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Budget 2026-27 — The Consolidation Imperative and the Growth Gamble

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INTERVIEW ANGLE

"Union Budget 2026-27 targets fiscal consolidation (4.3% deficit) while scaling capital expenditure. Is this fiscally prudent or does it risk crowding out private investment? What does the income tax reform signal about the government's growth strategy?"

WHY IN NEWS

Finance Minister Nirmala Sitharaman presented Union Budget 2026-27 on February 1, 2026 — targeting a fiscal deficit of 4.3% of GDP, capital expenditure of Rs 12.2 lakh crore, and new income tax slabs under the New Income Tax Act, 2025. The budget choices reflect a deliberate bet on supply-side growth through public investment and tax simplification rather than demand-side stimulus.

THE CONSOLIDATION-GROWTH DILEMMA INDIA HAS NOT RESOLVED

Every Union Budget since 2022 has attempted to square an uncomfortable circle: consolidate the fiscal deficit (to reduce debt sustainability risk and retain sovereign rating credibility) while simultaneously maintaining the public capex push that post-COVID recovery needed. Budget 2026-27 continues this ambidextrous act — but with diminishing room.

The arithmetic of the problem: India's total central government debt stands at 55.6% of GDP. Interest payments consume **40% of revenue receipts** — meaning that for every Rs 100 the government collects in taxes and non-tax revenue, Rs 40 goes to paying interest on past borrowings. This interest burden is not optional. It cannot be deferred. It comes before salaries, before MGNREGS, before health, before education.

The FRBM target of debt-to-GDP of **50% by March 2031** requires annual fiscal deficit reductions. The Budget's 4.3% target (down from 4.4%) achieves this incrementally. But the pace is slow — at this rate, reaching 50% debt-to-GDP by 2031 requires both sustained nominal GDP growth of ~10% and continued fiscal consolidation. If either falters (external shock, commodity price spike, domestic slowdown), the debt trajectory becomes more adverse.

WHAT THE 4.3% FISCAL DEFICIT REALLY SIGNALS

The composition matters more than the headline:

Revenue deficit at 1.5% (unchanged) — meaning the government is borrowing for capital, not current consumption. This is the fiscal equivalent of taking a loan to buy a house vs taking a loan for daily expenses. The former is productive; the latter is corrosive.

Capital expenditure at Rs 12.2 lakh crore (3.1% of GDP) — the government is deploying borrowed funds to build roads, railways, and digital infrastructure that will generate returns over decades.

The Keynesian multiplier for public capex is estimated at 1.5–2.5 in developing economies — meaning Rs 1 of capex generates Rs 1.5–2.5 of GDP impact. This justifies maintaining high capex even while consolidating.

The risk that consolidation-through-revenue-compression creates: The Budget's consolidation is achieved partly by maintaining the fiscal deficit target while tax revenues grow with GDP. But if tax revenue growth disappoints — as it did in 2025-26 when GST growth decelerated slightly — the government faces a choice: cut expenditure (damaging to growth) or allow deficit to slip (damaging to credibility). The Rs 17.2 lakh crore gross market borrowing programme is already large enough to affect bond yields if execution falters.

INCOME TAX REFORM — A SUPPLY-SIDE BET

The revised new regime slabs represent a deliberate policy choice: **reduce the tax burden on the productive middle class** rather than direct cash transfers to the poor. The economic logic is:

Higher disposable income → consumer demand — in the short term, tax cuts act as quasi-fiscal stimulus

Simplified regime (New Income Tax Act, 2025) → reduced compliance cost — the 1961 Act had become an impenetrable thicket of provisions; simplification reduces dispute litigation and improves voluntary compliance

Lower effective rates → reduced tax avoidance — the Laffer curve argument, which has some empirical support in India (GST rate cuts on some items have increased collections by expanding the base)

The critique: The primary beneficiaries of the new regime slab revision are middle and upper-middle income earners (Rs 8–24 lakh/year). These are not the most consumption-constrained segment of the population. For demand stimulus to reach rural India, direct benefit transfers (like PM-KISAN) or rural wage employment (MGNREGS/VB-G RAM G) are more targeted instruments. The choice to prioritise middle-class tax relief over welfare expansion is a legitimate policy choice, but it is a choice — and it reflects the government's underlying theory of growth: growth through supply (investment, productivity) rather than through redistribution.

