POLICY BRIEF #82

Fiscal Consolidation in India: Why the Next Phase Must Rest on Revenue

NOVEMBER 2026

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Abstract

India has consolidated substantially since the pandemic. The general government deficit fell from 13.1 percent of GDP in 2020-21 to 7.2 percent in 2025-26, and the debt from 89.2 to 81.8 percent. The Centre has met its deficit targets each year since 2021-22 and now has adopted a debt anchor. Growth running ahead of interest rates has helped bring debt down, and macroeconomic stability has kept borrowing costs contained. Even so, India's general government debt is still high and interest payments absorb about a quarter of revenue, the highest share among emerging-market G20 economies. This brief examines India's past consolidations and what the next phase, anchored on the Centre's new debt target, will require. Using changes in the cyclically adjusted primary balance, it identifies three consolidation episodes since 1996-97. The 1999-01 and 2004-08 episodes were driven mainly by revenue; the 2011-14 episode relied on spending cuts. The recent fall in the debt ratio has rested largely on growth running ahead of interest rates, but that gap has narrowed every year since 2021-22, and at its current level the primary deficit is too large to stabilise debt. Recent improvements in the fiscal position have also relied on receipts outside the tax system, notably RBI surplus transfers, that may not last. Shortfalls in budgeted receipts have led to in-year cuts in capital outlays, at both the Centre and the state level. Higher fertiliser and fuel costs following the West Asia conflict could erase the improvement projected for 2026-27. GST loses far more to exemptions, reduced rates and exclusions than to non-compliance. India collects about four-fifths of its estimated tax capacity. This brief argues that the next phase of consolidation should rest on broadening the tax base, realistic budgeting, subsidy reform and protecting capital, health and education spending.

Acknowledgements

The authors would like to thank Dr Shekhar Aiyar, Director and Chief Executive of ICRIER; Dr Benedict Clements, Assistant Director in the African Department at the International Monetary Fund; and Dr João Tovar Jalles, Senior Associate Professor of Economics at the University of Lisbon, for their valuable comments on an earlier version of this brief. The authors also thank ICRIER's administrative and library staff for their assistance. Any remaining errors are the sole responsibility of the authors.

Keywords: *Fiscal Consolidation; Public Debt; Cyclically Adjusted Primary Balance; Interest-Growth Differential*

JEL Classification: *E62, H20, H62, H63, H77, O23*

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List of Abbreviations

BE	Budget Estimates
CAPB	Cyclically Adjusted Primary Balance
COVID-19	Coronavirus Disease 2019
DAP	Di-Ammonium Phosphate
DSGE	Dynamic Stochastic General Equilibrium
ECF	Economic Capital Framework
FCNR(B)	Foreign Currency Non-Resident (Bank) deposits
FRBM	Fiscal Responsibility and Budget Management
G20	Group of Twenty
GDP	Gross Domestic Product
GSDP	Gross State Domestic Product
GST	Goods and Services Tax
ICRIER	Indian Council for Research on International Economic Relations
ICSD	Investment and Capital Stock Dataset
IMF	International Monetary Fund
LPG	Liquefied Petroleum Gas
MoHFW	Ministry of Health and Family Welfare
MOP	Muriate of Potash
MoSPI	Ministry of Statistics and Programme Implementation
NIPFP	National Institute of Public Finance and Policy
RBI	Reserve Bank of India
RE	Revised Estimates
Rs	Rupees
SGST	State Goods and Services Tax

Fiscal Consolidation in India: Why the Next Phase Must Rest on Revenue

Sanjeev Gupta* and Aashi Gupta#

1. Introduction

India's general government debt remains high, at more than 80 percent of GDP in 2025-26, despite some decline since the pandemic peak. Interest payments absorb about one-quarter of general government revenue, leaving less room for capital investment and spending on health and education. High debt also limits the government's ability to respond to future shocks. India's own experience shows why this matters. India entered the 2008-09 global financial crisis after several years of consolidation and was able to mount a substantial fiscal response. It entered the COVID-19 shock in 2020 with less room, and its direct fiscal support was more modest.

The position today is better than it was five years ago. The general government deficit has fallen from 13.1 percent of GDP in 2020-21 to 7.2 percent in 2025-26, and the debt ratio from 89.2 to 81.8 percent (IMF, 2026). Pandemic support has been withdrawn without disruption, and the IMF projects the debt ratio to keep falling, to about 75.1 percent by 2031. The Centre's adoption of a debt anchor from 2026-27 adds a firmer medium-term commitment. India has, therefore, already done a substantial part of the adjustment.

