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B.A. Economics

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Paper -9

Topic : The Concept of Federal Finance

The Concept of Federal Finance:

In usual parlance federation is defined as an association of two or more states. The federal setup is characterized by the existence of a union government (Central government) on the one hand and state government for different constituent units.

It is a form of political association in which two or more states constitute a political unity with a common government, but in which the member states retain a measure of internal autonomy. **Encyclopedia Britannica** defines federation “as a form of government in which the essential principle is that there is a union of two or more States under the central body for certain permanent objectives.”

Sir Robert Garran defined federation as a **form of government in which Sovereignty or political power is divided between the central and the local governments, so that each of them within its own sphere is independent of the other.**

As far as functions and resources are concerned the two sets of government are independent. Actual federations are however of different forms. For example India is more unitary than the federal type, where there is a large concentration of power in the hands of the central government.

Whereas USA is more of a federal than unitary type Country, Where there is lesser concentration of power with centre and larger exercise of power by provincial and local governments.

Thus depending on the type of federation fiscal responsibilities are shared between central, state and local governments. Therefore federal finance means divisions and coordination of different items of income and expenditure between central, state and local governments. This multilevel decentralized fiscal system is known as **fiscal federalism**.

Prof. K. C. Wheare states:

“By the federal principle I mean the method of dividing power so that the general and regional governments are each, within a sphere, co- ordinate and independent.”

Therefore federation is characterized by certain basic principles like:

- (a) Division of power and functions,
- (b) Supremacy of the constitutions,
- (c) Constitutional independence of the constituent units, and
- (d) Federal predominance.
