Does financial decentralization create financial risk?

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Abstract. The reform of financial decentralization and fiscal decentralization between central and local governments in China is important to strengthen the role of local governments in preventing financial risks, and is a hot issue of concern for academics and the financial industry. This study employs panel data from 30 provinces and cities in China between 2006 and 2019 to examine the impact of financial decentralization on financial risk. The empirical results demonstrate that financial decentralization can effectively reduce financial risks, with significant spatial heterogeneity observed in the impact. Moreover, the study finds that there is no effective synergy between fiscal and financial decentralization in suppressing financial risks, and financial decentralization does not increase financial risk by strengthening promotion incentives. Therefore, as the reform of the central and local economic decentralization system continues, greater attention should be paid to the coordination between financial and fiscal decentralization, and financial risk indicators should be integrated into officials' promotion incentive assessments to better prevent financial risks.

Keywords: Financial decentralization; Financial risk; Fiscal decentralization; Promotion competition.

1. Introduction

Currently, China is in the stage of "new normal" economic development, characterized by resilient and potential growth. However, this development is accompanied by a series of challenges for the real economy and the financial sector. The financial industry faces significant issues such as difficulties in financing for small and medium-sized enterprises and increased credit risk. These challenges directly contribute to the deterioration of commercial banks' assets, leading to a rise in non-performing loan rates. According to national statistics, China's commercial banks have experienced a continuous upward trend in their non-performing loan ratios in recent years. As of 2019, this trend is still approaching 3%, significantly impacting the stability and sustainability of the entire economic system. As the core financial institutions in China, the deterioration of commercial banks' core assets disrupts the stability of the credit environment, triggering the contagion of credit risk and posing financial risks to the entire financial system.

Empirical studies on the factors influencing commercial banks' NPL ratios have generated a large literature in recent years, either based on macroeconomic factors or empirical analysis from the perspective of banks (Sun, Wang, & Wang, 2017)[15], but few studies have been conducted from the context of China's financial decentralization system. Financial decentralization plays a crucial role in understanding the impact of China's financial system transformation on financial risks. According to Hong and Hu, commercial banks, as the core of China's financial system, play a vital role in the development process of financial decentralization, transitioning from "initial decentralization" to "recentralization" and eventually reaching "moderate decentralization." For instance, during the "initial decentralization" phase, China experienced a bubble economy, resulting in non-bank financial institutions and state-owned enterprises incurring losses that ultimately accumulated in banks, leading to a significant number of non-performing loans. Resolving this financial risk came at a high cost for China. Therefore, this study aims to examine the impact of financial decentralization on financial risks in the current stage of "moderate decentralization" from the perspective of commercial banks' non-performing loan ratios.

This paper has the following three contributions: first, it studies the impact of the decentralized competitive system on financial risk from the perspective of China's decentralized competitive system, expanding the perspectives and ideas of research in the area of causes and influencing factors of financial risk. Second, using data from the "moderate decentralization" period as a sample, tracing the impact of financial decentralization on financial risk and update the knowledge of the current evolution of financial decentralization. Third, the moderating effects of fiscal decentralization and promotion competition in the process of financial decentralization affecting financial risk are combined to further provide a reasonable explanation for the impact of China's decentralized competition regime on financial risk.

The following sections of this paper are organized as follows: Section 2 is the literature review and theoretical analysis; Section 3 is the empirical design; Section 4 is the empirical results and discussion, which mainly includes heterogeneity test, moderating effect and robustness test. Finally, the above research is summarized.

2. Literature review and Theoretical analysis

At present, domestic research on economic decentralization primarily focuses on fiscal decentralization. Early studies on financial decentralization mainly explored its definition and essence. Hong and Hu (2017) conducted the first systematic study on financial decentralization, summarizing it into three dimensions of rights: financial development and innovation, financial control, and financial regulation. They further categorized financial decentralization into two levels: central-to-local decentralization, known as financial decentralization I, and government-to-civil decentralization, known as financial decentralization II[7]. Based on this, Miao (2019) explained the connotation of the two levels: financial decentralization I includes financial regulation and stability, while financial decentralization II involves financial resource allocation and personnel regulation[13]. The gradual clarification of the definition of financial decentralization is a solid foundation and driving force for further research in this area.

