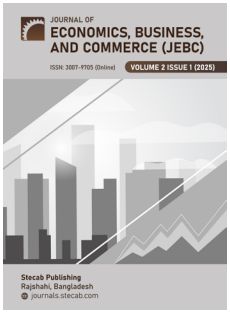

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Research Article

Fiscal Decentralization and Economic Growth in Kenya: An Autoregressive Distributed Lag (ARDL) Approach

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About Article

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ABSTRACT

This study investigated the effects of fiscal decentralization on economic growth in Kenya using time series data for the period 1991 – 2023. Both theoretical and empirical literature on the effects of fiscal decentralization on economic growth is controversial and inconclusive. This study complements this subject by looking at a composite measure of fiscal decentralization and examining other factors that might moderate the effects of fiscal decentralization on economic growth. Within the framework of the Keynesian model, the Autoregressive Distributed Lag model was used to estimate the short-run and long-run effects of fiscal decentralization on economic growth in Kenya. The paper employed a Composite measure of fiscal decentralization to measure the degree of fiscal decentralization in Kenya that combines both expenditure and revenue decentralization, since they are implemented simultaneously. According to the study's findings, fiscal decentralization has benefited Kenya's economic growth both immediately and over time. The findings' policy implications include that the federal government must grant county governments fiscal autonomy while establishing a system to impose budgetary restraints and hold them responsible for their spending.

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1. INTRODUCTION

Fiscal decentralization is the process by which regional or local governments take over management of public finances and service delivery from the federal government (Tanzi, 1996; Litvack, 1999). This process addresses four key fiscal relationships between the different levels of government: (i) the allocation of spending responsibilities, (ii) the authority to impose taxes, (iii) the ability of subnational entities to borrow, and (iv) the procedures for fiscal transfers between governments. Fiscal decentralization, which has been a major policy priority for many developing countries in recent years, has the strong support of international organizations such as the World Bank and the Organization for Economic Cooperation and Development (World Bank, 2003).

Enhancing market efficiency through liberalization and fostering an atmosphere that is more conducive to market operations were the main goals of economic reforms in developing countries during the 1980s. For a while, this emphasis was mostly on bolstering the private sector, frequently ignoring the public sector's potential to contribute to development. But in recent decades, there has been a growing push to remodel and reevaluate the public sector's role in these nations, with a focus on increasing its efficacy. Adoption of decentralization policies, which attempt to redistribute governmental duties, has been a crucial component of these efforts. Reforms to local government and fiscal decentralization have become key components of development initiatives since the early 1990s (World Bank, 2000).

Local governments were first founded in many developing countries as a result of colonial authority and foreign development assistance. But frequently, these institutions fell short of their goals or were not accepted by the local populace. Many nations inherited governance structures after attaining independence that did not fit with their developmental aspirations or cultural values. Therefore, rather than promoting local autonomy, political involvement, or economic advancement, local governments were largely utilized for administrative control. Furthermore, early development theorists discouraged the establishment of strong local governance by advocating for the centralization of economic control as a way to boost growth. In order to attain economies of scale, national development strategies frequently favoured spatial concentration and placed a strong emphasis on central planning, industrialization, and technology transfer. This led to the marginalization of local authorities, who were largely relegated to executing decisions made by central governments.

One of the main reasons local governments have often been overlooked in developing nations is the resistance from powerful central governments to decentralize authority (Smoke, 2001). While some of this resistance is justifiable—such as the need to maintain national unity in ethnically diverse societies or to preserve macroeconomic stability in vulnerable economies—other factors are more self-interested. Political elites, frequently from dominant ethnic groups, may resist decentralization due to concerns over losing control and access to resources. Additionally, central government ministries and political parties that manage significant budgets are generally reluctant to relinquish authority or share financial power with independent local institutions.

