of output (Y) is determined by two primary components of production, namely labor (L) and capital (K). In subsequent iterations of advanced models, the inclusion of human capital, government spending, and indicators of trade openness (Barro and Sala-i-Martin, 1995; 2004) has been introduced as supplementary factors influencing economic growth.

### **2.1.2 Growth Pole Theory**

In the field of local development, the post-development theory is a calculated theory that proposes the assumption that "development sinks," or major metropolitan regions, may optimally promote monetary development. This theory challenges the commonly accepted view that urban regions have a greater influence on monetary development than rural ones, with the pulling forces concentrated in cities having a disproportionately large effect. The basic premise is that financial institutions, including administrative buildings and assembly offices, are more likely to congregate in urban areas, which in turn serves as a strong incentive for financial development. Separation from rural growth characterizes this center, which presents urban centers as independent forces that drive monetary dynamism. The fast population and career growth in development roles makes them important axes that affect the local economy overall (C. Khan et al., 2021).

### **2.1.3 Neoclassical FD-Growth Models**

Fiscal policy, together with (effective) labour and capital, has long been recognized as a significant contributor in cross-country growth regressions when used with the Solow model. However, the conventional method ignored the division of budgetary responsibility among the several levels of government. Neoclassical and endogenous growth theories of the connection between FD and economic growth eventually developed. This literature's endogenous theoretical framework began earlier and has progressed much more than the neoclassical model, even though it was the starting point for all other economic growth models. Most of the time, the latter have broadened the methodology to take efficiency into consideration, differentiate between the short and long-term effects of FD on economic development, and look into transmission routes (Sasana, 2019). There are no clear theoretical references for adding an assumed growth determinate in the neoclassical growth models, thus they are seen as ad-hoc. For example, instead of looking at the direct economic effects of free trade, the endogenous growth model considers the indirect/intermediate effects of free trade (Zhang, Zhang, & Liang, 2017).

## **2.2 Empirical Review of Literature**

### **2.2.1 Impact of Revenue Decentralization on Economic Growth**

Zhang, Lu, and Xu (2019) analyzed how fiscal decentralization affected GDP growth in China between 1995 and 2015. Particularly in areas with high levels of monetary decentralization, research has shown that income decentralization may help stabilize financial markets. The states in the area argued that if they had more say over the pricing range, they could more effectively allocate assets and spend funds (Naeem, Ali and ur Rehman, 2021; Nantharath, Laochankham, Kamnuasilpa and Kang, 2020). According to the study, decentralizing currency would allow local governments to better meet the demands of their citizens, which in turn would allow for more profitable speculation and better financial outcomes. More pay decentralization means more opportunities for adjacent legislatures and other subnational organizations to determine and implement speculations according to local requirements, which benefits them, as the outcomes show. Below is the proposed hypotheses of the study  
H1: There is the significant impact of the Revenue decentralization on the economic growth of the Pakistan.

### **2.2.2 Impact of Expenditure Decentralization on Economic Growth**

Subnational governments with enhanced spending autonomy may distribute resources more efficiently and effectively react to local demands, as shown by the finding that expenditure decentralization has a beneficial influence on economic development by Liu, Huther, and Shah (2004). Also looking at OECD nations, Blöchliger and Vammalle (2014) discovered that fiscal decentralization contributed to economic growth. They contended that greater economic results would result from devolving decision-making authority over public expenditures to subnational governments. Although there is a favorable correlation between decentralizing spending and economic expansion, this is not always the case (Nguyen, Vo, Ho, & Vo, 2019). Below is the proposed hypotheses of the study

H2: There is the significant impact of the Expenditure decentralization on the economic growth of the Pakistan.

### 2.2.3 Impact of Own-Source Revenue on Economic Growth

Research on the effect of own-source revenues on GDP growth has shown a usually favorable correlation between the two. Increases in local governments' ability to raise money from their own citizens have been proved to boost economies. Revenue generation at the local level enables governments to fund local public goods, infrastructure projects, and public services, which in turn promotes economic activity and productivity (Martinez-Vazquez and McNab, 2003). Comparable results were found by Bird and Smart (2002), who looked at the provinces of Canada and found that greater amounts of own-source income were linked to better rates of economic growth (Slavinskaite, Lapinskiene, Hlawiczka, & Vasa, 2022). They maintained that when local governments have the power to impose and collect their own taxes, they can better respond to local economic circumstances and investment opportunities. Below is the proposed hypotheses of the study

H3: There is the significant impact of the Own-source revenue on the economic growth of the Pakistan.