Successive Finance Commissions[1] and the FRBM Review Committee (2017) have stressed the need to rebuild fiscal buffers and put public debt on a sustainable path. The Review Committee proposed a medium-term debt ceiling of 60 percent of GDP for general government: 40 percent for the Centre[2] and 20 percent for the states. The question now has added urgency. From 2026-27, the Centre has adopted debt-to-GDP as its main fiscal target, aiming to bring central government debt to about 50 percent of GDP by 2030-31.

Several studies have examined fiscal consolidation in India. Rangarajan and Srivastava (2005) showed that for about 45 years, until the late 1990s, nominal growth exceeded the effective interest rate on government debt, absorbing most of the cumulative primary deficits. When the gap reversed in 2000-01 to 2002-03, debt rose. They argued that the deficit target should be paired with a target for the debt ratio. Kumar and Soumya (2010) reviewed India's fiscal position after the global financial crisis. They found that the fall in central government spending after the FRBM Act came mainly from sharp cuts in capital expenditure, and they noted that the Act set no ceiling on public debt. They proposed withdrawing the stimulus by partly reversing the excise duty cuts, widening the tax base and introducing GST. Simone and

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1 Thirteenth Finance Commission, *Report of the Thirteenth Finance Commission, 2010-15* (2009); the Fourteenth Finance Commission, *Report of the Fourteenth Finance Commission, 2015-20* (2015); and the Fifteenth Finance Commission, *Finance Commission in COVID Times: Report for 2021-26* (2020).

2 The terms 'central government' or 'Union government' are used interchangeably in this brief.

Topalova (2009) reached a similar conclusion on the design of fiscal rules: they proposed anchoring medium-term policy on a debt target, with annual limits on the growth of nominal spending, and widening the rules' coverage to limit off-budget spending. Using a DSGE model, Tapsoba (2014) found that consolidation brings long-term gains but costs output in the short term. Growth was stronger when the savings went into public investment, or were shared between public investment and transfers to households that cannot borrow.

More recently, Eichengreen, Gupta and Ahmed (2023) found no immediate threat to debt sustainability. A captive domestic investor base, long maturities and rupee denomination limit rollover risk. They also found that, on current policies, general government debt is unlikely to fall below 80 percent of GDP even under favourable assumptions, and that the projected rise in debt comes mainly from the states. They identified two episodes of debt reduction, 1991-92 to 1997-98 and 2004-05 to 2012-13, and found that more than half of each reduction was later reversed. In their view, India's deficit reflects low revenue more than high spending. They argued that in India, where revenue is low by emerging market standards, consolidation through higher revenue can work.

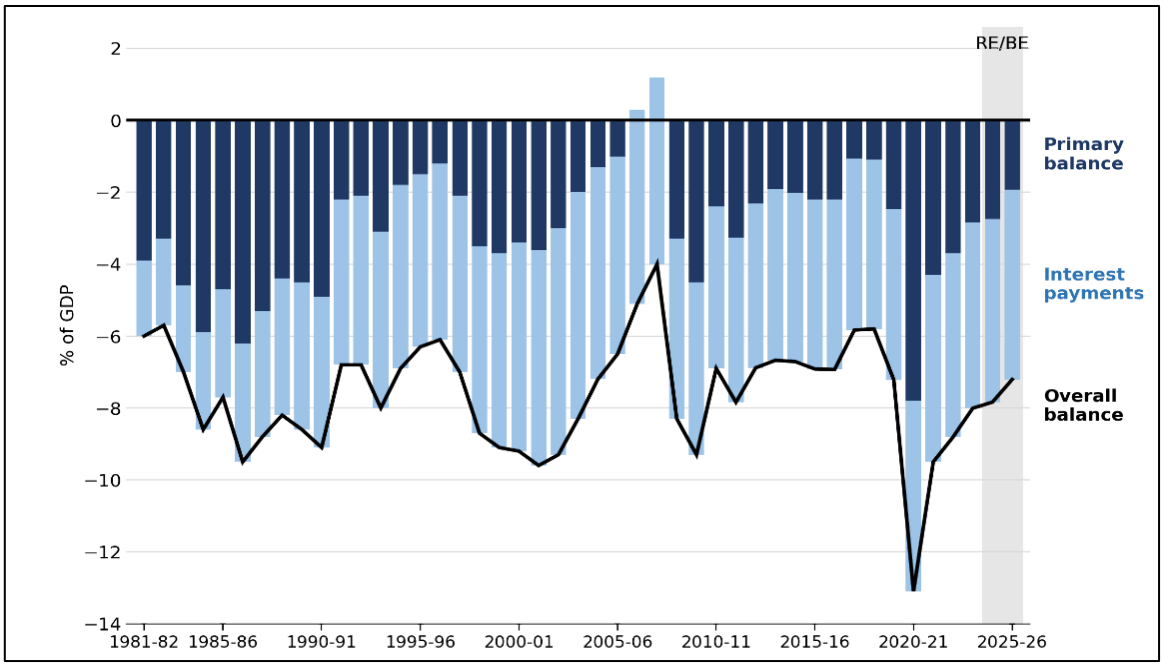
This brief adds to these studies in three ways. First, it identifies consolidation episodes from changes in the cyclically adjusted primary balance rather than from changes in the debt ratio, separating policy effort from the effects of growth and inflation on the debt ratio, and splits each episode into revenue and spending contributions. This shows that the 2004-05 to 2012-13 period which Eichengreen, Gupta and Ahmed (2023) treat as a single episode of debt reduction contained a revenue-driven adjustment in 2004-08, a large fiscal expansion in 2008-11, and spending-driven adjustment in 2011-14. Second, it shows that the conditions that made debt reduction easier are weakening: the interest–growth differential has narrowed every year since 2021-22, and the primary deficit consistent with stable debt is now well under half its 2008-19 level. Third, it examines the revenue side and disinvestment targets in more detail (the narrow GST base, the growing reliance on RBI surplus transfers, and disinvestment targets set well above outturns) and shows that shortfalls have coincided with in-year cuts in capital outlay at the Centre and the states.