Financial decentralization and financial risk are closely related. Banks are the most core financial institutions in China, and credit resources are naturally the most important financial resources in China. The influence of Financial Decentralization II, which includes the power of financial allocation, is reflected in the local government's deployment of financial resources through its indirect control of local financial institutions such as city commercial banks and state-owned joint-stock banks. This intervention from the government's hand may result in an irrational allocation of financial resources. On the one hand, government intervention may intensify "relationship-based financing" (Tan et al., 2012)[16] between local state-owned enterprises and local commercial banks, leading to a large amount of capital flowing to enterprises that may not be tested by the market in the long run and sowing the seeds of a large amount of financial risks. On the other hand, the government's intervention in financial resources according to its own preferences may lead to over-investment and capacity overcapacity, causing serious structural problems in the industry and eventually leading to an increase in the non-performing loan rate (Sun et al., 2017)[15].

The impact of current financial decentralization on financial risks remains inconclusive. As previously stated, the decentralization of power in our country is in a dynamic evolution. Some argue that financial decentralization reduces information asymmetry between central and local levels, prompting local governments to improve fund utilization through decentralized competition, thereby enhancing the allocation efficiency of financial resources (He et al., 2019)[6]. This, in turn, may reduce bank non-performing assets. Additionally, Hou and Song (2021) observed that financial decentralization curbs the growth of local government debt[8], consequently reducing default risk and financial risk. Based on these findings, this paper proposes the following hypotheses.

H1a: Financial decentralization will increase financial risk.

H1b: Financial decentralization will suppress financial risk.

Both financial decentralization and fiscal decentralization were born in the context of reform and opening up and are inextricably linked. Fiscal decentralization refers to the right of local governments to determine the scale and structure of their budget expenditures through the decentralization of the central government's power (Yang and Zhao, 2004)[21]. Nowadays, many scholars have examined the coordination between the two. Fiscal decentralization has been shown to impact local government financial intervention and financial decentralization by imposing tighter constraints on local government budgets (Ba et al., 2005)[1]. Conversely, financial decentralization has been found to alleviate these constraints (Qian & Roland, 1999)[27]. Although fiscal decentralization has a clear and explicit system, financial decentralization exhibits explicit centralization in terms of financial regulatory power but implicit decentralization in resource allocation power. This inconsistency between regulatory power and resource allocation power can contradict fiscal and financial decentralization, potentially leading to the emergence and expansion of financial risks (He & Miao, 2016)[5]. Furthermore, research suggests that fiscal and financial decentralization do not currently exhibit a positive interaction (Lv et al., 2020)[11]. Chen and Deng (2017) revealed a synergistic effect that drives the increase in local debt from the perspective of fiscal and financial linkage [2]. The possible reason is that an increase in the degree of decentralization in taxation can strengthen the incentive of local governments to expand government debt, while which the financial decentralization can reduce the financing constraints of local governments, which further amplify this incentive(Mao et al., 2019)[1]2. Thus, the inconsistency between fiscal decentralization and financial decentralization may lead to an increase in financial risk by expanding local debt and thus increasing the risk of default by local governments.

However, Tan and Zhang (2021) discovered that as fiscal decentralization deepens, the average asset-liability ratio of local enterprises decreases, thereby reducing the occurrence of non-performing assets[17]. If moderate financial decentralization in China can effectively reduce financial risk, does the discrepancy between financial decentralization and fiscal decentralization exacerbate financial risk? To examine how the moderating effect of fiscal decentralization influences the impact of financial decentralization on financial risk, this paper presents an alternative set of opposing hypotheses.

