

DECOMPOSITION OF INDIA'S FISCAL DEFICIT: AN EMPIRICAL STUDY OF THE UNION GOVERNMENT'S FISCAL POSITION AND CONSOLIDATION PATH

Dr. G.Ashok

Junior Assistant, (Admin. Staff)

Agurchand Manmull Jain College, Meenambakkam, Chennai -600061

Dr. V S Murali

Associate Professor and Head P.G & Research Department of Economics,

Agurchand Manmull Jain College, Meenambakkam, Chennai - 600061

ABSTRACT

India's fiscal deficit has remained a central concern of macroeconomic policy, particularly in the context of rising public expenditure, debt-servicing obligations and the need to sustain economic growth through public investment. The present study examines the evolution, composition and consolidation of the Union Government's fiscal deficit in India, with particular emphasis on the period covering the pre-pandemic, pandemic and post-pandemic phases. The study decomposes the fiscal deficit into revenue deficit, capital expenditure and non-debt capital receipts and evaluates changes in the quality of government expenditure and the sustainability of the fiscal consolidation process. The analysis is based primarily on secondary data obtained from Union Budget documents, Economic Surveys and the accounts of the Controller General of Accounts.

The findings indicate a substantial improvement in India's fiscal position after the pandemic-induced deterioration. The fiscal deficit declined from 9.2 per cent of GDP in FY2020–21 to 4.8 per cent in FY2024–25 and 4.4 per cent in FY2025–26. The revenue deficit has also declined substantially, while the government has increasingly prioritised capital expenditure. The Economic Survey 2025–26 reports that effective capital expenditure rose to about 4.3 per cent of GDP in FY2025–26, compared with 2.7 per cent in the pre-COVID period.

The study concludes that India's recent fiscal consolidation has been characterised not merely by reduction in the headline deficit but also by a gradual improvement in expenditure composition. However, high interest payments, persistent revenue expenditure requirements and the need to maintain growth-enhancing public investment remain important challenges. A credible medium-term debt reduction strategy, improved revenue mobilisation and expenditure efficiency are therefore essential for durable fiscal sustainability.

Keywords: Fiscal Deficit, Fiscal Consolidation, Revenue Deficit, Capital Expenditure, Primary Deficit, Public Debt, Union Government, India.

INTRODUCTION

Fiscal policy plays a crucial role in determining the pace and sustainability of economic growth. Government expenditure influences aggregate demand, infrastructure creation, employment and social development, while government revenue determines the extent to which such expenditure can be financed without excessive borrowing. The fiscal deficit therefore represents an important indicator of the fiscal health of an economy.

In India, fiscal management has become increasingly important because of the simultaneous requirement to finance social-sector programmes, infrastructure development, subsidies, interest payments and other public services. The COVID-19 pandemic further intensified these pressures. The Union Government's fiscal deficit increased sharply during the pandemic period as expenditure expanded while economic activity and revenue mobilisation were adversely affected.

Subsequently, the Government adopted a medium-term fiscal consolidation strategy. The fiscal deficit declined progressively from the pandemic peak. According to the Economic Survey 2025–26, the fiscal deficit was reduced from 9.2 per cent of GDP in FY2020–21 to 4.4 per cent in FY2025–26, while the revenue deficit also declined significantly.

The important issue, however, is not simply whether the fiscal deficit has declined, but **how it has been reduced**. A reduction achieved primarily through cuts in productive capital expenditure may have different long-term implications from consolidation achieved through stronger revenue mobilisation, expenditure efficiency and reduction in unproductive expenditure.

The present study therefore focuses on the **decomposition of India's fiscal deficit** and examines the extent to which recent fiscal consolidation has improved the quality and sustainability of the Union Government's fiscal position.

REVIEW OF LITERATURE

Fiscal deficit and public debt have been extensively studied in the Indian context. The literature broadly focuses on fiscal sustainability, the relationship between fiscal deficit and economic growth, the composition of government expenditure and the effectiveness of fiscal consolidation.

Earlier studies on Indian public finances emphasised the importance of reducing persistent revenue deficits because borrowing to finance current expenditure can adversely affect long-

term fiscal sustainability. The distinction between revenue and capital expenditure is particularly important because capital expenditure can create productive assets and potentially increase future economic capacity.

More recent policy literature has placed greater emphasis on the **quality of fiscal adjustment**. The Economic Survey 2025–26 observes that the reduction in the revenue deficit has created greater fiscal space for capital expenditure and describes this as an improvement in the quality of expenditure.

