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The Theoretical Impact of Fiscal Decentralisation on National Income Inequality: Does Quality of Governance Matter?

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ABSTRACT

There are long arguments among scholars about whether fiscal decentralisation increases or reduces national income inequality. The optimistic scholars indicate that the efficiency-enhancing effects of fiscal decentralisation to reduce income inequality are more likely to occur in high-economic-level regions since they have inter-jurisdictional competition, accountability, and revenue mobilisation. While the pessimistic view emphasised that fiscal decentralisation might increase income inequality because of low governance quality, which offsets the potential efficiency gains of decentralisation. The finding of this paper is that fiscal decentralisation cannot be optimistic or pessimistic, but after screening the empirical studies, it is based on three trends: the structure and design of fiscal decentralisation, the level of economic development, and the level of governance as a mediator.

Keywords: Fiscal Decentralisation, Income Inequality, Quality of Governance
JEL Classifications: H70, D73, D33

1. INTRODUCTION

There is a widely accepted consensus that fair income distribution represents a country's welfare and living standards. Further, unequal income distribution creates a feeling of injustice that should definitely attract the attention of economic policymakers and government officials. From a political point of view, a country with higher income inequality is a source of instability that threatens social peace and unity. Inequality studies often find a trade-off between equality and economic efficiency. Therefore, there is an "acceptable" range of income disparity that may coexist with economic development; but, as inequality rises over this "optimal" level, it begins to cause numerous distortions (social, economic, and ethical) (Kyriacou, 2020).

Concerned researchers and policymakers started to question the desirability of fiscal decentralisation[1] as a key public fiscal policy to reduce national income inequality through many channels. However, the existing literature on such desirability remains substantially fragmented and ambiguous, with mixed evidence. Furthermore, interest in the function of subnational governments in economic development has resulted in an extensive body of study on fiscal decentralisation.

1 There are three dimensions of decentralisation: fiscal, administrative, and political decentralisation. (Fiscal decentralisation involves shifting fiscal responsibilities of revenue collection and expenditure execution from the central to sub-national authorities; administrative decentralisation involves assigning decision-making autonomy to sub-national units; and political decentralisation involves allowing non-government entities to participate in governance, mainly, though not solely, through local electoral processes)

(IMF, 2017) report that fiscal policy can reduce income inequality through three main channels or motives. The first motive is through government transfers and progressive direct taxes that reduce market income inequality. Second, motives depend on subsidies and indirect taxes (or consumption taxes) that can reduce disposable income inequality. The third motive is in-kind transfers (e.g., education and health) that reduce market income inequality. According to (Beramendi, 2012), fiscal decentralisation is a fiscal policy that controls income redistribution, especially for poorer regions, favouring low-income citizens in poor regions who will not spend a major portion of their income on basic needs and services, such as education, health, and infrastructure.

A wide range of empirical studies have been conducted to explore the potential impacts of fiscal decentralisation on a country's economy, including income inequality (see [Martınez-Vazquez et al., 2017] for the survey), with a disproportionate amount of studies focusing on regional inequalities, recent examples include (Lessmann, 2009); (Kyriacou and Roca-Sagale´s, 2011) and (Ezcurra, 2014). The main implication of these studies is that fiscal decentralisation tends to increase regional inequality in low-income and highly centralised countries, while it is either neutral or tends to reduce inequalities in developed countries.

There are many claims that have been made in the literature including political discussions in the Organisation for Economic Co-operation and Development (OECD) and "Developed countries" about two essential elements to ensure a successful relationship between fiscal decentralisation and national income inequality:

The first element is the institutional factors, such as the quality of governance mechanisms and their interaction with the structure and design of fiscal decentralisation policies to reduce income inequality. For instance, some scholars such as (Neyapti, 2006); (Kaufmann, 2011); (Kyriacou and Muinelo-Gallo, 2015)and (Bartolini et al., 2016) have pointed out that fiscal decentralisation may not materialise regional convergence because of governance problems at lower levels of government. The second element is the structure of "fiscal decentralisation," which is based on four important variables that design the intergovernmental transfers: Assignment of expenditure responsibilities; allocation of revenue sources; locally spent national grants; and structure of sub-national borrowing between central and local governments. To achieve better service delivery, increase social welfare, and accelerate local-level development, one has to opt for a full-scale fiscal decentralisation system based on the four fiscal decentralisation pillars to maintain optimal fiscal autonomy (Vo, 2010).

In developing and emerging countries, the relationship between fiscal decentralisation and national income inequality cannot be ensured to be successful. The fiscally decentralised methods used for thousands of years to combat inequality are infeasible in terms of allocating enough fiscal resources for redistribution. In developing countries, they face limited fiscal resources to reverse or restrain increasing inequality. Fiscal transfers and taxes have had a strong effect on redistribution in developed economies; this effect is not as strong in developing countries because they tend to have fewer fiscal resources to use for redistribution. In addition, the specialised literature indicates that the size of financial resources and their degree of decentralisation also influence income redistribution and, consequently, inequality levels (Miranda-Lescano, 2022).

These limited fiscal resources can cause drawbacks in obtaining consistent fiscal decentralisation strategies. When implementing fiscal decentralisation, there is a possibility of creating an imbalance between its various dimensions. For example, if local governments are given responsibilities or tasks that result in increasing local expenditures, they must have adequate financial resources or revenues that are equivalent to their responsibilities and duties. Additionally, fiscal decentralisation is difficult to achieve because local governments in developing nations depend heavily on financial transfers from the central government and have few opportunities to generate revenue from their own private sources. Hence, resources must be allocated and transferred in accordance with spending tasks. Another major barrier to implement fiscal decentralisation is the central government's unwillingness to transfer or entrust control to local governments (Tselios and Rodr´ıguez-Pose, 2022). Hence, dependence on the fiscal decentralisation method needs to be sufficiently examined to find out how it can be used effectively to reduce income inequality.

Accordingly, this paper was conducted to explore the association between fiscal decentralisation and the evolution of income inequalities, which can be divided into three trends:

The first trend is to focus on the structure and design of fiscal decentralisation as a prerequisite for effective income distribution, which is mostly tested in OECD countries. See, for example, (Sepulveda, 2011), (Beramendi, 2012), (Moscovich, 2014) (Stossberg, 2016), (Bartolini et al., 2016) find that revenue decentralisation increases income inequality, and this effect is strongest if only those decentralised taxes are taken into account over which local authorities have complete authority. Moreover, they conclude that both expenditure and revenue decentralisation tend to reduce disposable income inequality; regions where local expenditure is mainly financed by local revenues perform better in terms of resource use and reduce income inequality.

The second trend finds that the impact of fiscal decentralisation on income inequality depends on government size. Recent empirical studies are applied by (Lessmann, 2009); (Sepulveda, 2011) and (Ezcurra, 2014) using a panel of both developed and developing countries. They find that expenditure decentralisation increases income inequality in developing countries with small government sizes but has an inequality-reducing effect when the government size increases in wealthier countries. Similarly, in other recent studies that depend on level of economic development, (Bojanic, 2019) claims that the relationship between fiscal decentralisation and national income inequality is determined by economic development indicators, using the Human Development Index for both developed and developing countries as a mediator to enhance the relationship between the two variables. The author finds that fiscal decentralisation reduces income inequality. However, as economic development grows, the effect of decentralisation on income inequality decreases.