H2a: Because of the inconsistency between financial decentralization and fiscal decentralization in China, when financial decentralization suppresses financial risk, the joint effect of fiscal decentralization and financial decentralization will increase financial risk.

H2b: Because of the inconsistency between financial decentralization and fiscal decentralization in China, when financial decentralization raises financial risk, the joint effect of fiscal decentralization and financial decentralization suppresses financial risk.

Since Zhou (2007), scholars have increasingly focused on the intervention of local officials in the financial sector and the allocation of financial resources under promotion pressure during China's economic transformation[25]. Promotion incentives can be categorized into economic competition, driven by economic and tax considerations, fostering trade and cooperation, and mixed competition, combining economic competition with political considerations, leading to local protectionism and unhealthy competition (Zhou, 2004)[24]. Continuous investment attraction is a common method of such competition. In the "promotion tournament," local officials strive to develop the local economy to enhance their political performance, often interfering excessively in the market. For instance, they may intervene in state-owned enterprises or politically connected private enterprises to facilitate their expansion, even investing in projects with limited prospects due to political interests (Liang and Feng, 2010)[10]. Qian and others (2011) have indicated that officials' promotion pressure may contribute to the increase in medium- and long-term loans, such as real estate loans, resulting in non-performing loans[14]. Tan et al. (2012) also argue that promotion competition can undermine resource allocation and debt enforcement effectiveness[16]. However, most of the literature is mostly from the perspective of financial decentralization and the selected samples are mostly urban commercial banks, while little literature has been studied from the perspective of financial decentralization.At a time when financial decentralization in China is more concerned with financial risk than in the past, will financial decentralization reinforce competition for promotion leading to higher financial risk? Based on the above theoretical analysis, this paper proposes the following set of opposing hypotheses:

H3a: Financial decentralization leads to increased financial risk through enhanced competition for promotion.

H3b: Financial decentralization does not lead to increased financial risk through enhanced competition for promotion.

3. Empirical design

3.1 Variable design

(1) Explanatory variables

The increase in non-performing loan (NPL) ratios in banks poses risks to bank assets, profitability, and the overall stability of the banking system, thereby amplifying financial risks in the entire economic system. Considering the close relationship between commercial banks' NPL ratios and financial risks, this study utilizes commercial banks' NPL ratios as an indicator of financial risk.

(2) Explanatory variables

Banks are the backbone of China's financial system, and credit is a key component of their business. By providing financial support to the real economy, banks facilitate the production and consumption activities of enterprises and individuals. In this study, financial decentralization is measured using the approach developed by He and Miao (2016), which employs the ratio of provincial bank loans to national bank loans as an indicator[5].

(3) Moderating variables

The first moderating variable examined in this study is fiscal decentralization. Fiscal decentralization is measured based on existing research[26] [29-30], which suggests that fiscal decentralization influences economic variables through the implementation of fiscal expenditures. The specific measurement used is the ratio of per capita budgeted local fiscal expenditure to the sum of per capita budgeted local and central fiscal expenditures. Another moderating variable considered is competition for promotion. Local government officials strive to excel in the "promotion tournament" by actively promoting local economic development. Investment promotion serves as a significant aspect of this competition. To measure the intensity of promotion competition among officials, this study refers to Hu et al.(2019), adopting the percentage of foreign direct investment (FDI) utilized by local governments in GDP as a proxy variable, analyzing its impact as a moderating variable on commercial banks' non-performing loans[9].

(4) Control variables

The control variables selected in this paper are: government intervention (Gov), trade factor (Openness), traffic density (Traffic), technology factor (Patent), industrial structure (TS), and Urbanization level (Urban).