Davoodi and Zou (1998) draw attention to a commonly held theoretical premise that giving local governments more authority over politics and administration improves the financial efficiency of providing public services. This is mostly because citizens have better access to information because local authorities are located closer to them both geographically and institutionally. Decentralization is therefore thought to favourably impact economic growth on a national and regional scale. Decentralizing revenue and expenditure duties can also improve public sector efficiency, lower fiscal deficits, and advance general economic development, according to academics like Oates (1993), Bird (1993), and Gramlich (1993).

Some scholars caution that fiscal decentralization may have a detrimental effect on macroeconomic stability in spite of these possible advantages (Tanzi, 1996; Prudhomme, 1995; Phillips, 1997; Ter-Minassian, 2000). Critics frequently bring up a number of recurrent issues. First, they draw attention to the fact that local governments usually run at a deficit and depend on funding from the federal government. Second, rigid systems of resource allocation from the central to local levels may weaken the central authority's ability to manage national finances effectively. Third, there are concerns that local authorities often default on loans provided by the central government, which may lead the latter to assume the repayment burden sometimes involving international creditors like the World Bank. Fourth, it is argued that local governments may exert political pressure on the central government to obtain more resources. Fifth, the perception that local administrations are more prone to corruption raises concerns about inefficient and improper use of public funds. Lastly, critics warn that competition between local governments and between local and central governments over tax bases or business-friendly policies can disrupt domestic trade and raise operational costs for businesses. Altogether, these issues are seen as significant threats to maintaining macroeconomic stability.

1.1. Fiscal Decentralization and Economic Growth

Economic growth has historically been largely disregarded as a primary goal of fiscal decentralization theory and practice. Economic growth has only recently been included in normative discussions alongside more conventional public finance objectives like ensuring economic stability, resolving horizontal fiscal imbalances, and allocating resources efficiently. Allocation, distribution, and stabilization are the three main roles that government plays in the economy, according to Musgrave (1956). Governments seek to improve social welfare through fiscal decentralization, giving subnational bodies more authority over the distribution of public goods. At the local level, this strategy enables more efficient public service delivery. Additionally, local governments may better tailor policies to local needs thanks to their increased information and closer proximity, which improves efficiency, especially in service delivery. Economic growth can be promoted by improving the quality, accessibility, and targeting of basic services including power, water, sanitation, health care, and education. However, the degree of local elite capture and the type and extent of local inequality determine these fiscal decentralization gains

(Bardhan & Mookherjee, 1998).

The theory of fiscal federalism advocates for allocation functions to subnational governments due efficiency in the provision of public goods. However, it does not does not support the participation of sub national governments in the redistributive and stabilization policies (Masgrave, 1959). Public goods should be allocated to the lower tiers of government in accordance with the efficiency criteria, also known as the subsidiarity principle, which stipulates that goods and services should be provided at the lowest tier of government in order to maximize social welfare. If reasonably possible, goods and services should be delivered by the level of government that is closest to the people. Goods and services can be better adapted to residents' tastes when they are offered at the governmental level closest to the people. The central government is thought to be appropriate for the other two functions of stabilization and income distribution.

Although fiscal decentralization is well recognized for its benefits in enhancing resource allocation (Tanzi, 1996), it also poses serious obstacles to preserving macroeconomic stability at the national level. The central government's control over a sizable amount of taxes and public spending is diminished as government duties are divided across several levels. Its ability to successfully guide macroeconomic outcomes may be limited by this deterioration of fiscal control. Furthermore, national attempts to preserve economic stability may be jeopardized if local governments are allowed unfettered access to capital markets or if they neglect to properly manage their budgets.

The precise nature of this relationship is yet unknown, despite the claims of some academics that fiscal decentralization improves macroeconomic stability (Prudhomme, 1995; Martinez-Vazquez & McNab, 2006) (Treisman, 2000; Rodden & Wibbels, 2002; Martinez-Vazquez & McNab, 2003). Some empirical studies have found a negative or insignificant effect, especially in terms of price stability (Feltenstein & Iwata, 2005; Shah, 2006; Thornton, 2007), while others have found a positive and significant impact on stability (King & Ma, 2001; Neyapti, 2004; Martinez-Vazquez & McNab, 2006). Additionally, a number of scholars argue that fiscal decentralization and inflation levels are not consistently correlated (Treisman, 2000; Rodden & Wibbels, 2002; Blessings, 2020).