THE STATE OF PRIVATE INVESTMENT — WHY CAPEX CROWDING-IN MATTERS

The Budget's capex push is only justified if it succeeds in crowding in private investment. There is evidence both ways:

For crowding-in:

IBC-reformed banking system (NPA at 2.2%) is capable of extending credit

Infrastructure bottlenecks identified by corporates as the #1 barrier to expanding capacity — each PMGSY road, each railway freight corridor directly reduces logistics costs

India's gross fixed capital formation (GFCF) at ~32% of GDP is below the investment rates of East Asian economies during their growth phases (~40%)

Against crowding-in:

High government borrowings (Rs 17.2 lakh crore gross) compete with private sector for the same pool of domestic savings

Interest rates remain elevated (though the RBI has begun a rate cut cycle)

Corporate India's investment intentions surveys show improving but still-cautious sentiment

Global trade uncertainty (US-China tensions, potential tariff spillovers) discourages export-oriented investment

THE NEW INCOME TAX ACT, 2025 — BEYOND SLABS

The replacement of the 1961 Act is administratively significant in ways that the slab changes are not. The 1961 Act had accumulated 64 years of amendments, judicial interpretations, and circulars — creating a compliance complexity that disadvantaged small businesses and individuals without tax consultants.

What the new Act promises:

Simplified drafting — provisions written in plain language

Clearer definitions — reducing scope for interpretive disputes

Default new regime — automatic switch reduces the annual decision burden for most taxpayers

Digital-first design — intended to integrate with pre-filled returns, GST data, and banking information

The implementation risk: New tax legislation always creates transition uncertainty. Businesses and individuals will need time to understand new section numbers, new interpretations, and new compliance procedures. Courts will need to adjudicate how old jurisprudence under the 1961 Act applies to the new Act's provisions. The expected efficiency gains may take 3–5 years to fully materialise.

UPSC RELEVANCE

Fiscal Deficit 4.3% of GDP; Revenue Deficit 1.5% of GDP; Capital Expenditure Rs 12.2 lakh crore (3.1% GDP); Effective Capex Rs 17.1 lakh crore (4.4% GDP); Central Debt-to-GDP 55.6%; FRBM Act 2003; Interest payments = 40% of revenue receipts; Gross Market Borrowings Rs 17.2 lakh crore; New Income Tax Act 2025 (replaces IT Act 1961 from April 1 2026); New regime slabs; VB-G RAM G (replaces MGNREGS; 125 days); Keynesian multiplier; Laffer curve; GFCF; Article 112; Article 110; Article 265; Money Bill.

*Union Budget 2026-27 — fiscal consolidation vs growth imperatives; capital expenditure multiplier effect and crowding-in of private investment; income tax reform — supply-side vs demand-side theory of growth; debt sustainability and FRBM; distinction between revenue deficit and fiscal deficit; what should India's optimal fiscal policy be at 7.4% growth? **GS-2:** Parliamentary budget process — role of Money Bill, Appropriation Bill, Finance Bill; constitutional provisions; Rajya Sabha's limited role in Budget.*

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FISCAL FRAMEWORK:

Fiscal Deficit FY27 BE: **4.3% of GDP** (path: 5.1% FY24 → 4.8% FY25 → 4.4% FY26 RE → 4.3% FY27 BE)

Revenue Deficit: **1.5% of GDP** (unchanged)

Central Govt Debt-to-GDP: **55.6%**; FRBM target: **50% by March 2031**

Interest payments: **26%** of total expenditure; **40%** of revenue receipts

Gross Market Borrowings: **Rs 17.2 lakh crore**; Net: Rs 11.7 lakh crore

CAPITAL EXPENDITURE:

Capex: **Rs 12.2 lakh crore** (3.1% of GDP)

Effective Capex (with state grants): **Rs 17.1 lakh crore** (4.4% GDP)

Keynesian multiplier estimate for public capex in India: **1.5–2.5x**

INCOME TAX REFORM:

New Income Tax Act, 2025: replaces **IT Act 1961** from **April 1, 2026**

New regime is now the **default** (taxpayers opt out for old regime)

New slab structure: 0-4L (nil); 4-8L (5%); 8-12L (10%); 12-16L (15%); 16-20L (20%); 20-24L (25%); >24L (30%)

MAT: **15% → 14%**

MGNREGS TO VB-G RAM G:

VB-G RAM G: **125 days** guarantee (vs 100 days MGNREGS)

Allocation: **Rs 95,692 crore** (MGNREGS line reduced to Rs 30,000 crore)

MGNREGS Act: **2005** (legislated under DPSP Art 41, 43)

OTHER RELEVANT FACTS:

Finance Minister: **Nirmala Sitharaman** (8th consecutive Budget; Minister since May 2019)

Budget presented to **Lok Sabha** as Money Bill; Rajya Sabha advisory role only

Budget shifted to **February 1** from 2017 (by Arun Jaitley; previously last working day of February)

FRBM Act: **2003** — mandates fiscal deficit and debt targets

India's GFCF (Gross Fixed Capital Formation): ~32% of GDP (East Asian growth economies: ~40%)

NSO GDP First Advance Estimate FY26: **7.4%**; FY27 projection: **6.8–7.2%**

Sources: The Hindu, PIB, PRS Legislative Research

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