Table 1 Description of variables

Variable Category	Variable Name	Symbols	Measurement Method
Explained variables	Non-Performing Loan Ratio of Commercial Banks	NPLr	Non-Performing Loan Ratio of Commercial Banks
Explanatory variables	Financial Decentralization	Findec	Provincial Loans / Total National Loans
Control variables	Government intervention	Gov	Fiscal expenditure/GDP
	Trade Factors	Openness	Import/export trade/GDP
	Transportation Density	Traffic	(Road+Rail)/Area
	Technological Factors	Patent	Number of domestic patent applications received

	Industrial Structure	TS	Value added of tertiary industry/value added of secondary industry
	Urbanization level	Urban	Ratio of urbanized population
Moderating variables	Fiscal decentralization	Fiscaldec	Local fiscal expenditure budget per capita / (Local fiscal expenditure budget per capita + Central fiscal expenditure budget per capita)
	Competition for promotion	Compe	Real utilization of FDI/GDP

3.2 Model Setting

Given the considerable heterogeneity across provinces and cities, this study employs a fixed-effects model to analyze the relationship between financial decentralization and commercial banks' non-performing loan ratios. The model controls for both time and regional effects, and the benchmark regression equation is expressed as follows:

$$\mathrm{lnNPLr_{it}} = \beta_0 + \beta_1 \times \mathrm{ln}Findec_{\mathrm{it}} + \sum \beta_2 \times \mathrm{lnX_{it}} + \eta_i + \upsilon_t + \varepsilon_{it} \quad (1)$$

i and t denote province and year, respectively, and Xit denotes the control variable. To eliminate heteroskedasticity and reduce the gap between data, all variables in equation (1) are logarithmically treated by referring to Zhao and Yu(2012)[23]. ηi and υt are province fixed effects and year fixed effects respectively, and εit is a random disturbance term. To test the joint effect of fiscal and financial decentralization and whether financial decentralization enhances promotion competition and brings about financial risks, the following moderating effect model is set:

$$\mathrm{lnNPLr_{it}} = \beta_0 + \beta_1 \mathrm{ln}Findec_{\mathrm{it}} + \beta_2 \mathrm{ln}Findec_{\mathrm{it}} \times \mathrm{ln}F\mathrm{iscaldec_{it}} + \beta_3 \mathrm{ln}F\mathrm{iscaldec_{it}} + \sum \beta_4 \mathrm{lnX_{it}} + \eta_i + \nu_t + \varepsilon_{it} \, (2)$$

$$\mathrm{lnNPLr_{it}} = \beta_0 + \beta_1 \ln Findec_{\mathrm{it}} + \beta_2 \ln Findec_{\mathrm{it}} \times \ln \mathrm{Compe_{it}} + \beta_3 \mathrm{lnCompe_{it}} + \sum \beta_4 \mathrm{lnX_{it}} + \eta_i + \nu_t + \varepsilon_{it} \, (3)$$

lnFindecit denotes financial decentralization, lnCompeit denotes competition for promotion. lnFindecit × lnFiscaldecit denotes the cross product of financial decentralization and fiscal decentralization and lnFindecit×lnCompeit denotes the cross product of financial decentralization and competition for promotion. Other variables are explained in the same way as model (1).

3.3 Data sources and Descriptive statistics

This study utilizes panel data from 30 provinces and cities in China from 2006 to 2019 (excluding Hong Kong, Macao, Taiwan, and Tibetan areas) for empirical analysis. The data sources include the China Statistical Yearbook, Provincial Statistical Yearbooks, China Finance Yearbook, and China Financial Yearbook. Table 2 presents the statistical results of each variable. The average non-performing loan (NPL) rate of commercial banks is 2.88%, with a significant range between the maximum and minimum values. Geographically, the eastern region has the lowest NPL ratio at 2.67%, followed by the western region at 3.01%, and the central region has the highest NPL ratio at 3.11%. The degree of financial decentralization exhibits substantial variation, with the eastern region having the highest level (0.05), followed by the central region (0.026), and the western region (0.017). This indicates significant differences in the implementation of financial decentralization across different regions.