There isn't much agreement in the literature regarding the nature or importance of the connection between economic growth and fiscal decentralization. The issue of whether fiscal decentralization significantly affects economic growth is still up for debate. The majority of earlier research has mostly examined its direct impact on economic expansion. The purpose of this study is to evaluate fiscal decentralization's direct and possible indirect effects on growth, with a focus on how it affects macroeconomic stability. The study specifically aims to assess how Kenya's macroeconomic stability is affected by fiscal decentralization.

1.2. Fiscal Decentralization in Kenya

Fiscal decentralization has been a technique used by several Kenyan administrations to encourage balanced growth across the nation's numerous regions, much like other emerging nations. The government has implemented a number of fiscal decentralization programs since achieving independence in 1963. The District Focus for Rural Development strategy of 1983/84, the Constituency Development Fund (CDF), the Local Government Transfer Fund (LATF) (1999), the District Development Grant Program (launched in 1966), the Special Rural Development Program (launched in 1969/1970), the District Development Planning (introduced in 1971), the Rural Trade and Production Centre program (implemented in 1988/89), and the Kenyan Constitution (2010) all serve to further solidify decentralization through fair revenue sharing between the national and county governments. Despite the introduction of a multiplicity of decentralized funds over the years, there is little improvement in the living standards and circumstances of the poor. This study seeks to investigate the effects of fiscal decentralization on economic growth in Kenya.

1.3. Fiscal Decentralization and Economic Growth in Kenya

The figure 1 represents the dynamics of fiscal decentralization and economic growth indicators for Kenya in the period 1991-2023.

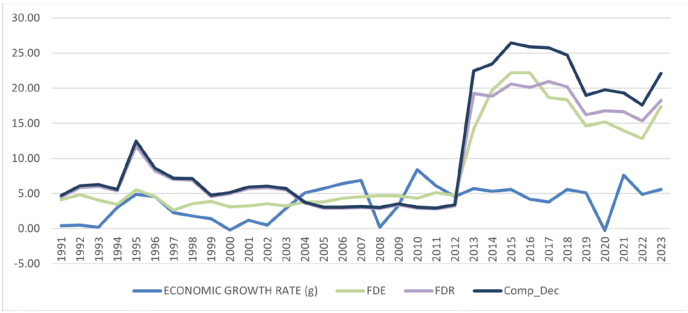

Figure 1. Dynamics of fiscal decentralization indicators and economic growth for Kenya in the period 1991-2023.

The most widely used indicators of fiscal decentralization are the share of subnational governments in total government expenditure (FDE) and the revenue autonomy indicator, which reflects the proportion of subnational revenue in total government revenue (FDR). However, this study has included a composite decentralization (Comp_Dec) that combines the effects of expenditure and revenue decentralization. Both the local government revenue to total government revenue ratio (FDR) and the subnational spending share (FDE), as shown in Figure 1, stayed low, indicating a high degree of centralization until 2013. After that year, there was a noticeable improvement, which was ascribed to the devolution measures that created counties as independent subnational organizations with more fiscal power.

Over the years, there have been noticeable variations in Kenya's economic growth. A favourable trend was observed in 1993, primarily as a result of economic liberalization and reform measures. Nevertheless, the nation's growth slowed after 1995, hitting -0.2% in 2000. Kenya saw faster development between 2002 and 2007, going from 0.5% in 2002 to a peak of 6.9% in 2007. However, the post-election violence in 2007 and the global financial crisis caused the country's GDP to decelerate to 0.2% in 2008. The economy rebounded, reaching a peak of 8.4% in 2010,

and remained relatively stable until 2020, when it dropped to an all-time low of -0.3% as a result of the COVID-19 pandemic. Despite a significant increase in fiscal decentralization from 2013 onwards, economic growth has remained low, showing no consistent upward trend.