The third trend is empirically applied by (Neyapti, 2006), (Kyriacou et al., 2017). Those authors examined the impact of fiscal decentralisation on regional disparities for the OECD countries groups and concluded that fiscal decentralisation promotes regional convergence in countries with high-quality institutions, including corruption, law and order, and bureaucratic quality as a mediator, while in countries with poor governance, it increases regional divergence.

It is noteworthy that although this paper's focus is on the theoretical impact of fiscal decentralisation on income inequality from a pessimistic and optimistic perspective, one should not disregard the importance of governance quality in addition how fiscal decentralisation schemes are designed and implemented. The author supports the notion that fiscal decentralisation itself cannot be appealed to as good or bad, but rather, it depends on the institutional quality, good governance and incentive structure of the relevant nation.

This paper is divided into four sections. Section one addresses the conceptual framework of fiscal decentralisation, National Income inequality, and quality of governance. Section two reviews the theoretical literature review. Section three focuses on the empirical literature review, and Section four and five are findings and conclusion, consequently.

2. CONCEPTUAL FRAMEWORK

The conceptual framework addresses the general objectives, dimensions, definitions, and types of fiscal decentralisation, national income inequality, and quality of governance.

2.1. Fiscal Decentralisation

Decentralisation evolved after the post-World War II period, when the neo-liberal economic paradigm based on nonintervention gradually replaced Keynesian state intervention by centralised governments. The neo-liberal economic model dates back to Adam Smith and started to emerge again after the globalisation era because centralised governments or Keynesian policies could not face the challenges of governing the new trends of economic development. Accordingly, the notion of decentralised government evolved to decentralise the pattern of governance. This picture of decentralised governance' is quite different from the centralised governance' paradigm that represented the era of the centralised state during the Cold War period. During this period, centralised governance and the state were considered to be the engines of fair income distribution; now it is the same centralised governance and state that are considered to be the main obstacles to income distribution. As a result, policy analysts, international financial institutions, and donor countries see decentralisation of power and authority as a key to achieving greater democracy at the grassroots level (Nadeem, 2016).

In its simplest definition, decentralisation is the process of transferring decision-making power and resources from the central government to subnational governmental units.There are three dimensions of decentralisation: fiscal (delegation), administrative (deconcentration), and political (devolution or democratic decentralisation). We shall also separate our discussion of the fiscal aspects of decentralisation from that of the issues of political and administrative decentralisation. Fiscal decentralisation involves shifting fiscal responsibilities of revenue collection and expenditure execution from the central to sub-national authorities, as it represents the public finance dimension of intergovernmental relations; administrative decentralisation involves assigning decision-making autonomy to sub-national units; and political decentralisation involves allowing non-government entities to participate in governance, mainly, though not solely, through local electoral processes (Martınez-Vazquez et al., 2017).

However, the application of fiscal decentralisation often involves huge variations in terms of the ways in which these elements are designed and implemented. These variations have pushed many scholars to define these elements for successful fiscal decentralisation. For example, (Hobdari, 2018) studies the experiences of several countries that were transformed to fiscal decentralisation and draws several clarifications to define fiscal decentralisation elements, including:

1. Assignment of expenditure responsibilities refers to the distribution of functions from central government among the different local government levels and subnational levels of government should independently set their expenditure priorities on health, education, and/or public services. It improves the responsiveness of the local government to local needs, enhances accountability and avoids unproductive overlap, duplication of authority and legal challenges.
2. Allocating own source revenue, It comprises not only the capability of subnational levels of government to have sufficient revenues and the power to make decisions about expenditures, but also, perhaps more crucially, the authority to create and collect their own revenues independently from the central government. It ensures subnational autonomy, promotes accountability and ownership, realises decentralisation efficiency gains and facilitates cash flow management.
3. Intergovernmental fiscal transfers (grants), are an essential component of fiscal decentralisation and refer to the transfer of finances from the central government to lower government levels. The assignment of revenue and expenditure gives rise to a vertical imbalance, that is, a mismatch between revenue sources and the expenditure needs of local governments. In general, the revenue capacity never matches the expenditure needs, so intergovernmental fiscal transfers are often necessary to redress this vertical imbalance and assure revenue adequacy. It ensures bridging the vertical fiscal gap, improve horizontal fiscal balance and fund national priorities.
4. local borrowing for subnational governments (SNGs), stands as the fourth pillar of fiscal decentralisation and can act as a major source of revenue for local governments (LG), especially in countries where own-source revenue and intergovernmental transfers are deficient with respect to local investment requirements.

These four elements are not mutually exclusive, and any country seeking fiscal decentralisation should have all of these elements in an integrated package (Vo, 2010) and (IMF, 2017).

In this meaning of fiscal decentralisation, the four elements can have an interchangeable impact on income distribution. Therefore, it is important to maximise fiscal decentralisation to achieve an optimal mix across different years. Furthermore, not all these aspects of fiscal decentralisation operate simultaneously in any particular case, and it is quite possible that a given economy may be decentralised in some respects but not in others. The drivers behind adopting decentralisation vary from one country to another based on the political, economic, and social conditions, including economic transformation to reach democracy, supporting post-conflict areas, improving public service provision, and enhancing participation (Nadeem, 2016). In countries with a long history of centralised control, public administrators frequently mean the decentralisation of some responsibilities, primarily related to fiscal powers, to regional branch offices at the local level for implementation in a specific sector, such as health and education (Bardhan, 1996).

For example, (Purbadharmaja, 2019) addressed an empirical analysis in developing and developed countries and found that expenditure decentralisation has a negative but insignificant effect on the quality of governance institutions, while revenue decentralisation has a positive and significant effect on the quality of governance institutions. This implies that in developing countries, revenue decentralisation would result in improved quality of governance institutions as it would result in improved fiscal responsibility, whereas expenditure decentralisation would deteriorate the quality of governance institutions in terms of poor law-and-order situations, high corruption in government institutions, low bureaucratic quality, and democratic accountability.

In general, revenue decentralisation appears to improve the quality of governance institutions in both developed and developing countries; however, expenditure decentralisation may improve the quality of governance institutions in developed countries but deteriorate the quality of governance institutions in the sub-sample of developing countries.

Hence, fiscal decentralisation should be seen as a comprehensive system. The main challenge in implementing fiscal decentralisation is no longer how much income the poorer regions have; rather, it must be supported by good-quality human resources who are able to interact and adapt to the real conditions of society while building partnerships with outsiders to use the funds distributed as best as possible. For instance, the regional income and expenditure budget allocation seems to be related to the corrupt behaviour of politicians and bureaucrats, where the expenditure process that gives more lucrative opportunities for corruption is more preferable. Hence, the role of good governance in regional governance is very important (Prud'Homme, 1995).