Table 2 Descriptive statistics of the variables

Variables	Sample size	Mean	Std.dev.	Min	Max
NPLr	420	0.0288	0.0369	0.00350	0.246
Findec	420	0.0333	0.0262	0.00324	0.114
Gov	420	0.228	0.0983	0.0837	0.628
Openness	420	0.299	0.358	0.0127	1.721

Traffic	420	0.902	0.496	0.0684	2.174
Patent	420	69272	112978	325	807700
TS	420	1.068	0.609	0.500	5.169
Urban	420	0.551	0.137	0.275	0.896
Fiscaldec	420	0.836	0.0576	0.669	0.937
Compe	420	0.808	0.155	0.0260	0.937
pFindec	420	1.151	0.964	0.421	6.502

4. Empirical Analysis

4.1 Analysis of Baseline Results

Table 3 presents the results of the baseline regression. The coefficient of financial decentralization is -1.889, which is statistically significant at the 1% level. This suggests that financial decentralization policies have a significant and positive impact on commercial banks' lending behavior and asset risk management. Holding other variables constant, a 1% increase in financial decentralization is associated with a 1.889% decrease in commercial banks' non-performing loan ratios, thus verifying hypothesis H1b. This may be due to the fact that the current deepening of financial decentralization focuses more on government decentralization to the market and the involvement of market resources, which reduces government intervention in the financial market, improving investment efficiency and market stability, and ultimately reducing non-performing loan rates.

Table 3 Baseline regression results

VARIABLES	(1) NPLr	(2) NPLr	(3) NPLr	(4) NPLr	(5) NPLr	(6) NPLr
lnFindec	-0.556	-0.563	-1.035**	-1.557***	-1.526***	-1.889***
	(-1.36)	(-1.33)	(-2.20)	(-2.82)	(-2.78)	(-3.53)
lnGov	-0.011	-0.017	0.053	0.013	-0.130	-0.013
	(-0.03)	(-0.04)	(0.14)	(0.04)	(-0.33)	(-0.03)
lnOpenness		-0.163	-0.177*	-0.251**	-0.235**	-0.292***
		(-1.55)	(-1.80)	(-2.38)	(-2.25)	(-2.93)
lnTraffic			1.410***	1.348***	1.372***	1.317***
			(2.87)	(3.12)	(3.09)	(2.92)
lnPatent				0.389***	0.438***	0.384***
				(2.79)	(3.17)	(3.05)
lnTS					0.361	0.401
					(1.08)	(1.21)
lnUrban						1.498*
						(1.86)
Constant	-4.567**	-4.858**	-5.761***	-11.361***	-11.837***	-11.424***
	(-2.50)	(-2.53)	(-2.84)	(-3.27)	(-3.45)	(-3.71)
Year	Yes	Yes	Yes	Yes	Yes	Yes
Region	Yes	Yes	Yes	Yes	Yes	Yes

Observations	420	420	420	420	420	420
Adj-R2	0.787	0.788	0.796	0.807	0.809	0.813

Note: All the above reported in parentheses are robust standard errors. ***, **, * indicate significant at 1%, 5%, 10% significance level, respectively.

4.2 Heterogeneity analysis

Considering that there are differences in resource endowment and economic development among regions, financial decentralization may also be regionally heterogeneous, so further spatial heterogeneity tests were conducted. According to the national statistical classification standards, the sample was divided into three regions, namely, the eastern, central and western regions, and the regression analysis was conducted in groups. The regression results are shown in Table 4.

Table 4 Heterogeneity grouping regression results

VARIABLES	(1) Eastern	(2) Central	(3) Western
lnFindec	-2.940**	0.549	-2.250***
	(-2.65)	(0.52)	(-5.10)
lnGov	-1.177	-0.309	1.546**
	(-1.76)	(-0.60)	(2.42)
lnOpenness	-0.384	-0.214	-0.285*
	(-0.98)	(-0.79)	(-1.89)
lnTraffic	2.320**	-0.042	1.140
	(2.76)	(-0.05)	(1.61)
lnPatent	0.669*	0.060	0.109
	(2.02)	(0.30)	(0.56)
lnTS	0.718	0.320	-0.577*
	(1.33)	(1.67)	(-2.18)
lnUrban	4.101**	1.133	0.996
	(2.85)	(0.42)	(0.59)
Constant	-18.540**	-0.603	-8.938**
	(-2.79)	(-0.08)	(-3.16)
Year	Yes	Yes	Yes
Region	Yes	Yes	Yes
Observations	182	84	154
Adj-R^2	0.745	0.955	0.877

Note: All the above reported in parentheses are robust standard errors. ***, **, * indicate significant at 1%, 5%, 10% significance level, respectively.