Whether higher county government spending boosts national economic growth and possibly jeopardizes macroeconomic stability is a crucial subject that still has to be answered. In general, there can be a lot of volatility in macroeconomic indices like inflation, money supply, interest rates, unemployment, and currency rates, which could impede the expansion of the national economy. Given that the central government's duty covers the entire nation, this issue is especially pertinent to the stabilization function that it normally plays, particularly in regulating the national currency and containing inflation. Consequently, it is clear that fiscal decentralization can have a big impact on macroeconomic stability and national progress. Using time series data from 1991 to 2023, this study attempts to examine how fiscal decentralization has affected Kenya's economic growth.

2. LITERATURE REVIEW

Tiebout (1956), Musgrave (1959), and Oates (1972) developed the first theoretical framework of fiscal federalism, which served as the foundation for a thorough examination of fiscal decentralization. Olson (1969) made a substantial contribution as well with his notion of fiscal equivalency. The fundamental, first-generation literature on fiscal decentralization includes these publications as well as Brennan and Buchanan's (1980) introduction of the public choice theory of multi-level governance in The Power to Tax: Analytical Foundations of a Fiscal Constitution.

According to Musgrave (1959), the three main purposes of public finance are resource allocation, income distribution, and economic stabilization. Especially outside the public choice framework, these functions have been important points of reference for traditional public finance experts in their initial assessments of fiscal decentralization. Although each function may be studied separately using a consistent theoretical framework, integrating them presents difficulties because of varying opinions regarding the relative significance of stability, equity, and efficiency. Musgrave's approach has been crucial in bringing attention to the limitations of fiscal decentralization, specifically stabilization and redistribution, as well as its potential benefit in enhancing allocative efficiency within the framework of federalism.

Spending decentralization tends to promote macroeconomic stability, especially in rich countries where its stabilizing benefits are more noticeable than in emerging ones, according to Treisman (2000). King and Ma (2001) found a negative correlation between revenue decentralization and macroeconomic stability in their examination of emerging economies, indicating that it reduces macroeconomic volatility. In a similar vein, Feltenstein and Iwata (2002) came to the conclusion that fiscal decentralization improves macroeconomic stability by reducing inflation. According to Neyapti (2004), macroeconomic stability was negatively impacted by revenue decentralization as indicated by the percentage of tax revenues allotted to subnational governments.

On the other hand, Thornton (2007) concluded that there is no statistically significant effect of revenue decentralization on macroeconomic stability. However, decentralization of spending had little influence on macroeconomic stability, whereas decentralization of revenue had a substantial negative association, according to Iqbal and Nawaz (2010). Additionally, their research showed that while population size has no discernible impact on inflation, investment has a detrimental impact on macroeconomic stability. In a similar vein, Jalil *et al.* (2012) discovered a substantial negative correlation between decentralization of revenue and spending and macroeconomic instability, indicating that decentralization enhances macroeconomic stability.

Ali and Batool (2017) concluded that both revenue and expenditure decentralization contribute to economic stability in Pakistan. Their findings also indicated that higher unemployment, increased investment, and GDP growth adversely affect macroeconomic stability. Similarly, Melnyk *et al.* (2018) found that decentralization of revenue and spending had a stabilizing effect and a substantial negative association with macroeconomic instability. Decentralization of revenue reduces inflation, whereas decentralization of spending may increase it, according to Bojanic (2018). Furthermore, it has been demonstrated that foreign direct investment (FDI) and GDP per capita promote macroeconomic stability. Dadgar and Nazari (2018) used the misery index to analyse the relationship between macroeconomic stability and economic growth in Iran. They discovered that GDP growth had a negative correlation with the index, indicating increased stability. Using the general government primary balance as a percentage of GDP to gauge stability, Lago-Peñas *et al.* (2019) discovered that spending decentralization greatly enhances macroeconomic stability across OECD nations.