### 2.2.4 Impact of Fiscal Balance on Economic Growth

There has been a lot of study into the link between government spending and economic development, and the results have been interesting. Keeping the government's books in the black has been shown to boost the economy. Promoting macroeconomic stability and fostering an environment favorable to long-term prosperity requires a sustainable fiscal balance, typified by cautious management of government income and expenditures (Tunio & Nabi, 2021). Because fiscal prudence encourages investment, lowers borrowing costs, and frees up government resources to be used more effectively, countries with better fiscal balances tend to have higher economic growth rates, according to research by Alesina, Campante, and Tabellini (2008). Below is the proposed hypotheses of the study

H4: There is s the significant impact of the Fiscal balance on the economic growth of the Pakistan.

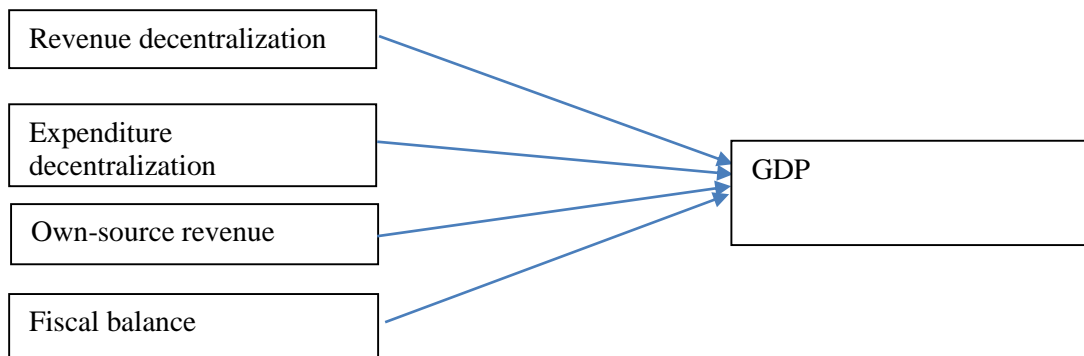
## 2.3 Conceptual Framework

### Independent Variable

Fiscal Decentralization

### Dependent Variable

Economic Growth



## 3 Methodology

### 3.1 Research Population

The purpose of this study was to examine the impact of fiscal decentralization on the economic growth of Pakistan. The research population includes data related to both the independent and dependent variables for Pakistan. To clarify, the research population refers to the dataset that includes the variables of interest for the stated period and context in Pakistan.

### 3.2 Data Collection

The current study relies on the time series data. The data for dependent and independent variables was obtained from a number of sources, including the Economic Survey of Pakistan, the OECD, the World Bank, the World

Developmental Indicators, the State Bank of the Pakistan (SBP), and so on. The data was collected between the years of 2000 and 2022, i.e., for 22 years.

### 3.3 Variables Measurement

The following table provides a concise overview of the variables and how they were measured

Table 3.1: Variables Measurement

S.no	Variable	Type of Variable	Measurement Proxy
1	Economic Growth	Dependent	Real GDP growth (at constant prices)
2	Fiscal balance	Independent	The diff between the income and spending of regional and local governments.
3	Own-source revenue	Independent	The share of total income that subnational governments get from their own sources.
4	Expenditure decentralization	Independent	The proportion of total expenditure incurred by sub-national governments in relation to the central government.
5	Revenue decentralization	Independent	The proportion of total revenue collected by sub-national governments in relation to the central government.
6	Trade openness	Control	(Exports + Imports) /GDP
7	Labor force	Control	Labour force participation rate

### 3.3 Research Model

Below is the regression model.

$$RGDP = \alpha + \beta_1FB + \beta_2OSR + \beta_3ED + \beta_4RD + \varepsilon \dots\dots\dots 1$$

While

RGDP is real GDP (Dependent variable), FB is Fiscal balance, OSR is Own-source revenue, ED is Expenditure decentralization , RD is Revenue decentralization ,  $\varepsilon$  is error term.

