A Smart budget in Constrained Fiscal Space

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Budget of 2025-26 has been presented at a time when the growth in the economy is showing a decelerating trend and the volatility in the global economy is building up. It is indeed true that the degree of volatility is still less, compared to Asian Crisis (1997-98), global meltdown of mid 2007 to 2009 or even taper tantrum (2013-14). However, one cannot deny that the tariff measures unleashed by Trump-2 regime have the potential of escalating into a full-fledged tariff war around the world. In this context, maintaining macroeconomic stability in general and fiscal stability in particular would be important. Presumably in anticipation of this, the current budget has lowered average customs duty from 11.65% to 10.66%. In terms of optics too we need to play the game astutely.

The question before us is can the budget contribute to accelerating the growth trend along with fiscal stability? The nominal GDP projection for 2025-26 has been pegged at 10.1%, should inflation come down to 4% it could mean a growth rate of around 6%. GDP deflator based inflation is less than the CPI inflation so the real growth could be a little more.

Getting back to fiscal stability, the current government has steadily followed the path of fiscal consolidation.

Deficit as a percentage of GDP

Year	2020-21	2021-22	2022-23	2023-24	2024-25 (Rev)	2025-26 (Est)
Deficit as a percentage of GDP	9.2	6.7	6.4	5.6	4.8	4.4

Given the focus on fiscal prudence the borrowing levels are likely to remain modest. In fact, G-Sec requirement is expected to come down marginally.

Market borrowings (G-Sec)

Year	2023-24	2024-25 (Rev)	2025-26 (Est)
Market borrowings (G-Sec) Rupees in Crore	1177754	1162678	1153834

Given the overt demonstration by the Government that it is serious about fiscal consolidation the 10 year benchmark G-Sec could come down to 6.69 to 6.5 range. This can get a further downward push on account of a rate cut and an improvement in liquidity by RBI.

It is indeed true that the focus on fiscal consolidation can also squeeze the fiscal space particularly at a time when gross tax receipts as a percentage of GDP is somewhat static and pace of disinvestment is tardy. Long term tax buoyancy is around 1.1.

Gross tax receipts as a percentage of GDP

Year	2023-24	2024-25 (Rev)	2025-26 (Est)
Gross tax receipts as a percentage of GDP	11.7	11.9	12

Till date government has done the heavy lifting in terms of Capital expenditure hoping that private investment would get tethered to it; however private sector has been restrictive in its investment behaviour. At the same time government cannot do more given the fiscal consolidation requirements.

Effective Capital Expenditure as a percentage of GDP

Year	2023-24	2024-25 (Rev)	2025-26 (Est)
Effective Capital Expenditure as a percentage of GDP	4.2	4.1	4.3

Note: Effective Capital Expenditure= Capital Expenditure plus Grants in aid for creation of capital assets.

Given the discipline of fiscal consolidation and in view of the current growth trends in net tax revenue, non-tax revenue and capital receipts the government has put a squeeze on total expenditure. The effective capital expenditure as percentage of GDP as shown earlier has gone up marginally but overall expenditure particularly revenue expenditure has come down.

Share of Expenditure in Budget

Year	2023-24	2024-25 (Rev)	2025-26 (Est)
Total Expenditure as a percentage of GDP	15	14.6	14.2
Revenue Expenditure as a percentage of GDP	10.8	10.5	9.8

Within revenue expenditure the government has to prioritise according to political compulsions in a democratic polity. That's exactly what the government has done in its sectoral allocations.

Given this scenario a standard prescription would be to get private sector investment tethered to government's investment by ameliorating private sector risks through land, labour, power, tax reforms and more emphasis on ease of doing business etc. All these are needed but results to be visible take time. Once that happens the domestic demand conditions would improve, employment and wages would increase.

What the government has done is to look for low hanging fruits, tax reduction for the middle class has its own political advantage. Secondly, more money (One Lakh Crore) in hands of the middle class will set in motion the consumption multiplier. The impact of consumption multiplier would be immediate assuming a large part of the tax cut will be spent on consumption goods. Existing industries in discretionary consumption items, durables, two-wheelers, EMI based goods, e-commerce platforms, domestic tourism, etc., would be benefited. Growth in GDP could be higher than anticipated due to the consumption multiplier and threat of cyclical downturn can be pushed back. This is indeed a smart move particularly in a period when export demand can be adversely affected due to tariff war and uncertainty on account of Trump-2. With exports of goods and services facing constraints the country's growth will be more dependent on the domestic sector demand.

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