On the other hand, Ahmad, Shah, Mazhar, Khan, and Javaid (2022) discovered that decentralization of both revenue and expenditures improves resource allocation, increases economic stability, and boosts Pakistan's overall economic performance. Similarly, fiscal dependency and rapid population growth have a negative impact on Pakistan's economic stability, according to Rauf *et al.* (2021), who used fiscal transfers as a stand-in for fiscal decentralization. Additionally, Osmani and Tahiri (2022) discovered that revenue decentralization, educational attainment (measured in years of schooling), and population growth increase the unemployment rate in Kosovo, thereby contributing to greater macroeconomic instability. Additionally, Mariani *et al.* (2022) found that fiscal decentralization measured using indicators such as Regional Original Revenue, Special Allocation Fund, General Allocation Fund, and Capital Expenditure has a significant effect in reducing the unemployment rate in Indonesia.

3. METHODOLOGY

This study uses the Keynesian School of thought as the theoretical framework to investigate the relationship between fiscal decentralization and economic growth, based on the fundamental ideas of fiscal federalism. It makes use of the two-sector production function model created by Barro (1990),

which is ideal for analyzing how fiscal decentralization affects important macroeconomic metrics including inflation, fiscal balance, and aggregate output growth. The model's adaptability is increased by adding policy variables, which makes it popular for examining a nation's macroeconomic performance, especially in emerging nations (Aigbokhan, 1999). According to the model, the economy is divided into two primary sectors: the public (G) and the private (P), with labour (L) and capital (K) having an impact on each sector's output. Additionally, the output of the public sector is thought to have an externality influence on the output of the private sector. The following is an expression for the economy's overall production function:

$$Y = f(L, K_P, K_G) \quad (1)$$

where the subscripts denote sectoral inputs:

K_P = private capital per labor

K_G = public capital per labor

The production functions of the respective sectors are thus:

$$Y_P = P(L_P, K_P, G) \quad (2)$$

$$Y_G = G(L_G, K_G) \quad (3)$$

Total inputs are given as:

$$L_T = L_P + L_G \quad (4)$$

$$K_T = K_P + K_G \quad (5)$$

Total output Y is given as the sum of sectoral output or a function of sectoral inputs:

$$Y = Y_P + Y_G \quad (6)$$

$$Y = P(L_P, K_P, G) + G(L_G, K_G) \quad (7)$$

$$Y = f(L_T, K_T, G_T) \quad (8)$$

The model further assumes that public spending is carried out by two levels of government: Central Government (c) and local Government (m). Thus:

$$Y = a_0 + L_T + K_T + G_T + \mu \quad (9)$$

The model is based on the assumption that government size influences the rate of economic growth (Aigbokhan, 1996), and that fiscal decentralization can lead to a reduction in government size (Aigbokhan, 1999). Building on this perspective, the study proposes that fiscal decentralization affects economic growth. In theory, decentralization is expected to enhance growth by improving allocative efficiency and the effectiveness of service delivery. However, empirical findings on this relationship are mixed. Some studies suggest that greater decentralization negatively affects growth (Zhang & Zou, 1996; Davoodi & Zou, 1997; Aigbokhan, 1999), while others find a positive relationship (Feltenstein and Iwata, 2005). As such, the effect of fiscal decentralization on growth remains an empirical question. The structure of intergovernmental fiscal relations is therefore expected to influence public sector output (Aigbokhan, 1999). Consequently, fiscal decentralization (FD) is introduced into the model as a policy variable, as indicated in equation (9).

$$G_t = f(FD) \quad (10)$$

Equation (8); $Y = f(L_t, K_t, G_t)$ becomes

$$Y = f(L_t, K_t, FD_t) \quad (11)$$

The study makes the assumption that the money supply (MS) has a positive impact on production, or growth. By introducing money supply into the model, equation (11) becomes;

$$Y = f(L_t, K_t, MS_t, FD_t) \quad (12)$$

Equation (12) will be estimated basic growth equation and its explicit form is:

$$EG_t = 0 + \propto_1 M2_t + \propto_2 GFCF_t + \propto_3 Pop_t + \propto_4 FD_t + \varepsilon_t \quad (13)$$

Where EG is growth rate of GDP (%); M2 is money supply proxied by M2 as a percentage of GDP; GFCF is Gross Fixed Capital Formation as a percentage of FDP; Pop is the population and FD is Composite measure of fiscal decentralization as a combined effect of expenditure and revenue (FD = Revenue Decentralization (%)/(100-Expenditure Decentralization (%)).