### 3.4 Data Analysis & Estimation Technique

Initially descriptive statistics of the data was performed to test for the normality of the data set. The initial stage in time series analysis is assessing the stationarity of the data. The selection of an estimation approach is determined based on the stability of the data. The unit root test is widely regarded as a crucial preliminary test to be conducted prior to the application of cointegration analysis. The integration order and parameter stationarity/non-stationarity may be determined using the unit root test. To evaluate the degree of integration and stationarity at various orders, such as level I (0) and first difference I (1), the Augmented Dickey Fuller (ADF) and Phillips Perron (PP) tests were used. Following stationery, and lastly, correlation test, and regression analysis were conducted. Data analysis was conducted through Eviews.

## 4 Results

### 4.1 Descriptive Analysis

The data's normality was examined using descriptive analysis. Every one of the study's independent and dependent variables had their mean, standard deviation, minimum, and maximum values examined.

Below are the results of the analysis.

Table 4.1: Descriptive Analysis

S.no	Variable	Mean	Standard Deviation	Maximum	Minimum
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1	Real GDP	5.3194	1.9990	9.0000	1.7000
2	Fiscal balance	-5.830	1.7734	-2.258	-29.641
3	Own-source revenue	15.7333	1.4283	19.2000	13.3000
4	Expenditure decentralization	0.2787	0.0474	0.2100	0.4400
5	Revenue decentralization	0.3620	0.0535	0.2800	0.4800
6	Trade openness	35.3308	3.7734	27.7198	42.7955
7	Labor force	30.4	0.8413	42.1	26.5

The studied period reveals an average growth rate of around 5.32% in terms of GDP, accompanied with a standard deviation of 1.9990. These figures suggest a modest level of economic growth with some degree of uncertainty around the mean. The fiscal balance, which denotes the disparity between the revenue and expenditure of sub-national governments, exhibits an average deficit of -5.83. The calculated standard deviation of 1.7734 indicates a degree of dispersion or variability in fiscal balances, spanning from -2.258 to -29.641. On average, sub-national governments generate approximately 15.73% of their total revenue from own-source revenue. The standard deviation of 1.4283, which is reasonably low, suggests that there is a consistent proportion of money being created independently. This proportion ranges from 13.3% to 19.2%. The average level of expenditure decentralization is 27.87%, indicating a moderate degree of decentralization. The standard deviation of 0.0474 suggests that there is low variability around this average value. The decentralization of revenue, with an average of 36.20%, demonstrates a modest level of variability, as indicated by a standard deviation of 0.0535. The range of revenue decentralization spans from 28% to 48%.

The measure of trade openness, which is determined by the ratio of total exports and imports to the gross domestic product (GDP), has an average value of 35.33%. This figure suggests a significant level of openness in trade. The calculated standard deviation of 3.7734 indicates that there is variety in the degree of trade openness, ranging from 27.7198% to 42.7955%. The labor force participation rate exhibits a mean value of 30.4%, accompanied by a standard deviation of 0.8413. This standard deviation suggests that there is relatively low variability observed around the average rate. The range of labor force participation rates spans from 26.5% to 42.1%.

#### 4.2 Unit Root and Stationary Test

In this study, Augmented Dickey-Fuller (ADF) test is conducted for the reason to test presence of the unit root in variables of the study (Hall, 1994). The null hypothesis for the ADF test was that “Ho: Series has unit root”. The below tables show the results of the ADF test for the variables of the study.

Table 4.2: Augmented Dickey-Fuller (ADF) test

Variables	At Level I(0)		At First Difference I(1)	
	t-statistics	Prob.	t-statistics	Prob.
Real GDP	-1.4896	0.2134	-8.478558	0.0126*
Fiscal balance	-1.3640	0.2201	-7.125005	0.00324*
Own-source revenue	1.036002	0.09848	7.979501	0.0345*

Expenditure decentralization	1.423206	0.5614	9.695515	0.0000*
Revenue decentralization	-1.000980	0.10355	-5.776601	0.0000*
Trade openness	-0.492094	0.8823	-6.419110	0.0000*
Labor force	-1.810889	0.3701	-6.082821	0.0000*

The test is conducted as the significance level of 5% at the level series. The test is conducted as the significance level of 5% at the first difference series. Lag length is selected through the automatic selection of Schwarz info Criterion that was having a maximum lag length = 9. ADF test was conducted through the econometric software package (Eviews). \* is indicating that the null hypothesis i.e., “Ho: Series has unit root” is rejected at 5% level of significance.

The results of the Augmented Dickey-Fuller (ADF) test for variables of the study are presented in table 4.2.