2.2. National Income Inequality

Economic inequality defines in general the differences among individuals or groups in a given population, which may be regional, national, or international, as regards wealth, resources, income, or opportunities. Economic inequality can be interpersonal or inter-group across social groups such as race, ethnicity, or religion. While the former generally refers to income or wealth differences among households.It is also important to note that income inequality has a different definition than poverty. Income inequality is about the wealth distribution among individuals, but poverty is about people living below a specific income level to meet basic human needs. Income inequality refers to the overall distribution of income across different income groups, while poverty refers to the distribution of income among the lowest income groups (Bertola and Williamson, 2017).

When referring to income inequality, there are two types: Structural inequality and market inequality (market inequality is also known as gross inequality). Structural inequality emerges when the written law ensures equal treatment between groups and, thus, good governance; however, in practise, this cannot be applied. In contrast, market inequality arises when income and wealth diverge in the context of voluntary market exchange. It can be the product of hard work, but it can also be the result of a variety of factors beyond one's control. For example, two people who are not legally discriminated against because of their skin colour may diverge economically if they do not have equal access to the resources required to develop their abilities (Kyriacou, 2020).

Alternatively, two individuals with the same dejure rights and similar initial endowments may have different incomes over time due to differences in innate capacities, personality traits, cultures, levels of effort, or simply beneficial or harmful luck. However, equal opportunity policies, such as those in public health and education, can reduce market inequality by mitigating the impact of uncontrollable factors. However, public policy can reduce market inequality by redistributing income and wealth through progressive redistributive policies on both the revenue and expenditure sides, such as decentralisation policies (Kyriacou, 2020).

The ultimate interest in the concept of income inequality is grounded in social, economic, and political objectives:

1. The first objective is that income inequality may be linked to social impact. For example, income is considered a proxy for well-being. Then, the social impact of income inequality is now increasingly well converted into health and social problems, such as, life expectancy and infant mortality, mental illness, drug use, obesity, child well-being, lower educational achievements, homicides, and imprisonment rates.
2. The second objective of being interested in income inequality is that it may have an economic impact. Income inequality has the potential to stifle economic growth. Empirical studies mentioned by (Kyriacou, 2020) use a large number of country-year observations from both developed and developing countries to demonstrate that higher net (after tax and transfer) inequality, as measured by the Gini index, is associated with lower growth. Since household income determines a person's standard of living, this paper focuses on household inequality in income. We are interested in both pre-tax and transfer inequality as well as redistribution via the

tax and transfer systems (De Ferranti, 2004). Poorer people, for example, have less access to capital and have higher fertility rates. As a result, they invest less in human capital, which harms economic growth. However, the redistribution mechanism in fiscal decentralisation may promote growth insofar as this redistribution finances public spending areas such as infrastructure, education, and health.

3. The third objective is the political impact of income inequality on the democratic system: "Economic inequality leads to political inequality, and political inequality leads to rewriting the rules to increase the level of economic inequality even more, and so on." As a result, people are becoming increasingly disillusioned with our democracy. However, high levels of income inequality may lead to redistributive pressures that are expected to emerge in the normal course of democratic politics through the decentralisation process (Atkinson, 2014). Most of these concepts revolve around the principles of the "social fairness" approach.

2.3. Quality of Governance

There is some overlap in the published literature between the ideas of institutional quality on the one hand and governance quality on the other. Most authors use the terms institutional quality and the quality of governance interchangeably. Since the early 1990s, the World Bank has actively promoted this idea of good governance. The most common definition of governance is the World Bank's: "The manner in which power is exercised in the management of a country's economic and social resources for development." The World Bank also refers to good governance as "sound development management" and considers it "critical to developing and maintaining an environment that encourages robust and equitable development, as well as a necessary complement to solid economic policy (Azfar, 2018)."

Similarly, (Kaufmann, 2011) defines governance as a development agenda based on promoting things such as the traditions and institutions by which authority in a country is exercised. This includes (a) the process by which governments are selected, monitored, and replaced; (b) the capacity of the government to effectively formulate and implement sound policies; and (c) the respect of citizens and the state for the institutions that govern economic and social interactions among them.

Historically, according to Max Weber (1922), good governance has been characterised as impartial governance, or more specifically, rational authority, wherein people obey superiors not as individuals but as members of an organisation due to the unemotional bureaucratic relationships that such authority implies. For government to be rational, "everyone in the same practical circumstance" must be treated the same. In contrast, under inspirational and conventional forms of leadership, one's fate depends on things like one's social standing, the attitudes of those in charge, and the strength of one's personal relationships with them. From a Weberian viewpoint, effective governance is related to written law. However, from a long-term historical perspective, written law has neither been a necessary nor sufficient condition for equal treatment; there is nothing inherent in formal law that secures equal treatment across social groups.

Rather than impartiality, Francis Fukumaya (2013) argued that "a government's ability to make and enforce rules such as raising taxes, which includes tax compliance by citizens, and to deliver services, regardless of whether that government is democratic or not," is a better indicator of good governance than impartiality. It follows that the degree of democracy is not a criterion for good government. Where actual measurements indicate that there are democratic nations with poor governance and non-democracies with strong governance. The focus on tax capacity here clearly differs from "impartiality." Thus, governance quality arose as a development objective centred on strengthening state capacity and bureaucratic autonomy. State capacity refers to institutional capacity, which includes the ability to generate taxes, educate and professionalise public officials, and develop autonomous civil workers.

Civil society is a big part of the "good governance" paradigm. In this situation, a strong civil society has become a sign of democracy. When a bureaucracy is not autonomous and is under the control of politicians, a government's quality is poor. For instance, if politicians continue to give more and more kinds of orders, the bureaucracy will lose some of its independence. Fukumaya says that state capacity is linked to the idea of "impartiality," which means that hiring public servants can't be based on personal, ideological, or group factors.Both of these definitions include democracy as part of good governance and, as such, diverge from those previously presented.

On the other hand, the reference to property rights protection, control of corruption, and respect of citizens and the state for institutions overlaps with governance-as-impartiality, while tax compliance and government capacity clearly coincide with Fukuyuma's approach.

But North's well-known definition of institutions from 1991 states that they are "human-made political, economic, and social constraints." They include both unwritten rules (such as prohibitions, taboos, customs, traditions, and codes of conduct) and written ones (such as constitutions, laws, and property rights).

In this sense, institutions contribute more to the quality of government. For instance, formal protection of property rights and de jure institutional restrictions may contribute to improved governance, but they do not necessarily indicate the extent to which these formal norms are truly implemented. Informal norms and, more broadly, cultural characteristics may impact the extent to which the government operates impartially, including respect for the rule of law, corruption control, and redistributive employment (Kyriacou, 2020).

Finally, governance matters for social welfare. Better-governed countries are richer, happier, and have fewer social and environmental problems. Good governance implies that public sector agents act or exercise their authority impartially," or, in other words, without regard to personal relationships, political affinity, or how powerful they are, and instead take decisions and select qualified public administrators based on laws and policies. Hence, the absence of impartiality implies corruption or the misuse of public office for private and political gain, since it means that public authorities are acting in their own specific interests (Nadeem, 2016).

3. THEORETICAL LITERATURE REVIEW

The arguments concerning the impact of fiscal decentralisation on income inequality are ambiguous. For this study's purpose, this section will investigate the theoretical impact of fiscal decentralisation on national income inequality and explain why fiscal decentralisation may either reduce or increase income inequality across countries from an optimistic and pessimistic perspective.