Equation 12 will be estimated using the Autoregressive Distributed Lag (ARDL) approach, with lag lengths determined based on the Akaike Information Criterion (AIC). The ARDL model is particularly suitable for small and finite sample sizes, offering greater efficiency in such contexts. It is also well-suited for cases where the variables are integrated at different levels specifically, when there is a mix of I(0) and I(1) variables or when all are I(1). Moreover, this method yields reliable long-run estimates and allows for valid statistical inference on certain endogenous regressors.

4. RESULTS AND DISCUSSIONS

A unit root test was conducted, and the results are presented in table 1.

Table 1. Augmented Dickey Fuller Test for Unit Root

Variable	ADF Test Statistics		Conclusion
	Level	First Difference	
EG	-4.382***		I(0)
M2	0.960	-6.156***	I(1)
GFCF	-2.043	-6.095***	I(1)
Pop	-2.811	-5.870***	I(1)
FD	-1.801	-5.317***	I(1)

, **, * significance at 1%, 5% & 10% respectively*
Source: Author's own calculation based on Stata

The results indicate that all the variables in the study, except for the economic growth rate (EG), which is integrated of order zero [I(0)], are integrated of order one [I(1)]. Therefore, the ARDL method was appropriate for estimation. The results of the ARDL model are presented in Table 2.

Table 2. ARDL Model Results of Equation 12 (lags (4,3,4,4,4) choice based on AIC Criterion

Variable	Coefficients	p-value
EG_{t-1}	-0.3809*	0.109
EG_{t-2}	-0.3923*	0.086
EG_{t-3}	0.2150	0.279
EG_{t-4}	0.3558	0.217
$M2_t$	1.3907	0.980
$M2_{t-1}$	-4.9906	0.328
$M2_{t-2}$	-0.0000148**	0.031
$M2_{t-3}$	0.0000228***	0.001
$GFCF_t$	0.3933**	0.048

$GFCF_{t-1}$	0.9229***	0.014
$GFCF_{t-2}$	-0.0692	0.799
$GFCF_{t-3}$	-0.2645	0.442
$GFCF_{t-4}$	-0.6694*	0.067
Pop_t	2.4165***	0.011
Pop_{t-1}	-1.8452**	0.036
Pop_{t-2}	-0.4424	0.614
Pop_{t-3}	0.5798	0.553
Pop_{t-4}	-0.9170	0.237
FD_t	-0.04533	0.705
FD_{t-1}	0.3625***	0.015
FD_{t-2}	-0.0645	0594
FD_{t-3}	0.1202	0.425
FD_(t-4)	-0.18335	0.218
Constant	0.6824	0.944
R-squared	0.9668	Prob > F 0.0247
Adjusted R-squared	0.8138	No. of Obs. 29

****, **, * Implies statistically significant at 1%, 5% and 10% respectively*
Source: Author's own computation, 2025

Fiscal decentralization (FD_{t-1}) exhibits a positive and statistically significant coefficient at the 1% level, according to the projected long-term relationship. These results are consistent with those of Behnisch *et al.* (2001), Malik *et al.* (2006), John (2024) and Lin and Liu (2000). The importance of this variable supports the theoretical link between fiscal decentralization and economic growth, indicating that while problems with distribution and equity still exist, the populace is starting to profit from fiscal decentralization. Furthermore, at the 1% level, the population variable displays a positive and significant coefficient. The money supply coefficient is not statistically significant, but the gross fixed capital formation coefficient is significant at the same level and favourably influences economic growth. In ARDL analysis, we estimate both short-run and long long-run (ECM) models if and if the study variables are cointegrated. Thus, we conducted bound test for cointegration whose results are shown in table 3.