First of all, all the variables were tested as level I(0). The results indicated that all the variables were not stationary at level I(0). As shown in the above table, the value of probability for Real GDP was 0.2134 (t=-1.4896), showing that the Real GDP was insignificant and thus the null hypothesis i.e., “Ho: Series has unit root” was accepted, meaning that Real GDP was not stationary. Similarly, the values of probability for other variables i.e., Fiscal balance, Own-source revenue, Expenditure decentralization, Revenue decentralization, Trade openness and Labor force were 0.2201 (t=-1.3640), 0.09848 (t=-1.3640), 0.5614 (t=-1.423206), 0.10355 (t=-1.000980), 0.8823 (t=-0.492094), and 0.3701 (t=-1.810889) respectively, showing that these variables were also insignificant and thus the null hypothesis i.e., “Ho: Series has unit root” was accepted, meaning that these variables were also not stationary. Then at second stage, the Augmented Dickey-Fuller (ADF) test was conducted at First difference I(1). The results of the first difference indicates that all the variables were significant at first difference I(1).

As shown in the above table, the value of probability for Real GDP was 0.0126 (t=-8.478558), showing that the Real GDP was significant and thus the null hypothesis i.e., “Ho: Series has unit root” was rejected, meaning that Real GDP was stationary at first difference I(1). Similarly, the values of probability for other variables i.e., Fiscal balance, Own-source revenue, Expenditure decentralization, Revenue decentralization, Trade openness and Labor force were 0.00324 (t=-7.125005), 0.0345 (t=-7.979501), 0.0000 (t=-9.695515), 0.0000 (t=-5.776601), 0.0000 (t=-8.609692), and 0.0000 (t=-6.419110), and 0.0000 (t=-6.082821), respectively, showing that these variables were also significant at first difference I(1) and thus the null hypothesis i.e., “Ho: Series has unit root” was rejected, meaning that these variables became stationary at first difference I(1).

So, from the above discussion, based on the Augmented Dickey-Fuller (ADF) test, all the variables were not stationary at Level, but all the variables become stationary at First Difference. This shows that there is same order of integration among the selected variables. Whenever, there is same order of integration among the variables then we can apply OLS regression to the variables to examine the impact of independent variables on the dependent variable (Hall, 1994). The results of the OLS regression are presented in the below sections.

### 4.3 Correlation Analysis

An examination of the connection between the independent and dependent variables was carried out by correlation analysis prior to regression analysis. In the table below, you can see the correlation analysis findings.

Table 4.3: Correlation Analysis

Variables	Real GDP	Fiscal balance	Own-source revenue	Expenditure decentralization	Revenue decentralization	Trade openness	Labor force
Real GDP	1						
Fiscal balance	-0.01969	1					
Own-source revenue	0.045302	0.162121	1				
Expenditure decentralization	0.328828	0.381423	0.103548	1			
Revenue decentralization	0.032390	0.054501	-0.187414	-0.000985	1		
Trade openness	0.269639	0.609493	0.302952	0.208008	-0.143495	1	
Labor force	0.179645	0.015503	0.162121	-0.281848	-0.187301	0.050031	1

Above table 4.3 is showing the values of the correlation efficient. The above table shows the relationship between the dependent and dependent variables of the study. The table shows that the value of correlation coefficient between Real GDP and Fiscal balance revenue is -0.019697 showing a weak negative relationship between Real GDP and Fiscal balance. Similarly, the value of the correlation coefficient between Real GDP and Own-source revenue is .045302 showing a weak positive relationship between Real GDP and Own-source revenue. Similarly, the value of the correlation coefficient between Real GDP and Expenditure decentralization is 0.328828 showing a moderate positive relationship between Real GDP and Expenditure decentralization, while the value of the correlation coefficient between Real GDP and Revenue decentralization is 0.032390 showing a weak positive relationship between Real GDP and Revenue decentralization.

#### 4.4 Multicollinearity

One way to check for multicollinearity is to calculate the variance inflation factor (VIF). When we run the regression on the explanatory variable q across all of the other explanatory variables in the model, we get the correlation coefficient q, which we use to calculate the variance inflation factor (VIF) as  $VIF\ q = 1 / (1 - q)$ .

Table 4.3: Multicollinearity

Variable	Coefficient Variance	Uncentered VIF	Centered VIF
C	0.002263	43.87784	NA
Fiscal balance	0.012462	22.84615	1.091461
Own-source revenue	1.394505	19.13514	1.042697
Expenditure decentralization	0.007299	5.932812	1.124462
Revenue decentralization	0.002744	1.755928	1.050329
Trade openness	2.160106	5.241457	1.063519
Labor force	0.021845	1.18238	1.040720

The above table shows that as the variance inflation factor for all the variables is less than 5, which is the evidence that there is no significant multicollinearity in these explanatory variables of the study.