3.1. Fiscal Decentralisation and National Income Inequality: Theoretical Optimistic Relationship

The conceptual framework provided above constitutes a good starting point to discuss the optimistic relationship between fiscal decentralisation and fair income distribution. A core assumption linking fiscal decentralisation and fair income distribution relies on optimistic assumptions such as, inter-jurisdictional competition, revenue mobilisation, and greater accountability.

3.1.1. First optimistic theoretical principle: Inter-jurisdictional competition

The first optimistic theoretical principle emerged through the classical theory of fiscal federalism, named the "first generation theory" of decentralisation, which started around the 1950s and 1960s. It suggests many benefits from the direct impact of decentralised governments on different economic outcomes. The founders of this theory start to recognise the important role of sub-central authorities in implementing redistributive policies and improving the distribution of individual income and justify decentralisation policy as a particularly beneficial way directly reduce inequalities, favouring low income citizens who will not spend a major portion of their income on basic needs and services provided by local (De Mello, 2003).

Driving back to economic history, (Tiebout, 1956) encourages the decentralised provision of public goods and services, building upon inter-jurisdictional competition. This inter-regional competition can foster vigorous resource mobilisation, here o□cials can use their knowledge of local conditions to formulate policies that attract skilled labor and capital. For instance, decentralisation puts pressure on subnational governments to be efficient because local governments implicitly compete with other jurisdictions for mobile factors of production. As one jurisdiction improves in providing local public goods and services to its population, it becomes more attractive to capital and workers, thereby increasing its economic development potential, as well as its tax base and spending capacity. In the long run, decentralisation should reduce income inequality and the effectiveness of providing services across all jurisdictions, with beneficial effects for national economic development (Cibils et al., 2015).

In this way, the need to reduce income inequality across countries has placed fiscal decentralisation at the forefront, aimed at fostering the quality and efficiency of government spending for service delivery and relying on the allocative efficiency gains of resource mobilisation. Hence, local governments are more efficient than central governments because the centralised system may lead to an unequal distribution of public resources by improperly favouring regions that have greater political influence. Accordingly, it is worth noting that the allocative efficiency of resource mobilisation is the main advantage and key strength of fiscal decentralisation policies to induce inter-jurisdictional competition.

3.1.2. The second optimistic theoretical principle: Accountability

Afterwards, Wallace Oates (1972) introduced the notion of increasing decentralised fiscal capacity to local governments, which can result in the transfer of power over funds to the local government and, hence, empower sub-national governments in the decision-making process. Providing local governments with decision-making power enhances accountability or governance quality and thereby increases "social welfare" through efficient public service delivery and resource allocation (Oates, 1972). Moreover, (Qian, 1997) ensures that sub-national governments can play an essential role in generating a more balanced distribution of income across regions than the central government.

Furthermore, (Bardhan, 2002) considered fiscal decentralisation as a self-process that directly promotes accountability, governance, better-informed local governments, and competition among the subnational governments, thereby decreasing income inequality. Bardhan justifies two basic perceptions of decentralised government that can directly induce accountability.

a. First, inhabitants can better supervise the behaviour of public officials when they live in the same local region as the central government, which is based in the distant national capital.
b. Second, local government officials are in a better position to judge what citizens want if they represent small communities and are more accountable when they are closer to what the people need. In other words, "each public service should be provided by the jurisdiction having control over the minimum geographic area that would internalise the benefits and costs of such a provision." This famous theorem states that local governments understand the concerns of local residents better than centralised regimes.

Accordingly, fiscal decentralisation can reduce corruption by empowering better-informed local governments and promoting inter-jurisdictional competition that has power over the central government. This literature also suggests that local officials usually have more flexibility compared to national decision-makers due to their distance from the central government and its rigid bureaucracy. The reason for this may be that federal states typically have a lower degree of corruption due to competition among governments.

Hence, if subnational governmental units seek to maximise social welfare within their jurisdictions and residents prefer a more equal income distribution, then decentralisation would allow for more targeted and hence more efficient efforts in reducing inequality only if it increased transparency and accountability, which would potentially empower disadvantaged groups and limit corruption.

Furthermore, the level of accountability is the main candidate for a positive impact of expenditure decentralisation on regional inequality (Tanzi, 1988); (Tanzi, 2002).

3.1.3. The third optimistic theoretical principle: Revenue mobilisation

The third theoretical principle of the relationship between fiscal decentralisation and national income inequality reduction evolved from the expected positive impact of fiscal decentralisation to an increase in the overall rate of revenue mobilisation at the local level. Along the core theme, the "Fiscal Interest Approach" is significant literature on fiscal federalism that identifies how fiscal mobility could be an incentive for subnational political officials that affects their policy choice and hence their jurisdictional performance. However, this approach can only be attained effectively if the local government is financially dependent on local resources or local revenue (rather than central or national resources) and has the discretion to act on its own decisions on public services (Weingast, 2006).

Fiscal decentralisation deals with income inequality through revenue mobilisation, which can result in the transfer of power over funds to the local government and, hence, empower sub-national governments in the decision-making process to finance their subnational expenditures from their own source of revenues. In this way, revenue mobilisation through fiscal decentralisation leads to a greater willingness to pay local taxes since local citizens receive services they satisfy. This is much more easily established with local taxes than with centralised taxes, since at local levels people can more easily see the connection between taxes and services (Shahzad and Yasmin, 2016). Hence, a sound revenue system for sub-national governments is an essential precondition for the success of fiscal decentralisation.

Revenue mobilisation also has the potential to increase overall national revenue by allowing better exploitation of revenue sources through local property or sales taxes. These taxes together reflect the municipality's capability in generating income, which would likely be neglected or administered less effectively at the central government level (Cibils et al., 2015). Despite regional inconsistencies in tax bases, local demands and needs are best met through local revenue mobilisation rather than grants and transfers from higher levels of government, so as to strengthen the link between costs and benefits of local service delivery. Moreover, local revenue mobilisation is also associated with social capital development at the local level and stronger accountability in local government (Ahmad, 2002).

Local revenue mobilisation reflects efforts to reduce the dependency of lower levels of government on grants and transfers from higher levels of government. Hence, it can reduce vertical fiscal imbalance and foster transparency and accountability in public finances with greater social control and civil society participation in service delivery. Accordingly, local governments can bear the full financial consequences of their policy decisions; hence, in a context of hard budget constraints, the independence of central government transfers may increase the expected results from fiscal decentralisation and, as a consequence, increase local tax compliance by enhancing the connection between local authorities and taxpayers and, accordingly, increase local revenue mobilisation.

The sources of revenues for subnational governments can be increased by borrowing from the public and private sectors to finance their expenditure obligations. Loans from government financial institutions can be subsidised. For self-financing projects where costs can be recovered from the users of services, private borrowing through loans or bonds is the most efficient way to mobilise resources. A well-designed regulatory framework should be in place for borrowing from capital markets. Moreover, to curb excessive borrowing by subnational governments and avoid defaults on loan repayments, limits on the borrowing ability of subnational governments can be imposed. This is important for controlling public debt and achieving macroeconomic stability. Any design of decentralisation measures must follow a proper sequence if it is to be successful. To begin with, the responsibilities of subnational governments, keeping in view their capacities, should be decided in order to determine their expenditure requirements; then, sources of revenues should be identified and allocated (Sanogo, 2017).