The regression analysis shows significant regional heterogeneity in the impact of financial decentralization on commercial banks' non-performing loan (NPL) ratios. In the eastern region, the coefficient of financial decentralization is -2.940, significant at the 5% level. Similarly, in the western region, the coefficient is -2.250, significant at the 1% level. However, in the central region, the coefficient is positive and not statistically significant. These findings indicate that financial decentralization has a significant suppressive effect on NPL ratios in both the eastern and western regions, with a stronger effect observed in the western region. In contrast, the suppressive effect of financial decentralization on commercial banks' NPL ratios is not significant in the central region.

Several factors may account for these regional differences. First, the financial market structure in the eastern region is likely to be more developed, with more stringent regulations and risk management practices in place for commercial banks. Therefore, the implementation of financial decentralization policy can effectively coordinate with the original system, promote market competition and improve the loan quality of commercial banks. The development of the financial market in the western region is relatively backward, so the effect of financial decentralization policy is remarkable, even more than that in the eastern region. In the central region, where economic and financial market development are intermediate between the east and west, the impact of financial decentralization policy is not as pronounced. Second, differences in policy implementation may also contribute to the observed regional heterogeneity. The government's determination and strength in implementing financial decentralization policies may be greater in the eastern region, while the western region may receive more policy support due to its relative backwardness. In contrast, the central region may be subject to less financial regulation due to its relatively robust development. Both factors likely play a role in shaping the different impacts of financial decentralization policies across regions.

4.3 Analysis of the Moderation Effect

Table 5 presents the results of the test for the moderating effect. Column (1) shows the effect of financial decentralization moderated by fiscal decentralization on commercial banks' non-performing loan (NPL) ratios. The inclusion of fiscal decentralization leads to a negative coefficient of financial decentralization (-1.301), which remains significant at the 5% level. Moreover, the coefficient of fiscal decentralization on commercial banks' NPL ratios is -7.649, which is significantly negative at the 1% level. However, the interaction term between financial decentralization and fiscal decentralization is significantly positive at the 5% level, implying that the current reforms of fiscal and financial decentralization systems in China do not synergize effectively. Instead, their joint effect weakens the inhibitory effect of decentralization system reform on commercial banks' NPL ratios. This highlights the need for deeper synergy between the fiscal and financial decentralization systems in China.

Column (2) shows the effect of financial decentralization moderated by promotion competition on commercial banks' NPL ratios. The coefficient of financial decentralization is -2.017, which is significantly negative at the 1% level, while the coefficient of competition for promotion is negative but not significant. The interaction term between financial decentralization and competition for promotion is -0.425, but it is also not significant. This result indicates that financial decentralization does not enhance financial risk by strengthening promotion competition from the data of national commercial banks, verifying H3b. It shows that promotion competition is now focusing not only on economic development, but also on financial risk prevention, and there is a good development trend.

