

We hosted Subhash Garg, former Economic Affairs and Finance Secretary to the Government of India (GoI), to delve deeper into the FY27 Union Budget. Garg said that the 'bland' nature of the Budget was due to the Centre's fiscal constraints, with lower expenditure in FY26RE (vs BE) also reflecting implementation challenges. He clarified that the spending on Defence for FY26RE is even higher than thought due to an allocation via the Department of Economic Affairs, while emphasizing on looking beyond headline capex numbers. With regard to states, Garg believes that the 16th Finance Commission (FC) recommendations are healthy and will improve states' fiscal position over time while, contrary to popular opinion, there are constraints on states' deficits and borrowing that the RBI and the GoI exercise when needed.

'Boring' Budget reveals the GoI's fiscal constraints

Garg opined that this Budget was a routine one, largely due to the limited fiscal space available to the GoI. He noted that the FY27BE growth in both total expenditure (~8%) and net tax revenue (~7%) was far lower than nominal GDP growth (~10%) – indicating a lack of fiscal room. Another area of interest was the fall in income tax and GST receipts in FY26RE vs FY26BE (on account of rate cuts during the year). The reduction in fiscal leeway due to this is the reason behind the sharp fall (of ~Rs1trn) in total expenditure in FY26RE vs BE. He also mentioned the fall in expenditure for various schemes/heads in FY26RE vs FY26BE (eg Jal Jeevan Mission allocation fell to only Rs170bn from Rs670bn FY26BE; PMAY allocation—rural and urban combined—fell ~48% vs FY26BE) shows the government's struggle in program implementation. This also has implications for the various new programs announced in this Budget. Nevertheless, there has been an improvement in Defence spending (Rs500bn higher than BE) – even higher after accounting for a ~Rs316bn allocation via the Department of Economic Affairs.

'Others' category is Centre's cash balance; need to focus beyond headline capex

There were a few areas of confusion which Garg also helped clear up. The sources of fiscal financing saw a large swing in the 'others' category – from Rs759bn in FY26RE to -Rs458bn in FY27BE. Garg explained that this category is the Public Accounts (less NSSF and State Provident Fund) cash balance, and a negative entry here implies that the government is putting cash back into the account, rather than using it to fund a part of the fiscal deficit. Garg also said that the government prefers to put out a predictable borrowing calendar, and to then manage its cash as needed, rather than tinkering with the borrowing calendar due to cash swings. On capex, he cautioned against looking solely at headline capex numbers, as the data also includes various loans. The sectors to look at closely for capex are Roads, Metros, and Housing, as these are the major sectors with economic value-add, while Defence, Railways, and Telecom do not have much value-add (but are important as public goods).

States to benefit from 16th FC; constraints on states' borrowings are in place

Garg mentioned that the 16th FC recommendations are broadly healthy for states, with the 41% devolution limit maintained, and new criteria being introduced for horizontal devolution (share of state's GDP in total GDP). This will incrementally reward states that deliver better economic growth. The 16th FC has also removed all grants, other than for disaster relief and local bodies, with the revenue deficit grant also withdrawn. As a result, the total FC transfers for FY27BE are lower than those for FY26BE – an unprecedented outcome. However, Garg stated that this would be better for states in the medium-to-long term, as it would force fiscal discipline and revenue-raising efforts. Furthermore, Garg emphasized that contrary to popular opinion, states cannot borrow beyond 3% of GDP as the RBI will prevent them from issuing SDLs. Additionally, the Centre monitors states' borrowing and deficits, and states are penalized with a reduction in their borrowing limits for the subsequent year if they exceeded limits in a given year. Thus, while some states may post extremely high budgeted FD/GDP, the actuals are usually far lower due to these constraints.

Webinar recording link -

<https://emkayglobal.egnyte.com/dl/gGKxmb87Kw7>

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