

Federal Finance

Concept, Principles & Problems

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Federal Finance

Federal finance refers to the system of assigning the source of revenue to the Central as well as State Governments for the efficient discharge of their respective functions i.e. clear-cut division is made regarding the allocation of resources of revenue between the central and state authorities.

Division of Powers:

In our Constitution, there is a clear division of powers so that none violates its limits and tries to encroach upon the functions of the other and functions within own sphere of responsibilities. There are three lists enumerated in the Seventh Schedule of constitution.

They are: the Union list, the State list and the Concurrent List.

- The **Union List** consists of 100 subjects of national importance such as Defense, Railways, Post and Telegraph, etc.
- The **State List** consists of 61 subjects of local interest such as Public Health, Police etc.
- The **Concurrent List** has 52 subjects important to both the Union and the State, such as Electricity, Trade Union, Economic and Social Planning, etc.

1. Principles of Federal Finance

- 1. Principle of Independence.
- 2. Principle of Equity.
- 3. Principle of Uniformity.
- 4. Principle of Adequacy & Elasticity.
- 5. Principle of Fiscal Access.
- 6. Principle of Integration and coordination.
- 7. Principle of Efficiency.
- 8. Principle of Administrative Economy.
- 9. Principle of Accountability.

Problems of Federal Finance:

- Intergovernmental fiscal problems
- A considerable divergence exist between the sources of revenue and functional expenditure obligations among the government of a federation.
- Imbalance between revenue and expenditure, that too between different levels of government.
- Decentralized fiscal system in fiscal federalism
- Imbalance in the distribution of resources and needs among different levels of government.
- Growing conflict between Centre and State in matters regarding the distribution of financial resources, between the units in a federation, owing to political and ideological grounds.
- Multiplicity of taxing and spending activities in a federation

Vertical Fiscal Imbalance

- The situation of imbalance of revenue and expenditures vertically between levels of government is referred to as the problem of non-correspondence or vertical fiscal imbalance.

The important methods adopted to achieve vertical fiscal equality between the Centre and regional governments in a federation are:

- Tax sharing,
- 2. Tax credit,
- 3. Tax deductibility,
- 4. Tax denial,
- 5. General grants-in-aid, and
- 6. Selective grants-in-aid.

Horizontal Fiscal Imbalance:

- Horizontal imbalance exists between units at the same level of sovereignty. When fiscal imbalance occurs between different units of government at the same level of government in a federation, it is known as problem of equalization or horizontal fiscal imbalance.