

Union Budget's Fiscal Consolidation drive may hit Growth momentum

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The Union Budget 2026-27 emphasized the need for fiscal consolidation, targeting a reduction of the Debt-to-GDP ratio to 50 percent, plus or minus 1 percent, by 2030. The Debt-to-GDP ratio is estimated at 55.6 percent of GDP in 2026-27. There is no decline projected in the revenue deficit, which is estimated at 1.5 percent of GDP, the same level as the previous year. The fiscal deficit is estimated at 4.4 percent in 2025-26 and 4.3 percent in 2026-27. The irony is that fiscal consolidation is being pursued by cutting the total expenditure by 5%. No significant growth momentum is expected with only a 10.9 percent growth in capital expenditure. In terms of GDP, there is no corresponding increase in capital expenditure.

Only a marginal increase is seen in the Union Government's revenue expenditure, rising from Rs.3,944,255 crore in the 2025-26 Revised Estimates to Rs.4,125,494 crore in the 2026-27 Budget Estimates, a growth rate of 4.5 percent. There is only a marginal absolute increase in the transfers towards Centrally Sponsored Schemes (CSS), rising from Rs.541,850 crore in the 2025-26 Budget Estimates to Rs.548,798 crore in 2026-27, an increase of only 1.28 percent. Similarly, Finance Commission grants have declined from Rs.132,378 crore in the 2025-26 Budget Estimates to Rs.129,397 crore in the 2026-27 Budget Estimates.

Marginal rise in Receipts

On the revenue side, only a marginal increase is seen in revenue receipts, from Rs.3,430,409 crore in the 2025-26 Budget Estimates to Rs.3,533,150 crore in the 2026-27 Budget

Estimates (2.99%). Revenue receipts have declined from 13% of GDP in the 2023-24 Actual to 10.7% in the 2024-25 Revised Estimates. It is interesting to note that there is no estimate of GST compensation cess collection, and the budget is silent about the future of the GST compensation cess. The states' share in revenue has fallen from Rs.1,422,444 crore in the 2025-26 Budget Estimates to Rs.1,392,971 crore in the 2025-26 Revised Estimates, a decline of -2.07 percent. For the year 2026-27, the estimated tax share to states is Rs.1,526,255 crore, which is only 7.3 percent higher than the previous year, even after considering the 16th FC tax devolution. The Centre's tax share to states amounts to only 34.65 percent instead of the mandated 41 percent.

Additionally, a reduction in non-tax revenue is noted, falling from Rs.667,662 crore in the 2025-26 Revised Estimates to Rs.666,228 crore in the 2026-27 Budget Estimates (-0.21%). The Government has not announced any steps to increase non-tax revenue collection or for additional resource mobilization. Subsidies have also been reduced in the Budget 2026-27. This is evident in the allocation for Urea Subsidy and Nutrient-Based Subsidy. Urea subsidy is reduced to Rs.116, 805 crore in the 2026-27 Budget Estimates from Rs.126, 475 crore in the 2025-26 Revised Estimates.

Promising announcements in the Budget 2026-27 include a focus on India's Semiconductor Mission (ISM) 2.0, a scheme for rare earth magnets, development of waterways, and the setting up of a National Institute of Hospitality to bridge academia, industry, and government. Announcements in the pharma sector and exemptions in customs duty on certain medicines are a welcome step. Amplifying the potential of cities to deliver the economic power of agglomerations, with a particular focus on Tier II, Tier III, and temple towns, are positive steps.

Finance panel's Horizontal and Vertical Devolution

The 16th Finance Commission recommends retaining the states' share in the divisible pool at its present level of 41 percent. For horizontal devolution, there is a change in the criteria and weights from the 15th Finance Commission: Population (17.5%), Demographic Performance (10%), Area (10%), Forest (10%), Per Capita GSDP-Distance (42.5%), and Contribution to GDP (10%). The major changes in the criteria are the inclusion of 'Contribution to GDP' (10%) and 'Demographic Performance' (10%) by each state.

With regard to the Revenue Deficit Grant (RDG), the 16th FC has categorically stated: ""fundamental problem with recurrent revenue deficit grants across successive FCs typically exemplifies the problem of time inconsistency where fiscal policies that appear optimal ex ante by the FCs are not adhered to ex post by the States once expectations of central assistance are internalized. When States anticipate that shortfalls in their revenue account will be compensated through RDGs, the incentive to undertake difficult but necessary fiscal reforms such as rationalizing subsidies, improving tax administration, or curbing revenue expenditures weakens. Over time, this softens fiscal discipline and embeds dependency rather than resilience. Therefore, in continuation of the diminishing trend of the revenue deficit grants recommended by FC 15, which reduce to near zero level by 2025-26, we do not recommend any revenue deficit grants to States. We also do not recommend any sector specific or State specific grants".

16th FC and Kerala

With the change in devolution criteria and weights by the 16th FC, Kerala's horizontal share of tax has increased from 1.92 percent to 2.382 percent, an increase of 0.462 percent. Though this has a positive fiscal implication on Kerala's tax share, the abolition of the Revenue Deficit Grant will have a severe impact on the state, resulting in a decline of more than Rs.50,000 crore in its overall share of resources. Therefore, the mild increase in the Centre's share of tax to Kerala (from 1.92% to 2.382%) will not at all commensurate with the fall in revenue due to the absence of the Revenue Deficit Grant.

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