

## 1 INTRODUCTION

Fiscal history throughout the world has demonstrated convincingly both the advantages of 'size' and gains from decentralisation. With the strengthening of interdependence of the international economic system, the vulnerability of small open economies in conducting macroeconomic policies has become obvious. In addition, the beneficial effects of a large common market have been amply demonstrated with the emergence of the prosperous European Common Market. At the same time, the importance of smaller jurisdictions in providing a number of important public services continues to grow. In most federal countries, the growth of sub-central levels of government has been faster than that of the Central government. These events have generated a good deal of interest in the study of multilevel finance. "Fiscal Federalism" thus has emerged as an important area of study.

The economics of federalism or 'fiscal federalism' is an area of study in which the principles of economics are applied to the functioning of the public sector in a federal system. It deals with the traditional concerns of the economists - resource allocation and income distribution in a multilevel public sector organisation (Oates, 1972, 1977). Although there are no distinct or unified theories of fiscal federalism, one can find various models analysing the equity and efficiency implications arising from fiscal location of both of consumers and producers, inter-jurisdictional competition and cooperation, and multi-jurisdictional community (Musgrave, 1969).

The study of fiscal federalism in a developing mixed economy, like India, assumes additional significance. In market economies the governmental role is confined mainly to the provision of public services and to interventions in cases of market failure. In contrast, in India, the government has taken over the major responsibility for allocating resources to achieve growth and equity, both inter-personal and inter-regional, in consonance with social priorities as determined by the policy makers. The emphasis on multilevel physical planning has necessitated financial planning and this brings an additional dimension to the problem of federal or multi-level finance. Besides, since historically considerations of a colonial power did not necessarily enable resource allocation across different regions according to their endowments, fiscal federalism in the Indian context is perceived to play a more dynamic economic role than what is seen in many of the other federations<sup>1</sup>.

Considering the importance of the subject, it is not surprising that the issues of federal finance in India have received considerable scholarly attention. The purpose of this survey is to review the contributions to the analysis of Indian fiscal federalism. Given the large and growing volume of literature on the subject, it is not possible to analyse all the contributions and some selectivity becomes unavoidable. While the historical, political and legal aspects of federalism are equally important, we have, for analytical convenience, attempted to focus attention on the economics of federal finance or 'fiscal federalism'. Also, for understandable reasons, we have preferred to emphasise the studies with more analytical content rather than those which are more descriptive.

Section II reviews the major theoretical and empirical contributions on fiscal federalism summarising, in the main, the theory of fiscal decentralisation, the rationale for intergovernmental transfers and the effects of various types of intergovernmental transfers. Against this background, the developments in the Indian fiscal federalism are

**analysed and contributions of both official and academic experts on Indian federal finance are reviewed in section III and in section IV, important areas for future research on the subject are highlighted.**