Smart spend key for sustainability

Dr. Manoranjan Sharma

- **GOVERNMENT** is certain to meet its fiscal deficit target of 4.9% of GDP (₹16.1 lakh cr) in FY25, despite lower nominal GDP growth than budgeted.
- **FISCAL** consolidation, enhanced domestic savings, and distributive equity focused on welfare schemes and rural transfers could feature prominently in FY26.

India's deficit and debt dynamics imperil the macro-economy. A high fiscal deficit raises the interest burden crowding out expenditures on productive sectors, increasing borrowing costs, and financially crowding out private investments triggering inflation, weakening the balance of payments. This makes financial sector reform more protracted, severely damages the financial ability of future generations, and rating downgrading makes foreign borrowing costly.

Vitor Gaspar, IMF justifiably maintains "countries around the world face a fiscal policy trilemma: pressure to increase spending, public resistance to higher taxes, and risks from rising debt levels. Countries must navigate these challenges to maintain economic stability and growth." Similarly, Era Dabla-Norris, et al, IMF demonstrate large fiscal deficits and elevated debt levels call for greater fiscal prudence, but political forces are pulling in the opposite way.

Since 2022, India's fiscal deficit has steadily declined, and the rise in gross debt as a percentage of GDP has been lower vis-à-vis China, Thailand, Malaysia, Russia, Brazil, and South Korea. The government is certain to meet its fiscal deficit target of 4.9 per cent of GDP (₹16.1 lakh crore) in FY25, despite lower nominal GDP growth than budgeted, as stipulated in the medium-term budgetary policy-cum-fiscal strategy statement with the FY25 budget. Higher direct taxes (which rose from 52 per cent in FY22 to 57.5 per cent of gross tax revenue in FY25) and increased non-tax revenues would offset shortfalls in corporate taxes and excise duties. Further, reducing capital expenditure should help counterbalance the rising food subsidy costs.

With reduced non-productive expenditures, and curbing borrowing dependencies, the fiscal deficit target for FY26 could be 4.4-4.6 per cent of GDP for FY26. Long-term debt sustainability could be achieved by reducing current expenditure, excluding interest and subsidies, by 0.2 per cent of GDP, while maintaining capital expenditure at 3.2 per cent of GDP, partially supported by increased transfers to states.

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(The writer is chief economist at Infomerics Valuation and Rating)