3.2. Fiscal Decentralisation and National Income Inequality: Theoretical Pessimistic Relationship

This sympathetic outlook on fiscal decentralisation has not remained without criticism, and decentralisation can have the opposite effect and somewhat exacerbate income inequalities. In this context, sceptics put a question on the validity of the "fiscal decentralisation theorem." A new strand of literature emerged to answer this question, focusing on the dark side of decentralisation, its underlying theoretical pitfalls and unrealistic assumptions, and highlighting the threats arising from ineffective implementation (Saito, 2012).

3.2.1. First pessimistic theoretical principle: Hazardous Inter-jurisdictional competition

Indeed, (Musgrave and Peacock, 1958) found that inter-jurisdictional competition could not be a solution for improving the distribution of individual income. The author mentioned in his book "The Theory of Public Finance" that sub-national governments could not have the fiscal strength and capacity of resources to "control" income inequalities, especially in poorer regions of less developed countries. In this case, fiscal decentralisation cannot narrow income inequalities because of the hazards of competition among subnational governments, especially in wealthier regions that have strong fiscal resources and can outcompete poorer regions.

Moreover, (Prud'Homme, 1995) emphasised that relative to poorer jurisdictions, more rich areas with access to more extensive tax bases are likely to be more adept at providing higher levels of public goods or the same quantity and quality of public services at lower tax rates. Local governments can face the problem of a shifting tax base. In other words, if a local government imposes heavy taxes for redistributive purposes, taxpayers can move to other parts of the country where local taxes are low. Therefore, a local government may not be able to achieve its desired objective. In sum, central governments should have a greater role in mobilising resources for redistribution and poverty reduction. A major share of these resources can be passed on to local governments to achieve better results in terms of the delivery of goods and services to the poor.

In this case, decentralisation induced competition may exacerbate existing regional disparities as mobile factors of production relocate to more wealthy regions that provide better socio-economic infrastructure and qualified human capital at lower comparative costs. Hence, if governments aim to equalize living standards across regions, the tax-transfer-scheme should be implemented at the central level. It is because the local authorities are considered to be weak and inefficient in developing countries with lack relevant expertise to implement the desired policies and strategies for human development.

3.2.2. Second pessimistic theoretical principle: Absence of Accountability

The second limitation of the relationship between fiscal decentralisation and national income inequality is based on the idea that the absence of accountability and transparency in local governance makes governments less responsive to their societies and increases the corruption rate significantly. This eventually reduces the efficiency of redistribution mechanisms in public service by reducing the positive effects of decentralisation and can increase poverty and income inequality. The results of doing so may not guarantee that the poor will gain access to basic services. In light of this limitation, (Treisman, 2000) argue against (Oates, 1972) "fiscal theorem", which relies on assigning decision making responsibility or more resources to lower levels of government, because it may worsen the level of corruption and administrative quality, therefore increasing the level of income inequality. For example, more levels of government provide more opportunities for abuse of office or interest groups, principally as sub-national government leaders may be less trained and high-jack states to improve their position.

Furthermore, fiscal decentralisation might be dangerous for enhancing accountability. The simplest analysis believes that when inequality increases, rich people have more motivation and a higher opportunity to participate in corrupt activity. In a society with higher income inequality, rich people use their economic resources as a political instrument to maintain their opportunities and increase their interests. This can be done through corrupt activities to change public policy, satisfying their benefits. Hence, it is recognized the possibility that officials in less well-governed countries may resist fiscal decentralisation to maintain their access to public resources. Corrupt public officials may "shake down" poorer people for bribes and accept bribes from economic elites in exchange for policies that worsen the distribution of income. Moreover, voters are less likely to support redistributive programmes, such as fiscal decentralization policy, if they perceive the public sector to be biased, inefficient and corrupt (Treisman, 2000).

An additional reason for this undermining is that in many countries, as one would expect, local institutions are less developed than national ones. As a consequence, their ability to control abuses of power by public employees and officials is more limited than at the national level. Many factors can account for this difference in the quality of institutions at the national and subnational levels. For one thing, the brightest and best-trained people tend to join the national government, where their career prospects and salaries tend to be higher; national governments are therefore more likely to be able to create more transparent and accountable public administrations. Furthermore, foreign technical assistance from international institutions and industrial countries is generally provided to the national governments of developing countries and not to the local governments (Tanzi, 2002).

Regarding the argument of Bardhan that assumes local government officials are in a better position to judge what citizens want and thereby induce accountability, (Prud'Homme, 1995) finds that it is better to satisfy the needs instead of focusing on the preferences, as the needs are universal and do not vary significantly across regions. Hence, the central government will be more suitable for the provision of these goods as compared to the local government.

Furthermore, if countries in the region are still facing corruption, the quality of service delivery and resource allocation has not made much improvement despite some critical progress in fiscal decentralisation or assigning fiscal responsibility and accountability. Corruption may impact the poor in many ways. It may impact the sectoral allocation of public resources. For example, it can worsen income distribution by diverting resources from social sectors and infrastructure maintenance to defence and war expenditures. It can also impact geographically, that is, on inter-jurisdictional distribution, by diverting resources away from needy areas (Rodr´iguez-Pose, 2004).

In East Asian countries such as Indonesia and the Philippines, decentralisation could not achieve the desired goals. Decentralisation increased corruption and policy uncertainty across different levels of government and promoted organisations and groups that were not accountable and evaded the rule of law. Further, the design of institutional change resulted in unintended consequences. Decentralisation brought social and institutional changes that eventually led to social conflict in local areas of power. In South Asia, decentralisation in countries such as Bangladesh has also been a failure. The local governments' performance has been disappointing. Decentralisation significantly increased corruption (Malik, 2019). Furthermore, due to poor governance in developing countries, fiscal decentralisation suffers from wasteful duplication of expenditure in the same areas of spending functions among the different levels of government or co-sharing responsibilities and an increase in the cost burden of public service provisions such as the basic infrastructure and urban development services for the private sector (Cibils et al., 2015).

Furthermore, controlling corruption through the relationships between fiscal decentralisation and national income inequality is crucial to "ensure access for public service delivery" and promote income convergence. Moreover, (Ezcurra, 2014) argues that both the effectiveness of regional development strategies (which include the efficiency of public service delivery) and the capacity of regions to attract foreign direct investment (FDI) are likely to be negatively affected by poor governance. Their empirical evidence documents the positive impact of government quality on regional convergence. Hence, fiscal decentralisation, if properly structured with good quality of governance and prevailing institutions, can lead to an equitable distribution of public resources, increase local citizen productivity, and afterwards promote income convergence.

3.2.3. Third pessimistic theoretical principle: Unequal revenue mobilization

Turning to the third challenge, the pessimistic view argues against revenue mobilisation because its capacity is unequal across municipalities and concentrated in large municipalities and state capitals, because jurisdictions vary in resource endowments and have different fiscal capacities and different preferences for redistribution. Therefore, resource differences will lead to disparities in income.

