Debt reduction central to fiscal policy from FY27, says FM

States urged to improve fiscal transparency

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NIRMALA SITHARAMAN
FINANCE MINISTER

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FINANCE MINISTER NIRMALA SITHARAMAN on Wednesday made it clear that reducing the debt-to-GDP ratio will be the central pillar of the government's fiscal policy from the next financial year, with the fiscal deficit continuing as an important marker to operationalise the architecture.

Speaking at a Times Network event, Sitharaman also underlined the need for states to align with the Centre's fiscal approach.

"The central government has set clear goals for transparency in Budget-making, ensuring that fiscal management is visible to all and meets the highest standards of accountability," she said.

The minister's reiteration of debt becoming the key fiscal anchor, ahead of the Budget for FY27, signals availability of moderately higher leeway on the fiscal front in the next financial year. In Budget FY26, the minister had committed to "staying the course for fiscal consolidation", but added that the endeavour would be to keep the fiscal deficit each year such that the Central government debt remains on a declining path as a percentage of the GDP.

This allows a bit of additional flexibility on the quantum of fiscal deficit reduction in a given year.

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Debt reduction key focus: FM

IT COULD COME in handy for the government which is facing a potential tax revenue shortfall compared with the Budget Estimate, and a possible dip in tax buoyancy in the near term, on account of massive the reliefs offered to taxpayers in terms of income tax and GST reductions.

The fiscal roadmap for the next six years was presented in the Fiscal Responsibility and Budget Management (FRBM) statement unveiled with the last Budget, as per which the fiscal deficit is estimated to be 4.4% of GDP in FY26.

The minister noted that the Centre has already made progress since the post-Covid period, when debt-to-GDP had crossed 60%. "It is now on a declining path, and from the next financial year, this will be a core focus area," Sitharaman said, adding that while the fiscal deficit would remain an important indicator, debt reduction would increasingly guide policy decisions.

The shift marks a decisive break from the earlier FRBM framework, which was anchored to rigid annual targets—limiting the fiscal deficit to 3% of GDP and central government debt to 40% of GDP. Under the new fiscal architecture announced in the 2025 Budget, the focus is on keeping the fiscal deficit below 4.5% of GDP, allowing flexibility to support growth in a volatile global environment while ensuring a steady decline in debt.

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Officials explained that under various debt-GDP scenarios modelled by the Centre, even maintaining a fiscal deficit of around 4.4% would keep debt well below alarming levels. The objective now is to ensure a consistent downward trajectory so that by 2031, the Centre's debt-to-GDP ratio settles around 50%, plus or minus one percentage point. This will require annual fiscal consolidation, calibrated to economic conditions—deeper consolidation in good years and milder adjustment when growth-supporting spending is needed.

While the Centre is tightening its fiscal stance, concerns are mounting over state finances. RBI studies have flagged worrying debt-to-GDP ratios in several states, where high-cost borrowing is increasingly being used to service existing liabilities rather than fund development. Economists warn that breaching FRBM limits and relying on populist spending could undermine long-term growth.

Recent examples include Bihar, where the Nitish Kumar government announced pre-election measures that could add ₹20,000–30,000 crore annually to the state's expenditure. The rollout of free electricity schemes—mirroring Punjab's long-standing model—could further strain finances. Bihar's liabilities are already estimated at 37.3% of GSDP in FY25, while Punjab tops the list at around 46%. Experience suggests such schemes are politically difficult to roll back once implemented.

Addressing criticism over the 2019 corporate tax cuts, Sitharaman rejected the Opposition's charge that firms are reaping profits without investing. "That reduction was necessary, and businesses have to grow in the country," she said, acknowledging investment decisions ultimately rest with companies.

She also highlighted emerging growth drivers such as global capability centres and data centres, which are generating jobs but require reliable energy. This, she said, explains the government's push on energy security, including the nuclear bill, small modular reactors and a diversified clean energy mix spanning pumped storage, hydro, solar and wind. "On these areas, we will support," Sitharaman said, signalling continuity in policy priorities.