Table 3. Bound Test for Cointegration

Computed F-statistics Value	Level of Significance	Critical Values (unrestricted intercept and unrestricted trend)	
		I(0)	I(1)
12.937	1%	3.74	5.06
	5%	2.86	4.01
	10%	2.45	3.52

Source: Author's estimate and critical values based on Stata

Table 3 presents the calculated F-statistics alongside the critical values provided by Pesaran *et al.* (2001). The F-statistic value of 12.937 exceeds the upper bound critical values for I(1) at the 1%, 5%, and 10% significance levels when using a model with both an unrestricted intercept and an unrestricted trend. This implies that the null hypothesis of no levels relationship was rejected. Thus, it was established that there is a long run relationship among the variables. Once the cointegration was established the ECM was estimated and the results are presented in table 4.

Table 4. Error Correction Model (ECM) (lags (4,3,4,4,4) choice based on AIC Criterion

Variable		Coefficients	p-value
ECT_{t-1}		-1.2023**	0.038
	M2	2.56	0.241
	GFCF	0.2596	0.145
	Pop	-0.1731	0.602
	FD	0.1575	0.196
	ΔEG_{t-1}	-0.1786	0.671
	ΔEG_{t-2}	-0.571	0.140
	ΔEG_{t-3}	-0.3558	0.217
	$\Delta M2_t$	-2.94	0.565
	$\Delta M2_{t-1}$	-7.93	0.156
	$\Delta M2_{t-2}$	-0000228***	0.001
	$\Delta GFCF_t$	0.08112	0.770
LR	$\Delta GFCF_{t-1}$	1.003136**	0.018
	$\Delta GFCF_{t-2}$	-0.9339*	0.048
	$\Delta GFCF_{t-3}$	0.6694*	0.067
	ΔPop_t	2.6247**	0.027
	ΔPop_{t-1}	0.7795	0.319
	ΔPop_{t-2}	0.3371	0.752
	ΔPop_{t-3}	0.917	0.237
	ΔFD_t	-0.2347*	0.071
	ΔFD_{t-1}	0.1278	0.188
	ΔFD_{t-2}	0.0632	0.533
	ΔFD_{t-3}	0.1835	0.218
	Constant	0.6824	0.944
R-squared		0.9763	
Adjusted R-squared		0.8670	No. of Obs. 29

****, **, * Implies statistically significant at 1%, 5% and 10% respectively*
Source: Author's own computation, 2025

The sign of short-run dynamic impacts were maintained to the long-run. The ARDL model demonstrated a good fit, with an adjusted R-squared of 0.8670, indicating that approximately 88% of the variation in GDP growth was accounted for by the

explanatory variables. According to Appendix 1, it passed all diagnostic tests, including those for autoregressive conditional heteroscedasticity (ARCH) and serial correlation. The residuals' normal distribution was confirmed by the model's compliance with the normality assumption. In addition, structural stability was evaluated using the CUSUM and CUSUMSQ tests for recursive residuals. Given that both test statistics stayed under the 5% significance thresholds, the results demonstrated that the model is stable and suitably described.

5. CONCLUSIONS

This analysis used the most recent time series data from 1991 to 2023 to investigate how Kenya's economic growth was affected by fiscal decentralization. A composite measure that incorporated revenue and spending decentralization was utilized in the study. The ARDL model is used to evaluate the long-term relationship among the variables of interest after adjusting for the impact of economic growth by adding other factors to the model. Empirical research indicates that fiscal decentralization has a long-term favorable impact on economic growth but a short-term negative effect.

According to the findings' policy implications, FD can be a strategy for boosting economic growth by improving the accountability and efficiency of public resources. Secondly, because of its long-term correlation with economic growth, it offers a different approach to policymaking that can help achieve the goal of long-term, sustainable economic growth. Moreover, the national government should consider granting greater fiscal autonomy to county governments, while also establishing mechanisms to enforce budgetary discipline and ensure accountability in expenditure management.

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