Moreover, lack of freedom to mobilise own revenues, the precondition for sound fiscal decentralisation is the allocation of own sources of revenue to local governments and giving them full freedom to levy, collect, and revise rates of taxes and non-tax items. To reduce their dependence on tied-transfer funds and become more autonomous.

Hence, local governments should focus on mobilising their own revenues, where empirical studies suggest that partial and distorted fiscal decentralisation won't improve performance. To achieve better service delivery, increase social welfare, and accelerate local level development, one has to opt for a full-scale fiscal decentralisation system based on four pillars: expenditure assignment, revenue assignment, sound intergovernmental transfers, and subnational borrowing.

Implementing or improving transfer systems aimed at balancing revenue capacities and spending needs must go hand in hand with reforms to strengthen the mobilisation of subnational own-source revenue. In order to have a sound intergovernmental relations system, it is important to consider the distribution of revenue capacities within a country, which are typically quite uneven and frequently do not match the distribution of spending needs.

Central governments need to support subnational governments in mobilising own-source revenue through policy and administrative reforms. Unfortunately, central governments are often a major obstacle to developing own-source revenue because they fear loose fiscal control, political bargaining power, and bureaucratic influence (Cibils et al., 2015).

3.2.4. Findings

This theoretical part proves that the relationship between fiscal decentralisation and national income inequality cannot be optimistic or pessimistic, but that governance conditions are needed to mediate this relationship. This previous optimism rested on the ease with which decentralisation would lead to effective governance that reflected the experience and conditions in high economic regions. In these countries, the assumptions of relatively good governance, effective subnational governments, and politically alert and mobile electorates, facilitated decentralisation. However, the more recent literature on decentralization, has questioned the realism of those assumptions, especially in low-income regions. Indeed, most critical studies against decentralisation theories stem from the findings in developing and least developed countries; however, not many studies underline a causal pathway between the level of income and the outcome of decentralisation. Rather, these critical studies mostly underscore the quality of governance in cross-country studies that hinder the effective control of these potential exogenous influences on the relationship between decentralisation and fair income distribution (Tanzi, 2002).

Having established the fact that fiscal decentralisation might support national income distribution, it is crucial to analyse the important role of good governance in mediating the relationship between fiscal decentralisation and national income inequality.

3.3. Fiscal Decentralisation and National Income Inequality: Importance of Quality of Governance Mediators

In 1990s, a new strand of literature emerged called "Second Generation Fiscal Federalism." The core idea of the second generation is that fiscal decentralisation is not a self-sustaining process. These findings helped a 'second generation theory of fiscal federalism emerge, which is essentially oriented towards a political economy and institutional perspective approach. Moving beyond normative and idealised assumptions, it is clear that more research is needed for a systematic understanding of this popular policy. In other words, it cannot directly impact economic outcomes, but the quality of institutions matters for effective fiscal decentralization's success. For example, local governments exist within the broader surroundings of institutional settings that highly affect officials' motives and performance. Public officials are not benevolent policymakers who aim at maximising social welfare; they rather aim at maximising their own welfare, subject to the constraints imposed on them by the legal, political, and administrative institutions. These findings helped a second-generation theory of fiscal federalism emerge, which is essentially oriented towards a political economy and institutional perspective approach and moves beyond normative and idealised assumptions. It is clear that more research is needed for systematic understanding of this popular policy (Saito, 2012).

Therefore, the institutional framework is the main determinant of the incentive structure and, consequently, the main driver of the whole decentralisation programme and fiscal outcomes. And as countries differ in their institutional settings, their fiscal and economic performance differs, even if they adopt similar decentralisation schemes. Hence, the second generation theory emphasised the relevance of establishing the appropriate institutional structure, and explicitly explored the different opportunities and threats arising in different institutional frameworks and their final impact on decentralisation programme outcomes, highlighting that the absence of required institutions might lead to adverse fiscal position rather than enhancing fiscal management (Oates, 2005).

In this vein, Weingast is an expert in the first camp who developed the "Comparative Theory of Decentralised Governance," which supports the notion that fiscal decentralisation itself cannot be appealed to as good or bad but rather depends on the institutional quality, good governance, and incentive structure of the relevant nation.

(Weingast, 2006) theory examines the conditions and incentives facing political officials and determines a set of conditions that a market-preserving federalism should meet. These conditions include the prevalence of a hierarchy, subnational autonomy, a common market, hard budget constraints, and institutionalised authority.

Other things that can cause a soft budget constraint are weak or highly discretionary subnational borrowing control mechanisms, subnational fiscal rules that aren't clear or aren't enforced well, ambiguous expenditure assignments, and unfunded central government mandates. Hence, Fiscal decentralisation is not a panacea. It has its advantages and disadvantages. The overall impact of fiscal decentralisation on national income inequality depends critically on its design and prevailing governance arrangements.

Additionally, (Ahmad, 2002) and (Malik, 2008) suggest that the expected benefits of decentralisation are based on the assumption that regular democratic elections of local governments will help people to elect better representatives who will work to improve the quality of life in their jurisdictions over time and encourage participation of local communities in policy-making progress through local elections or federalist government structures.

Moreover, tax and expenditure policies that are pre-defined or pre-determined and implemented by locally elected officials constitute a very different system from one in which such powers are granted to governors, mayors, or other officials who are appointed by the central government, even if that government is democratically elected. When devolution of fiscal authority is accompanied by devolution of political authority and legitimacy, there is a priori reason to suppose greater citizen participation in local governmental decision-making that enhances revenue mobilisation (Azfar, 2018).

However (Tanzi, 2002); (Kyriacou and Muinelo-Gallo, 2015) recognize the possibility that corrupted officials may resist fiscal decentralisation to maintain their access to public resources. Therefore, the dangers and threats of decentralization need to be tackled more obviously afterwards, and the rules and prerequisites for effective design and implementation gained increasing attention in public finance writings. This undermining relationship between fiscal decentralization and governance might have undesirable equity consequences, particularly on the income distribution side. Accordingly, (Tanzi, 2002) sheds light on the important role of governance quality to regulate the process of fiscal decentralisation.

4. EMPIRICAL LITERATURE REVIEW

This paper divided the empirical literature it into three trends that shape the research on the relationship between fiscal decentralisation and national income inequality.

1. The first trend focuses on the structure and design of fiscal decentralisation as a condition for effective income distribution.
2. The second trend focuses on the state of countries that implement fiscal decentralisation policies, whether they have high or low economic development.
3. The third trend highlights the role of quality of governance as an important mediator for effective fiscal decentralisation policies that could reduce national income inequality.

4.1. The First Empirical Trend Assesses the Success of Fiscal Decentralisation and National income Inequality: The Design and Structure of Fiscal Decentralisation

The first trend assesses the optimistic relationship between fiscal decentralisation and national income inequality that depends on the design and types of fiscal decentralisation. This trend expands to simultaneously cover revenue decentralisation, expenditure decentralisation, and tax decentralisation and their effect on the outcomes of specific income inequality reduction schemes or on national income inequality measures within a particular jurisdiction.