The Economic Survey also notes that India's general government debt-to-GDP ratio has fallen substantially since 2020 while public investment has remained strong. The Central Government's medium-term objective is to move towards a debt-to-GDP ratio of approximately 50 ± 1 per cent.

The existing literature therefore suggests that fiscal consolidation should be assessed through multiple indicators rather than the headline fiscal deficit alone.

OBJECTIVE OF THE STUDY

The study has the following objectives:

1. To examine the trends in the Union Government's fiscal deficit in India.
2. To analyse the major components contributing to the fiscal deficit.
3. To examine the relationship between fiscal deficit, revenue deficit and primary deficit.
4. To analyse the changing composition of government expenditure.
5. To evaluate India's recent fiscal consolidation path.
6. To assess the implications of fiscal consolidation for public investment and economic growth.
7. To identify major challenges to achieving long-term fiscal sustainability.
8. To suggest appropriate policy measures for strengthening fiscal management.

RESEARCH QUESTIONS

The study seeks to answer the following questions:

- How has India's Union Government fiscal deficit evolved over the study period?
- What are the principal components responsible for the fiscal deficit?

- Has fiscal consolidation been accompanied by an improvement in expenditure quality?
- What role has capital expenditure played in the recent consolidation strategy?
- To what extent has the reduction in the fiscal deficit improved the Union Government's debt position?
- What challenges could affect the sustainability of India's fiscal consolidation?

RESEARCH METHODOLOGY

The research methodology is based on **descriptive methods**. **Secondary data has been** collected Major sources include:

- Union Budget documents of the Government of India
- Economic Survey of India
- Controller General of Accounts
- Ministry of Finance
- Budget at a Glance
- Medium-Term Fiscal Policy statements
- Relevant academic literature and research publications

The latest official data indicate that the fiscal deficit for FY2025–26 was 4.4 per cent of GDP, while the FY2026–27 Budget estimates the deficit at 4.3 per cent of GDP. The averages, ratios, percentage analysis is used.

PERIOD OF STUDY

For the main analysis, the study covers **FY2017–2018 to FY2026–27**, with earlier years used where necessary to provide historical context.

The fiscal deficit can be decomposed conceptually as:

Fiscal Deficit = Revenue Deficit + Capital Expenditure – Non-Debt Capital Receipts

This decomposition allows the study to determine whether the deficit arises predominantly from current expenditure pressures, capital investment or insufficient non-debt receipts.

EVOLUTION OF INDIA'S FISCAL DEFICIT

The fiscal position of the Union Government changed dramatically during the COVID-19 period. The fiscal deficit reached approximately **9.2 per cent of GDP in**

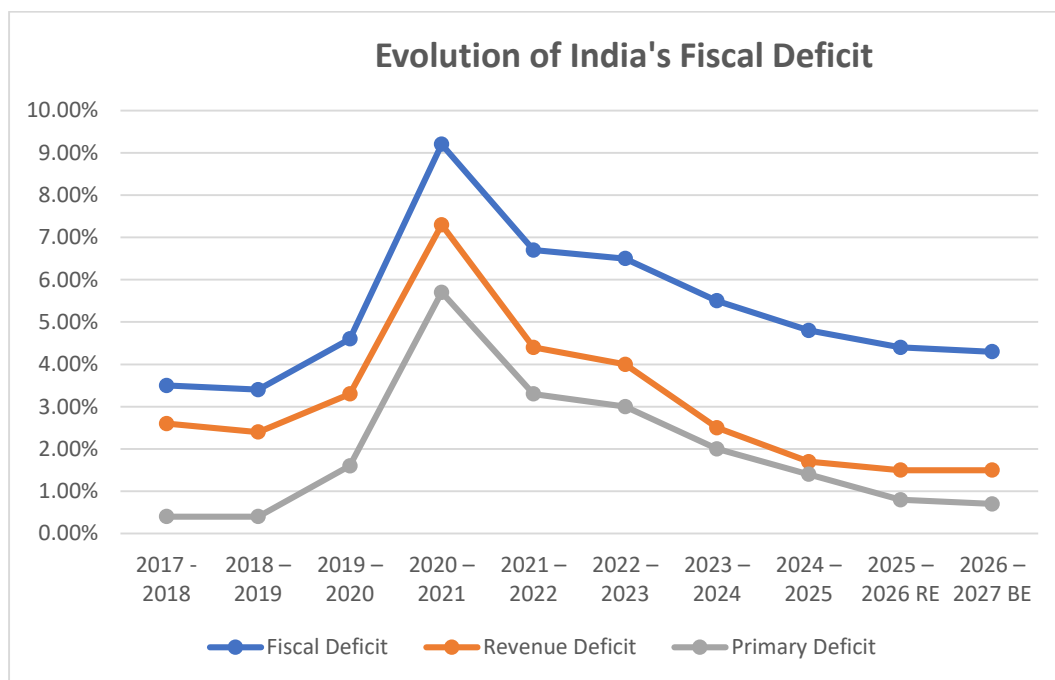
FY2020–21. It subsequently declined as economic activity recovered and government revenues strengthened.