Table 5 Regression results of moderation effects

VARIABLES	(1) NPLr	(2) NPLr
lnFindec	-1.301**	-2.017***
	(-2.51)	(-4.38)
lnFiscaldec	-7.649***	
	(-3.70)	
lnFidec×lnFiscal	2.941**	
	(2.66)	
lnCompe		-0.712

		(-1.37)
lnFidec×lnCompe		-0.425
		(-0.75)
lnGov	0.860**	0.012
	(2.32)	(0.03)
lnOpenness	-0.151*	-0.306***
	(-1.81)	(-3.56)
lnTraffic	1.616***	1.267**
	(2.93)	(2.61)
lnPatent	0.406***	0.391***
	(3.64)	(2.99)
lnTS	-0.028	0.314
	(-0.14)	(0.99)
lnUrban	2.628***	1.439*
	(3.01)	(1.76)
Constant	-8.773***	-12.340***
	(-3.27)	(-4.47)
Year	Yes	Yes
Region	Yes	Yes
Observations	420	420
Adj-R^2	0.839	0.817

Note: All the above reported in parentheses are robust standard errors. ***, **, * indicate significant at 1%, 5%, 10% significance level, respectively.

4.4 Robustness tests

This paper employs three methods to conduct robustness tests. First, this paper uses the method of replacing the core explanatory variables for robustness testing, drawing on the idea of Fu and Li (2017), who use per capita financial decentralization, i.e., provincial (per capita) bank loans/national (per capita) bank loans, as the variable for robustness testing [6]. Secondly, considering the possible lag of the suppressive effect of financial decentralization on financial risk, this paper uses financial decentralization with a one-period lag for the regression. Finally, considering the possible endogeneity problem, this paper uses one-period lagged financial decentralization as an instrumental variable. The regression results of the three methods are shown in columns (1) (2) (3), respectively, and the significant negative coefficients of the core explanatory variables confirm the robustness of the results.

Table 6 Robustness test results

VARIABLES	(1) NPLr	(2) NPLr	(3) NPLr
lnpFindec	-1.713***		
	(-3.76)		
L.lnFindec		-1.123*	
		(-1.76)	

lnFindec			-1.225***
			(-3.94)
lnGov	0.048	0.236	0.273
	(0.12)	(0.59)	(1.10)
lnOpenness	-0.259**	-0.234**	-0.215***
	(-2.44)	(-2.08)	(-2.89)
lnTraffic	1.084***	1.284**	1.207**
	(2.93)	(2.25)	(2.18)
lnPatent	0.353***	0.293**	0.290***
	(2.88)	(2.20)	(3.47)
lnTS	0.460	0.395	0.358**
	(1.61)	(1.24)	(2.17)
lnUrban	1.949**	1.161	1.361**
	(2.15)	(1.34)	(2.32)
Constant	-3.848**	-7.643**	-9.184***
	(-2.13)	(-2.28)	(-5.37)
Year	Yes	Yes	Yes
Region	Yes	Yes	Yes
Observations	420	390	390
Adj-R^2	0.814	0.743	0.779

Note: All the above reported in parentheses are robust standard errors. ***, **, * indicate significant at 1%, 5%, 10% significance level, respectively.

5. Conclusions and Recommendations

The decentralization of the central-local relationship is an ongoing reform that is crucial for strengthening local governments and preventing financial risks. This paper examines the impact of financial decentralization on financial risk using panel data from 30 provinces and cities in China. The main findings are as follows: Firstly, financial decentralization can effectively reduce financial risk. Secondly, there is significant spatial heterogeneity in the impact of financial decentralization on financial risk. The inhibitory effect of financial decentralization on financial risk is stronger in the east, where the financial market is more mature, and in the west, where financial development is relatively backward. However, the inhibitory effect of financial decentralization on financial risk is weaker in the central region, which is intermediate in terms of financial and economic development. Finally, China's financial decentralization and fiscal decentralization cannot effectively synergize, and although both can suppress financial risk, the interaction of the two increases financial risk. At the same time, financial decentralization will not increase financial risk by enhancing competition for promotion.

Based on the above findings, this paper puts forward the following policy recommendations. First, the implementation of financial decentralization in China should be promoted according to local conditions, and sufficient attention should be paid to the central region, where the financial market is not mature. Second, fiscal decentralization and financial decentralization should be coordinated to make them match as much as possible. Finally, local financial risks should be included in the assessment index to prevent local officials from using their rights to interfere excessively with financial resources and trigger financial risks.

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