

Fifty Years of Fiscal Federalism in India: An Appraisal*

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I Introduction

It is a great honour and a privilege to be invited to deliver the Kale Memorial Lecture at the Gokhale Institute. More so for one like me, who cannot claim to be treated as an academic, having spent the better part of my life in departments of government. Over the years, lectures delivered on this occasion have come to be regarded as an opportunity for scholars to put across new ideas to a wider audience on a wide range of issues in public policy, befitting the memory of the great man to whom these lectures are dedicated. Gokhale Institute deserves to be congratulated for keeping alive the tradition of disseminating the findings of academic research through public lectures in the best traditions of the city of Pune.

The paper I am going to present in the course of this lecture is, as the title indicates, a retrospective of Fiscal Federalism in India in the last fifty years. This is a rather ambitious task and calls for more extensive research than has been possible for me to undertake. Nevertheless, I thought, given the vital role of intergovernmental fiscal relations in a federal polity in shaping its public sector and its bearing on the performance of the economy and the well-being of its people, despite its limitations, such an appraisal might be of some interest and use. By way of introduction, a few words on the rationale for federalism and its pre-requisites for success may be in order.

Federalism, it is universally acknowledged, has many virtues. Federal governance promotes efficiency, both economic and political. Economic efficiency is advanced by the division of governmental functions among different levels depending on their comparative advantage. Assignment of matters that concern the nation as a whole, or where there are externalities or large economies of scale, to the government at the centre combined with decentralisation of responsibility to provide services that benefit smaller segments of the country or the community to lower level governments, promotes efficiency in the allocation of resources in the economy. What is more, in a federal polity the economy benefits from the operation of a common market facilitated by the free flow of goods, services and factors of production within the country.

Federalism is considered efficient from the political angle as well because of the facility it provides for a heterogeneous population to come together under the banner of one nation and acquire strength from unity while allowing the constituents to retain their identity and autonomy over a wide area of public life. Federalism also fosters democratic values and the civic virtues of people's participation in political processes (Inman and Rubinfeld or I-R, 1997). In recent years it is the economic benefits of federalism that

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