Tightrope act: The budget deftly balances divergent imperatives

Its expenditure strategy creates space for future capital outlays but evolving economic conditions must be kept under watch

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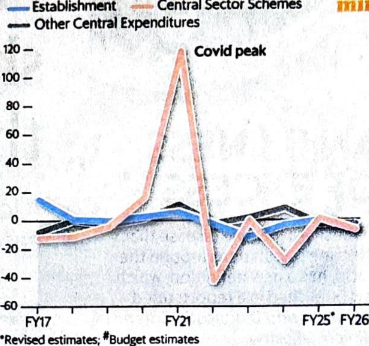
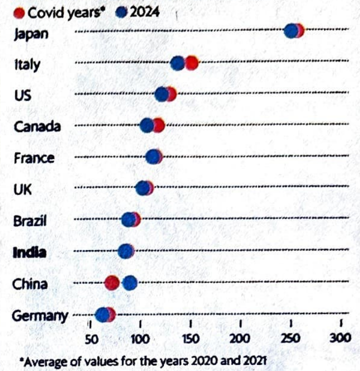
Budgetary compression at work

The government has been curtailing its running expenses by ensuring they grow slower than the economy (in nominal terms) to consolidate its fiscal and debt position.



*Revised estimates; #Budget estimates

Note: A negative figure shows expenditure growth less than nominal GDP



Source: Budget documents, IMF World Economic Outlook (October 2024)

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India's budget for 2025-26 demonstrates a careful balance between an unwavering focus on macroeconomic stability by continuing on a path of fiscal prudence and addressing growth concerns. It comes after a strong fiscal performance in 2024-25, when the government managed to outperform its fiscal targets, achieving a deficit of 4.8% of GDP against the budgeted 4.9%, primarily through reduced capital expenditure. Notably, fiscal consolidation remains the budget's primary focus, with its fiscal-deficit target set at 4.4% of GDP, a further reduction of 0.4 percentage points. This is underpinned by conservative assumptions, including nominal GDP growth of just above 10% and its measured expectation of tax buoyancy at 1.07, after the highs of 1.40 in 2023-24 and 1.15 in 2024-25. The quality of spending has also improved; the ratio of capital-to-current spending rose from about 20% in 2021-22 to stabilize at about 30% in 2023-24 and 2024-25, and a similar pattern will be seen next year. To those saying that central capital expenditure has hit a ceiling, this budget is actually freeing up fiscal space for the future. The devil lies in the details, and here, the government's clever strategy deserves a closer look.

The government plans to reduce its budget deficit mainly through efficient revenue account management and *significantly limiting increases in day-to-day spending. While investment spending is set* to grow by 10.1% (about matching nominal GDP growth), regular operational spending is planned to increase by only 6.7%. This cut, which accounts for almost the entire fiscal consolidation of 0.4 percentage points, comes from reductions in three main areas: administrative costs, central government programmes and other expenses (including on public enterprises, autonomous organizations and debt payments). Administrative costs, which include fixed expenses like salaries, pensions and office expenses, had been growing faster than GDP between 2017 and 2022 (*see chart 1*). However, recent efforts have focused on reducing government overheads. These measures can help create more budget flexibility, including for state governments. Currently, many states aren't able to fully use their capital development grants (1.2% of GDP) from the total investment plan (4.3% of GDP).

Finally, the government continues to show confidence in the private sector, particularly for building infrastructure. Following the success of the National Monetization Pipeline, which liquidated ₹6 trillion worth of assets between 2022 and 2025, new plans are in place to monetize assets worth ₹10 trillion. This strategy will improve the management of assets while encouraging public-private partnerships (PPP) to enhance operational efficiency. Despite these consolidation efforts, fiscal challenges persist. India's sovereign debt remains a concern, estimated at about 84% of GDP in 2025-26 (*see chart 2*). A particularly striking aspect is the high burden of interest payments, which are budgeted at 37% of expenditure. These interest payments account for more than 80% of the fiscal deficit, resulting in a primary deficit (fiscal deficit excluding interest payments) of just 0.8% of GDP. This warrants deleveraging to improve India's sovereign rating and create fiscal space for development initiatives. Though it isn't fully clear how credit rating agencies decide sovereign ratings, these strongly influence both how much foreign money flows into a country and perceptions of how likely that country is to fail to repay its debts; and the stock of debt as a proportion of GDP remains a key component of their rating models.

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Further, addressing India's slowdown in growth momentum is on top of the minds of policymakers, as evident in the many measures in the budget to stimulate growth, most notably through revised income tax thresholds. These changes are expected to provide a significant boost to urban consumption and follow the belief of former PM Atal Bihari Vajpayee, who had remarked: "Empowering the individual means empowering the nation. And empowerment is best served through rapid economic growth with rapid social change."

From a macroeconomic perspective, however, the budget's impact needs to be evaluated through the lens of its overall fiscal impulse. While measures like income-tax relief may provide some stimulus, fiscal consolidation will exert a moderating influence on growth.

In a positive development for the external sector, the budget increases the foreign direct investment (FDI) limit in the insurance sector. This is timely, given the recent decline in net FDI, and should help attract foreign capital.

An analysis of the budget cannot be complete without a discussion of the two engines—agriculture and MSMEs—crucial for sustained high growth and realizing its Viksit Bharat vision. In agriculture, the budget aims to enhance productivity, adopt crop diversification and sustainable practices, and augment post-harvest storage and irrigation facilities at the local level, as also the availability of credit. Further, the Prime Minister Dhan Dhanya Krishi Yojana unifies schemes under an inclusive umbrella, targeting 100 low-productivity districts. The budget also provides for a new employment generation scheme, along with much-needed boosts to MSME investment and turnover categorization limits and enhanced guarantee covers. Allocations for the expansion of Patna's IIT as well as an airport and other greenfield projects in Bihar hit the right note on balanced development. A focus on the country's poorest state is essential to address India's employment and economic inclusion challenges.

The budget's success will depend on the government's ability to execute its planned capital expenditure while maintaining support for labour-intensive sectors and vulnerable populations. Its conservative projections and focus on macroeconomic stability provide a solid foundation, but the government will need to be vigilant in monitoring domestic and external economic conditions.

These are the authors' personal views.