**FEDERAL FINANCE**

**Meaning Federal Structure**

Federation or Federal structure is a political system in which there is constitutional division of powers (executive, legislative and financial) between the Central and the State governments. In other words, a federation is characterized by different layers of government, like the Central, State and Local governments. The division of functions and financial resources between the Central (federal) and State (unit) governments is the important feature in any federal structure.

**Meaning Federal Finance**

The federal set-up, apart from the division of functions, has also defined properly the division of financial powers between the Central government and the State governments. The two sets of governments are independent so far as their own functions and resources are concerned. **Federal finance** refers to the matter of division of financial resources between the Central and State government. It examines and solves the problems of division of financial power i.e., power to raise revenue through taxes and, to incur expenditure and to raise the public debt between the Central and State governments.

The fundamental problem of federal finance is that ensuring that the division of revenue between the Central and Regional governments corresponds with the distribution of function in order that each government may have the functional capacity to carry out its responsibility far as possible.

**Principles of Federal Finance**

There are some important principles which should govern the working of federal finance:

1. **Independence and responsibility** – Full freedom of financial operations must be extended to both Central (federal) and State governments in order that they may not suffer from a feeling of cramp in the discharge of their normal activities and in the achievement of their aspirations for the promotion of social and economic advancement. It means that Central and State governments must each have under it, its own independent Central Financial resources sufficient to carry out its exclusive functions. Each should be financially independent within their own sphere.
2. **Adequacy and elasticity** – The principle of adequacy means that the resources of Central and State governments should be adequate so that each layer of government can discharge its obligations laid upon it. It stands for sufficiency of resources for the discharge of functions and duties assigned.

Besides adequacy, there should be elasticity in the financial resources. It means that resources should be capable of expansion in response to rapidly growing needs and responsibilities of the government concerned.

1. **Administrative economy and efficiency** – For the success of Central-State Financial Relations, it is very much required that the administrative cost should be minimum and there should be no frauds and evasion in matters of finances. It should also be taken into account that at the time of allocating resources as to whether a certain source can be better administered by Federal or State governments.
2. **Principle of equity** – The applicability of equity principle in Federal System is important. Because in the assignment and allocations of functions, there is an opportunity for inequity to creep in and may spoil the entire structure basically. Therefore, according to this principle, the burden of taxation will be distributed in accordance with marginal sacrifice which is different in the different states. There should be proper adjustment between Federal and State taxation so as to make the tax burden on all citizens equitable as far as possible.
3. **Principle of Integration and Co-ordination –** The whole financial system of a Federation should be well integrated and each layer of financial system of Federation should not be taken as completely isolated from the other layers of financial system. Co-ordination is also important for smooth and efficient working of Federal Financial System. The co-ordination of Federal State should not be in taxation alone but in every aspect of finance.
4. **Principle of Accountability –** Freedom and democracy are sister institutions in a Federal System. Therefore, in Federal System, government should be accountable to its own legislature for its having and spending decisions. It should make its decisions with regard for their effect on other government.
5. **Principle of uniformity –** The Financial System in a federation should be such as to enable each Regional Government to provide an adequate level of public service without resort to higher rates of taxation substantially than those of other regions.
6. **Principle of Fiscal Assess –** There should be no bar on Central and State governments in developing new sources of revenue within their own prescribed fields to meet the growing financial needs. It implies that resources should grow with the increase in responsibilities.
7. **Economic Regulation –** The financial resources should be allocated between the Centre and the States in such a way as to ensure that the economic system is effectively regulated and there is high degree of stability.
8. **Principle of Autonomy –** The principle of autonomy calls for independent financial powers for States with regard to taxation, expenditure and public borrowing. Clear-cut demarcation ensures independency and autonomy to States who need not be under the pressure of obligation of the Central Government. This will ensure smooth sailing between the Central government and the State governments.