The empirical studies that work on both expenditure and revenue indicators were applied mostly in developed countries. The writings presented by (Musgrave and Peacock, 1958); (Prud'Homme, 1995); (Weingast, 2006) perfectly presents the first trend. (Goerl, 2014) confirms the importance of both types of fiscal decentralisation (expenditure and revenue decentralisation) and government size using a panel of a mix of developed and developing countries from 1980 onwards. The author finds that the interaction between expenditure decentralisation and government size reduces income inequalities, suggesting that sub-national dependency on transfers from other levels of government raises inequality. Thus, if revenue and expenditure assignment do eventually lead to the perceived level of efficiency, there will be an agreement to adopt fiscal decentralisation policy that poses national tax systems risks with generating equivalent benefits, such as altering fair income distribution. On the long run, the efficient allocation of resources and possible dumping of vital areas of expenditure programmes that target the poorest local governments might promote the distribution of income across decentralised jurisdictions and help determine a fair way to raise the revenues to be redistributed (Sanogo, 2017).

Furthermore, (Sacchi, 2011) assesses the effect of seven different indexes of fiscal decentralisation that take into account the real autonomy of sub-national governments. They find that revenue decentralisation increases income inequality and that this effect is strongest if only those decentralised taxes are taken into account over which local authorities have complete authority. Moreover, (Martinez-Vazquez and Sepulveda, 2011), shed some light on the types of fiscal decentralisation effects on income inequalities. For example, expenditure decentralisation may lead to higher income inequalities in developing and emerging economies. Revenue decentralisation may have a negative impact on income inequality if it causes a change in the national structure of revenue tools. Standard revenue categories of sub-central governments (SCGs) tend to be less progressive or can even be ordinarily regressive, such as property taxes and user fees. If decentralisation leads to a more substantial reliance on these instruments, the overall progressiveness of the tax system might be reduced, leading to higher income inequality.

Pablo Beramendi and Melissa Rogers, in 'Fiscal decentralisation and the distributive incidence of the Great Recession' (Beramendi, 2012), focus on the relationship between decentralisation and inequality. Using data from 21 OECD countries in the years following the Great Recession, they find that fiscally decentralised at expenditure nations saw increased interpersonal inequality and lower redistribution, but lower interpersonal inequality with tax revenue decentralisation.

(Stossberg, 2016) empirically investigates the relationship between fiscal decentralisation and national income inequality. Drawing on a dataset of up to 20 OECD countries over a period from 1996 to 2011, spending and revenue decentralisation tend to reduce disposable income inequality, but the impact is somewhat weak in magnitude and significance. For instance, an increase in expenditure decentralisation by ten percentage points leads to a reduction of the (between 0 and one-ranging) Gini coefficient of roughly 0.01.

(Bartolini et al., 2016) found that regions where local spending is mainly financed by local revenues perform better in terms of resource use and reduce income inequality. Since decentralisation tends to be associated with a reduction in income inequality between high incomes and the median, it is linked to a divergence of low income groups from the median.

These writings are considered traditional decentralisation literature because they focus on the direct impact of fiscal decentralisation on national income inequality by facilitating access to basic services. However, in fact, most empirical results show a negative and significant relationship for OECD and developed countries. None of these writings specifically addresses these relationships within a broader framework include developing countries.

4.2. The Second Empirical Trend Assesses the Success of Fiscal Decentralisation and National Income Inequality: Based on Country Type and Level of Economic Development

(Sacchi, 2011) and (Martinez-Vazquez and Sepulveda, 2011) address the relationship in a broader framework by explicitly considering that the association between fiscal decentralisation and the evolution of income inequalities varies significantly and based on different channels. List some channels through which fiscal decentralisation might affect income inequality indirectly. These are economic growth, stable macroeconomic conditions in terms of stability in prices, budget deficit, and exchange rate, and the size of government intervention into the economy.

For example, beyond the restraining effects that fiscal decentralisation may have on national income inequality, such an impact may depend on the type of fiscal decentralisation. For example, (Martinez-Vazquez and Sepulveda, 2011) conjectures the impact of fiscal decentralisation on income inequality. Using a panel of both developed and developing countries over the period 1971-2000, they find that expenditure decentralisation increases income inequality in countries with small government sizes and low levels of economic development but has an inequality-reducing effect when the government size is 20 percent of GDP.

Furthermore, (Bojanic, 2019) use a panel data set of OECD and non-OECD countries spanning from 1980 to 2016 to investigate the effects of decentralisation on income inequality. He finds that the effects of fiscal, administrative, and political decentralisation on inequality both individually and in interaction. Moreover, the author tested for a moderating effect of economic development using the Human Development Index. The result is that decentralisation reduces income inequality, but the effect diminishes and eventually reverses as economic development increases.

4.3. The Third Empirical Trend Between Fiscal Decentralisation and National Income Inequality: Quality of Governance Conditional Mediator

The third trend incorporates the effect of fiscal decentralisation on national income inequality through institutional development or quality of governance, which is considered rare in the literature. Governance characteristics-political and institutional aspects of a nation-that are influenced by public policies and afterwards affect income inequality need special consideration to draw some overall judgement about the desirability of fiscal decentralisation. These effects have not been considered in different studies with appropriate control variables. This section critically reviews major debates around "quality of governance" and "decentralisation" (local governance). The concept of governance quality was added to the decentralisation agenda after the failure of structural criteria in the decentralisation process in developing countries.

Accordingly, this literature broadens the scope of assessment by displaying the indirect impact of fiscal decentralisation on income inequality via different channels and determining whether this relationship is moderated by the level of quality of governance that can be complemented by a sound institutional structure. Further, (Gupta, 2002) used cross-sectional data from 37 countries and found a significant positive impact of corruption on income inequality.

In this type of literature, governance factors are introduced as major determinants of the outcomes of decentralization. For instance, (Neyapti, 2006) in an early empirical attempt to assess the effect of fiscal federalism in combination with the quality of governance on income distribution, based on a mainly cross-sectional sample of 37 countries from the OECD and LAC. Neyapti found that revenue decentralisation has a decreasing effect on inequality if combined with good governance in the form of control of corruption, the rule of law, political stability, governmental efficiency, voice and accountability, and regulatory quality. This demonstrates the importance of controlling for different factors that may affect the decentralisation-inequality relationship: in this case, the impact of revenue decentralisation is mediated by the quality of public institutions. However, revenue decentralisation measures do not perfectly capture the entire range of meanings included in the concept of fiscal autonomy of sub-national governments, such as the three dimensions of fiscal decentralisation, which include revenue, expenditure, and tax decentralisation.

Moreover, (Lessmann, 2009) literature also focuses on the fact that decentralisation tends to increase disparities in developing countries and reduce disparities in high income countries. Because rich countries generally enjoy better governance, and considering the governance problems that may be associated with fiscal decentralisation, this has led scholars to propose, but not empirically pursue, the idea that the differential impact of decentralisation in rich and poor countries is largely due to differences in the quality of government in each setting.