The broad trajectory is shown below:

Financial Year	Fiscal Deficit	Revenue Deficit	Primary Deficit
2017 - 2018	3.5%	2.6%	0.4%
2018 – 2019	3.4%	2.4%	0.4%
2019 – 2020	4.6%	3.3%	1.6%
2020 – 2021	9.2%	7.3%	5.7%
2021 – 2022	6.7%	4.4%	3.3%
2022 – 2023	6.5%	4.0%	3.0%
2023 – 2024	5.5%	2.5%	2.0%
2024 – 2025	4.8%	1.7%	1.4%
2025 – 2026 RE	4.4%	1.5%	0.8%
2026 – 2027 BE	4.3%	1.5%	0.7%

Source: Government of India, Union Budget 2026 – 2027, Budget at a Glance

The table shows a significant increase in the fiscal deficit during the pandemic year 2021-2021, subsequently, the deficit declined steadily as economic activity recovered and fiscal consolidation progressed.



The trend demonstrates a substantial reduction in the headline fiscal deficit. The Government had originally committed to bringing the fiscal deficit below 4.5 per cent of GDP by FY2025–26, a target that was achieved according to the latest official estimates.

DECOMPOSTION OF FISCAL DEFICIT

A useful way of analysing fiscal deficit is to examine its principal components. The fiscal deficit is essentially the difference between total expenditure and total non-debt receipts. It can therefore be expressed through revenue deficit, capital expenditure and non-debt capital receipts.

The Economic Survey 2025–26 provides a decomposition showing that the **revenue deficit has progressively fallen as a proportion of the fiscal deficit**, while capital expenditure has assumed greater importance. This change is significant because it indicates a shift from financing current expenditure towards financing asset creation.

Revenue Deficit

Revenue deficit occurs when revenue expenditure exceeds revenue receipts. The revenue deficit declined from **5.7 per cent of GDP in FY2020–21 to 1.5 per cent in FY2025–26 Budget Estimates**, according to the Union Budget framework. The decline represents a major improvement in the quality of fiscal adjustment.

A lower revenue deficit implies that a smaller proportion of government borrowing is being used to finance current expenditure.

Capital Expenditure

Capital expenditure has become one of the major instruments of India's growth-oriented fiscal policy.

The Economic Survey 2025–26 reports that effective capital expenditure increased from approximately **2.7 per cent of GDP in the pre-COVID period to around 4.3 per cent in FY2025–26**. This is particularly important because infrastructure expenditure can generate multiplier effects and improve the productive capacity of the economy.

Interest Payments

Interest payments remain a major structural constraint on fiscal management. For FY2025–26, interest payments were budgeted at approximately ₹12.76 lakh crore, accounting for a substantial proportion of revenue receipts.

Consequently, even when the primary deficit declines, the Government continues to face significant fiscal pressure from accumulated debt.

FISCAL CONSOLIDATION PATH

India's fiscal consolidation strategy has increasingly shifted from short-term deficit reduction towards a **debt-based fiscal anchor**.

The Government's medium-term objective is to place Central Government debt on a declining trajectory. The FY2026–27 Budget estimates Central Government debt at **55.6 per cent of GDP**, compared with 56.1 per cent in FY2025–26.

The Government has indicated an objective of moving towards approximately **50 per cent of GDP by FY2030–31**

This represents an important change in fiscal strategy. Rather than focusing exclusively on an annual fiscal-deficit ceiling, the policy framework increasingly considers the relationship between borrowing, debt accumulation, economic growth and interest costs.

CHANGING QUALITY OF GOVERNMENT EXPENDITURE

One of the most significant findings from the recent fiscal consolidation period is the change in the composition of expenditure.

Revenue expenditure declined as a proportion of GDP, while capital expenditure increased. According to the Economic Survey 2025–26, revenue expenditure moderated from **13.6 per cent of GDP in FY2021–22 to 10.9 per cent in FY2024–25**

At the same time, effective capital expenditure increased. This suggests that fiscal consolidation has not been based exclusively on expenditure compression. Instead, there has been an attempt to **reallocate expenditure towards productive investment**.

