NEXT IAS

DAILY EDITORIAL ANALYSIS

TOPIC

FISCAL POLICY PLANNING: WHY INDIA NEEDS A CLEARER MEDIUM-TERM PLAN

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Context

- In the **Union Budget 2026-27,** the government has placed greater emphasis on the **debt-to-GDP ratio, i**nstead of focusing narrowly on the annual fiscal deficit.

About Fiscal Policy

- **Fiscal policy** refers to how the Government of India uses its **budgetary tools** i.e. revenue collection (taxes, non-tax receipts), expenditure, borrowing, and debt management.
- It aims to balance **development priorities** (infrastructure, health, education) with **long-term sustainability** (deficit management, debt control) while responding to domestic and global economic conditions.
- It is primarily articulated through the **Annual Financial Statement (Union Budget)** under **Article 112 of the Constitution.**
- A key indicator of fiscal health is the **fiscal deficit** *(the gap between government expenditure and revenue)* which **directly adds to public debt.**

Current Fiscal Position & Future Targets

- **Fiscal Deficit & Debt:** Fiscal deficit reduced from **9.2% of GDP in 2020-21** (pandemic year) to **4.4% in 2025-26**.
    - **Target for 2026-27:** Fiscal deficit at **4.3% of GDP**.
    - Central government **debt-to-GDP ratio** projected to decline from **56.1% in 2025-26** to **55.6% in 2026-27**.
- **Growth & Macroeconomic Environment:** According to Economic Survey (2025-26):
    - **Real GDP growth** was estimated at **about 7.4% for FY 2025–26**, one of the highest among major economies.
    - Growth for FY 2026–27 is projected at **6.8–7.2%**, underlining resilience despite global headwinds.
- **Revenue & Expenditure Patterns: Tax revenues** (direct & indirect) remain the core revenue source; efforts continue to improve tax buoyancy.
    - **Non-tax revenues**, notably dividends from the RBI and public sector entities are budgeted higher, providing additional fiscal space without raising taxes.
    - **Capital expenditure** is a strong priority, reaching a record ₹**12.2 lakh crore (~₹12.2 trillion) in FY 2026–27,** aimed at infrastructure and growth-oriented initiatives.

Major Concerns & Issues

- **High Debt Levels Despite Consolidation:** Even if the government achieves its target of reducing central government debt to **50±1% of GDP by 2030-31**, debt will remain well above earlier benchmarks.
    - The **FRBM framework** had envisaged central government debt at **40% of GDP** by 2025, implying a gap of nearly **10 percentage points** even by 2031.
- **Limited Ambition in the Near Term:** Given stronger-than-expected economic growth, the government could have pursued faster consolidation.
    - It is especially relevant as future pressures loom, including:
        - Implementation of the **Eighth Pay Commission;**
        - Fiscal demands associated with a **general election before 2030-31;**
- **General Government Debt Risks:** S**tate government debt is expected to rise**, keeping general government debt close to **80% of GDP**, potentially offsetting gains made at the central level while Union government debt may decline.

Key Policy Efforts & Initiatives

- **Union Budget 2026–27 Strategy:** It framed the fiscal approach around three pillars i.e. **growth acceleration, aspirations of people, stability and sustainability of finances.**
    - **Enhanced Capital Expenditure:** A **record rise in capital expenditure**, focusing on roads, railways, ports, urban & rural infrastructure, and logistics corridors (green & sustainable infrastructure).
        - It strengthens the supply side and employment generation.
    - **Strategic Sector Support:** Support to **manufacturing, semiconductors, biopharma, electronics, and strategic minerals** aims to boost productivity and reduce import dependence.
    - **MSME & Enterprise Support:** Enhanced liquidity and credit provision for MSMEs to drive employment and grassroots growth.
- **Structural Reforms & Policy Initiatives:**
    - **Regulatory Reforms & Ease of Doing Business:** The **Economic Survey 2025-26** highlights continued efforts to simplify regulations and reduce compliance burdens across sectors, improving efficiency and domestic investment climate.
    - **Labor Market & Skills Focus:** Policy thrust on labor reforms and skill development continues, aiding formal employment and productivity.
    - **State-Level Fiscal Health (Fiscal Health Index):** The **Fiscal Health Index** initiative by **NITI Aayog** assesses state finances on indicators like tax buoyancy, debt sustainability, and expenditure quality.
        - It helps align **state fiscal discipline** with national goals.

Other Efforts & Initiatives

- Shift towards **debt-to-GDP targeting** rather than short-term deficit fixation.
- Gradual fiscal consolidation without abrupt expenditure cuts.
- Improvement in expenditure quality, supporting long-term growth.
- Signalling commitment to medium-term fiscal discipline to markets.
    - These efforts have helped restore credibility after the pandemic-induced fiscal expansion.

Way Forward

- **Aim for a Primary Surplus:** Running at least a small **primary surplus (excluding interest payments)** would accelerate debt reduction.
- **Sustain High Nominal GDP Growth:** Debt dynamics depend critically on growth remaining higher than interest rates.
- **Coordinate Union–State Fiscal Consolidation:** A comprehensive strategy covering both Centre and states is essential to reduce overall government debt.
- **Account for Financing Constraints:** With household financial savings at around **6% of GDP**, rising government borrowing risks crowding out private investment and pushing up interest rates.
- **Adopt Medium-Term Fiscal Planning:** A transparent medium-term framework for general government finances would improve policy credibility and market confidence beyond annual Budgets.

Daily Mains Practice Question

[Q] Discuss the role of medium-term fiscal planning in ensuring macroeconomic stability, managing public debt, improving expenditure quality, and anchoring expectations of markets and states.

Source: BS

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