Consistent with (Kyriacou and Muinelo-Gallo, 2015) work, the author used the simultaneous equation model (SEM) and found that the extent to which fiscal decentralisation decreased the regional income gap was greater than that in the opposite direction. A possible explanation for this is that, compared with a centralised system, it granted the local governments autonomy in designing development programmes that match the unique characteristics of a particular region and distributing more balanced resources within it. Accordingly, decentralisation enables a local government to efficiently provide public services when needed. Also, the author concluded that fiscal decentralisation motivates local politicians to effectively allocate local public goods and services. This is because regional heads are selected through a direct election in Indonesia, and they are keen on being re-elected by better serving the voters.

Similarly, (Shahzad and Yasmin, 2016) stressed the importance of institutional quality using the democracy index in Pakistan for the time period 1972-2013. The estimation technique Generalised Method of Moments (GMM) was employed for estimation. The case study of Pakistan suggests that fiscal decentralisation has discretely resulted in increasing poverty and income inequality, but the presence of better institutional quality along with fiscal decentralisation can promise to mitigate the negative consequences of fiscal decentralisation for poverty and income inequality in Pakistan. For example, a one-unit increase in revenue (expenditure) decentralisation worsens the income distribution by 0.651 (1.035) percent. Whereas, a one-unit increase in institutional quality brings about a 0.012% decline in income inequality with revenue decentralisation and a 0.005 percent decline with expenditure decentralisation.

In light of this trend, (Kyriacou et al., 2017), who addressed two different statistical analyses using feasible general least squares (FGLS) and simultaneous equation models (SEM) using the technique of the Generalised Method of Moments subsequently. The authors started to examine two linked questions: whether regional income inequalities, the degree of fiscal decentralisation, and the quality of government are simultaneously determined, and whether fiscal decentralisation, accompanied by measures to improve the quality of government, would be an effective strategy for reducing regional inequalities. Their conclusion matches their premise that the quality of governance determines the outcomes of fiscal decentralisation. Their empirical results based on an unbalanced panel of 23 OECD countries over the period 1984-2005 concluded that fiscal decentralisation promotes regional convergence in countries with high quality institutions, while in countries with poor governance, decentralisation tends to widen regional disparities. They support the statement that regional income differences may lead to redistributive conffiicts over the sub regional distribution of resources, something which will tend to crowd out efforts towards governance reforms. Hence, if corruption at the local level is high, inequality might be tackled less efficiently.

Furthermore, (Martınez-Vazquez, 2017), examines an empirical sample of 24 OECD countries over the period 1984-2006 using panel data techniques. They support the fact that fiscal decentralisation promotes regional income convergence in high-quality government settings, but, of some concern, it leads to widespread regional disparities in countries with weak governance. The results of this literature indicate that there is no significant effect of fiscal decentralisation on improving the quality of governance.

Recently, (Siburian, 2020) concluded that fiscal decentralisation appears to reduce inequality in Indonesia. This study aims to investigate the impact of fiscal decentralisation on income inequality. This study uses panel datasets from 33 provinces in Indonesia during 2001-2014. Furthermore, this study introduced a democratic election system as the main proxy for the implementation of fiscal decentralisation in Indonesia.

4.4. Findings

Theory and practise affirm that the relationship between fiscal decentralisation and national income inequality can be positive or negative. An extensive number of empirical studies have been highlighted previously, and it has been demonstrated that fiscal decentralisation is a successful fiscal policy that can contribute to the reduction of income inequality in developed countries. As a result, fiscal decentralisation needs to be empirically applied in a large sample of less developed countries to examine its effect on income inequality.

Developing countries tend to have larger regional inequalities, have traditionally been more centralised, and have lower government quality. Additionally, there is a need for more studies that examine the effects of decentralisation on regional inequality in developing countries but require good comparative local data.

The concerns that are briefly discussed in this paper should be understood as challenges for those who believe that fiscal decentralisation is the answer to most problems. Instead, we must draw the conclusion that if decentralisation is a key political goal for a country, then that country must also be capable of establishing the institutions that will make decentralisation work with a reasonable degree of efficiency. These include tax administration, expenditure management systems, budgets, and so on, but most importantly, "quality of governance" allows the central government to transfer resources to subnational governments with some assurance that they will be used effectively.

Despite developing countries citing a need for fiscal decentralisation reform, there does not seem to be a major consolidated effort to reform subnational fiscal and institutional capacities in any of the countries. The problem is that the process of establishing an intergovernmental fiscal framework faced many obstacles on the path to equalising subnational expenditures and revenues. A fiscally decentralised structure, where subnational governments have a more imperative role than the central government in the provision of public services, guides the promotion of fair income distribution. Public service provision, like health, education, and infrastructural development, that responds to state and local circumstances is expected to be more efficient in enhancing income distribution than central government strategies that neglect geographical differences (Martinez-Vazquez and Sepulveda, 2011).

Nevertheless, the central government still has an important role to play in developing countries, even when subnational governments are key providers of public goods and services. The central government is often called upon to finance provision, including in some cases the equalisation of expenditure capacity among subnational jurisdictions; to avoid shortfalls in the financing of critical social services; and to provide technical assistance to subnational jurisdictions (De Mello, 2003).

Fiscal decentralisation represents an opportunity and a threat: an opportunity for achieving allocative efficiency and maintaining fair income distribution, and a threat of reinforcing adverse incentives and inducing fiscal imprudence and mounting deficits. The final outcome does not depend on the degree of decentralisation but rather on the quality of the decentralisation programme, implemented according to the right sequencing, and supported by well-established, mature institutions.

Hence, (Rodr´iguez-Pose, 2004) found that the quality of service delivery and resource allocation has not made much improvement despite some critical progress in assigning fiscal responsibility and accountability, due to ineffective governance models.

There is no unique optimal structure for fiscal decentralisation to achieve the perceived efficiency gains without compromising fiscal stability. A well designed decentralisation programme will set clear assignments of roles and responsibilities, enhance local revenue autonomy to catch up with spending responsibilities, reduce vertical fiscal imbalance and transfer dependence, design a well-structured intergovernmental transfer system, eliminate gap filling transfers and fiscal bailouts, regulate subnational borrowing to avoid excessive indebtness, allow for close monitoring and supervision, promote vertical and horizontal accountability, and develop and support the required fiscal, political, and legal institutions to ensure effective implementation of designed policies.

5. CONCLUSION

That is to say, the recent trend in fiscal decentralisation and federalism writings highlights the notion that in order to determine the potential impact of fiscal arrangements on fiscal and economic outcomes, they must be addressed in a broader framework incorporating the institutional structure in which all parties operate. Fiscal decentralisation might lead to market position, fit is well designed and the right instructional setting is in place, or it might lead to market distorting policies and fiscal distress if it fails to meet institutional prerequisites. After all, the logic behind decentralisation is not just about weakening the central authority, nor is it about preferring localities to central power; it is primarily about creating governance at the national and local level that is more approachable to the felt needs of the vast majority of the population.

To sum up, fiscal decentralisation might lead to reducing income inequalities through allocative efficiency criteria if it is well designed and the right instructional setting is in place, and it might lead to exacerbating national income inequality if it fails to meet governance prerequisites.

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