This distinction is important for developing economies such as India, where fiscal policy must simultaneously achieve three objectives:

- fiscal sustainability;
- economic growth; and
- social and infrastructure development.

EMPIRICAL INTERPRETATION

The available evidence suggests three broad conclusions.

First, the fiscal deficit has undergone substantial consolidation.

The decline from 9.2 per cent of GDP in FY2020–21 to 4.4 per cent in FY2025–26 represents a significant improvement.

Second, the composition of the deficit has improved.

The declining revenue deficit and increasing capital expenditure indicate that a greater share of government borrowing is being associated with investment rather than ordinary revenue expenditure.

Third, debt sustainability remains a challenge.

Although debt ratios have begun declining, interest payments remain large. Therefore, continued fiscal consolidation is required to create fiscal space for future development expenditure.

MAJOR CHALLENGES

Despite the improvement in fiscal indicators, several challenges remain.

High Interest Burden

Interest payments constitute a substantial component of government expenditure. This limits the resources available for development expenditure.

Revenue Mobilisation

Sustained fiscal consolidation requires continued growth in tax and non-tax revenues. The Economic Survey notes improved revenue mobilisation in recent years, including stronger tax collection and improved compliance.

Maintaining Capital Expenditure

Reducing the fiscal deficit should not result in excessive compression of productive public investment. Maintaining infrastructure investment is important for long-term economic growth.

Social Expenditure Requirements

India requires continues substantial expenditure on health, education, social protection and rural development. Fiscal consolidation must therefore be designed without disproportionately affecting vulnerable groups.

Global Economic Uncertainty

External shocks, commodity-price fluctuations, geopolitical tensions and changes in global financial conditions can influence India's fiscal position through growth, inflation, exchange rates and borrowing costs.

POLICY IMPLICATIONS

The study suggests the following policy measures:

1. **Continue medium-term fiscal consolidation** rather than relying on abrupt expenditure reductions.
2. **Protect capital expenditure**, particularly infrastructure and human-capital investment.
3. **Improve tax buoyancy** through better compliance, digitalisation and broadening of the tax base.
4. **Rationalise non-merit subsidies** while protecting essential social-sector expenditure.
5. **Improve expenditure efficiency** through outcome-based budgeting and periodic evaluation of government schemes.
6. **Reduce the interest burden over time** through sustained debt reduction.
7. **Strengthen fiscal transparency** through timely and comprehensive reporting of government liabilities.
8. **Maintain a credible debt anchor**, with declining debt-to-GDP ratios over the medium term.
9. **Strengthen coordination between Union and State fiscal policies**, since overall public-sector debt sustainability depends on general government finances rather than the Centre alone.

FINDINGS OF THE STUDY

The major findings are as follows:

- India's Union Government fiscal deficit increased sharply during the COVID-19 period but has subsequently declined substantially.
- The fiscal deficit declined from 9.2 per cent of GDP in FY2020–21 to 4.4 per cent in FY2025–26.
- The FY2026–27 Budget targets a further reduction to 4.3 per cent of GDP.
- The revenue deficit has declined considerably, indicating an improvement in the quality of fiscal adjustment.
- Capital expenditure has become increasingly important in the Union Government's expenditure strategy.
- Effective capital expenditure has increased substantially compared with the pre-COVID period.
- The primary deficit has also declined, suggesting improvement in the underlying fiscal position.
- Central Government debt has begun moving downward as a proportion of GDP.
- Interest payments continue to be a major constraint on fiscal space.

The current consolidation strategy increasingly emphasises debt sustainability rather than only annual deficit reduction 2026–27 Budget targets 4.3 per cent. The Government has also shifted towards a medium-term debt-based fiscal framework, with Central Government debt projected at 55.6 per cent of GDP in FY 2026–27 and an objective of moving towards approximately 50 per cent of GDP by FY2030–31.

CONCLUSION

The fiscal position of the Union Government of India has undergone a significant transformation since the COVID-19 pandemic. The pandemic resulted in an unprecedented expansion of the fiscal deficit, but subsequent fiscal consolidation has brought the deficit down substantially.

Overall, India's recent fiscal trajectory indicates a movement from **pandemic-induced fiscal expansion towards credible consolidation**, with increasing emphasis on investment-led growth and debt sustainability. The challenge for policymakers is to maintain this balance without compromising India's long-term development priorities.

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