#### 4.5 Regression Analysis

Based on the findings of Augmented Dickey-Fuller (ADF) test, multiple regression is conducted through Pooled Ordinary Least Squares method. The results of the regression analysis are presented in the below table 4.4.

Table 4.4: Regression Analysis

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	6.895736	3.246422	2.124104	0.0313
Fiscal balance	-41.39114	16.24762	-2.547661	0.0023
Own-source revenue	18.61227	8.346791	2.229872	0.0031
Expenditure decentralization	47.37730	12.34672	3.837237	0.0017
Revenue decentralization	14.74753	7.213464	2.044444	0.0044
Trade openness	2.161507	0.924224	2.338725	0.0025
Labor force	1.344305	0.597937	2.248239	0.0318
R-squared	0.322325	Mean dependent var	5.3194	
Adjusted R-squared	0.134613	S.D. dependent var	1.9990	
S.E. of regression	0.050431	Akaike info criterion	2.715543	
Sum squared resid	0.49257	Schwarz criterion	4.131188	
Log likelihood	-25.11864	Hannan-Quinn criter.	4.822736	
F-statistic	169.142	Durbin-Watson stat	2.120175	
Prob(F-statistic)	0.013180			

Table 4.4 displays the outcomes of the regression analysis, which can be seen above. According on the data in the table, the adjusted R-squared value is 0.322325. What this indicates is that economic growth can be predicted with a 32% degree of certainty for every unit change in the independent variables (fiscal balance, own-source revenue, expenditure decentralization, and revenue decentralization). Since the Durbin-Watson value typically falls between 1.5 and 2.5, the fact that it is 2.124675 indicates that the data does not exhibit autocorrelation. With a regression coefficient of 47.37730 at the significance level of ( $p=0.0017$  and  $t=3.837237$ ), as shown in the preceding table, expenditure decentralization is a strong predictor of economic development and a major factor in that growth. Fiscal balance, own-source revenue, and revenue decentralization all have statistically significant regression coefficient values: -41.39114 for fiscal balance, 18.61227 for own-source revenue, and 14.74753 for revenue decentralization. The corresponding p-values and t-values are 0.0023, -2.229872, and 2.044444, respectively. These high numbers also demonstrate that revenue decentralization, fiscal balance, and own-source income all play important roles in driving economic development.

## 5. Conclusion and Recommendations

### 5.1 Conclusion

In the pursuit of understanding the intricate relationship between fiscal decentralization and economic growth in Pakistan, this study has unveiled significant insights that carry implications for policy formulation and governance.

The effects of fiscal balance, own-source revenue, decentralization of expenditures, and decentralization of revenues on national economic development were the primary foci of the study. Empowering subnational organizations to independently raise and manage their money has the potential to boost the economy, since there is a positive association between revenue decentralization and growth. This provides further evidence that local and regional governments can help the economy grow when given more responsibility for collecting taxes. Similarly, the research found that decentralizing expenditures contributed to economic development, albeit only slightly. This conclusion supports the idea of giving local governments more freedom to decide on their own budgets. Economic growth and better resource allocation may result from letting local organizations adjust expenditures to match regional goals. The favorable correlation with own-source income highlights the importance of subnational self-sufficiency promotion. Pakistan may strengthen its economy and better respond to opportunities and threats in the area if it gives local governments the power to earn money on their own. However, the study also shows that fiscal imbalance might have negative consequences, since it finds a negative link with economic growth. This shows how crucial it is for regional and local governments to manage their finances carefully and avoid running huge deficits if they want to remain financially stable in the future.

## 5.2 Recommendations

Below are the recommendations of the study.

- a) Given the beneficial correlation between decentralizing income and monetary development, it is prudent for policymakers to contemplate funding systems that empower subnational organizations to independently create and oversee their own revenue.
- b) Letting subnational legislatures supply money independently is necessary since own revenues and monetary development are positively related. Legislators should think about a few things to do to boost local income sources, such as using expenditure collecting strategies and encouraging local tax collection campaigns.
- c) Policymakers should customize their interventions to Pakistan's unique financial and political landscape, taking into account the clear financial components.

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