2. Evolving Expenditure Composition

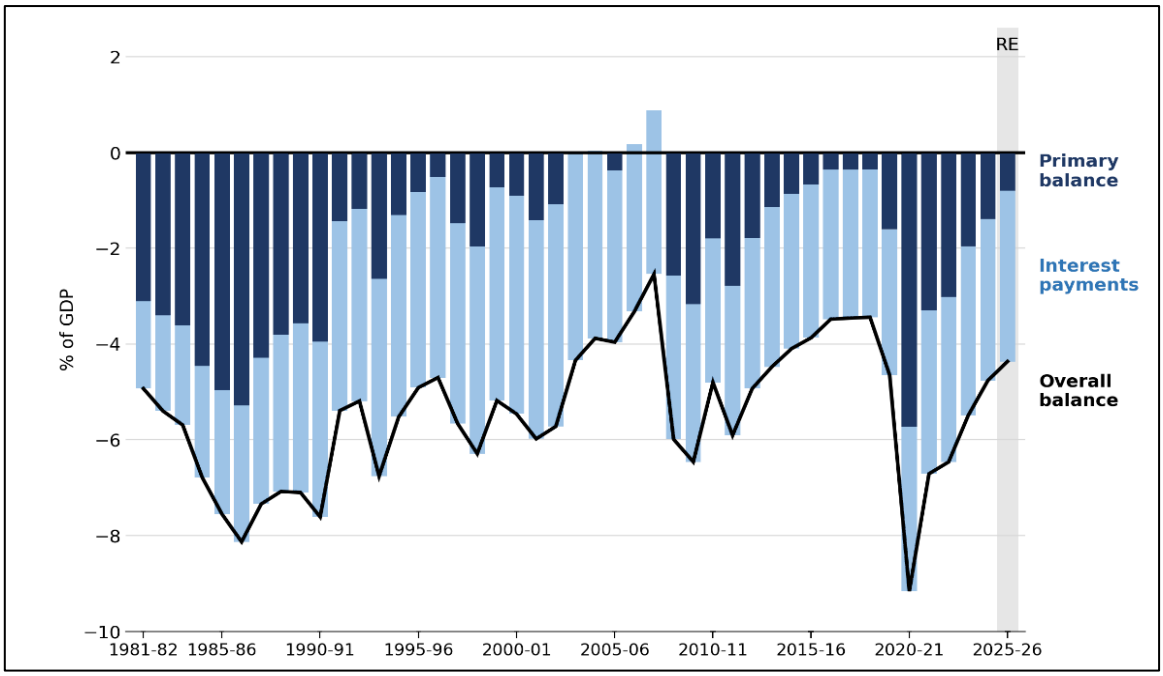
Figure 1 displays primary balance (overall balance excluding interest payments) since 1981-82 for the general government and the Centre. For the general government, interest payments rose from 4.2 percent of GDP in 1990-91 to 5.3 percent in 2025-26 (BE) and their share in the fiscal deficit rose from 46 percent to 73 percent. At the Centre, interest payments are about the same share of GDP, at roughly 3.5 percent, but they now make up a much larger share of the fiscal deficit: about four-fifths in 2025-26, up from about half in 1990-91. This is because the deficit has narrowed while the interest bill has not.

Figure 1: Overall Balance, Primary Balance and Interest Payments (% of GDP)

Panel A: General Government



Panel B: Union Government

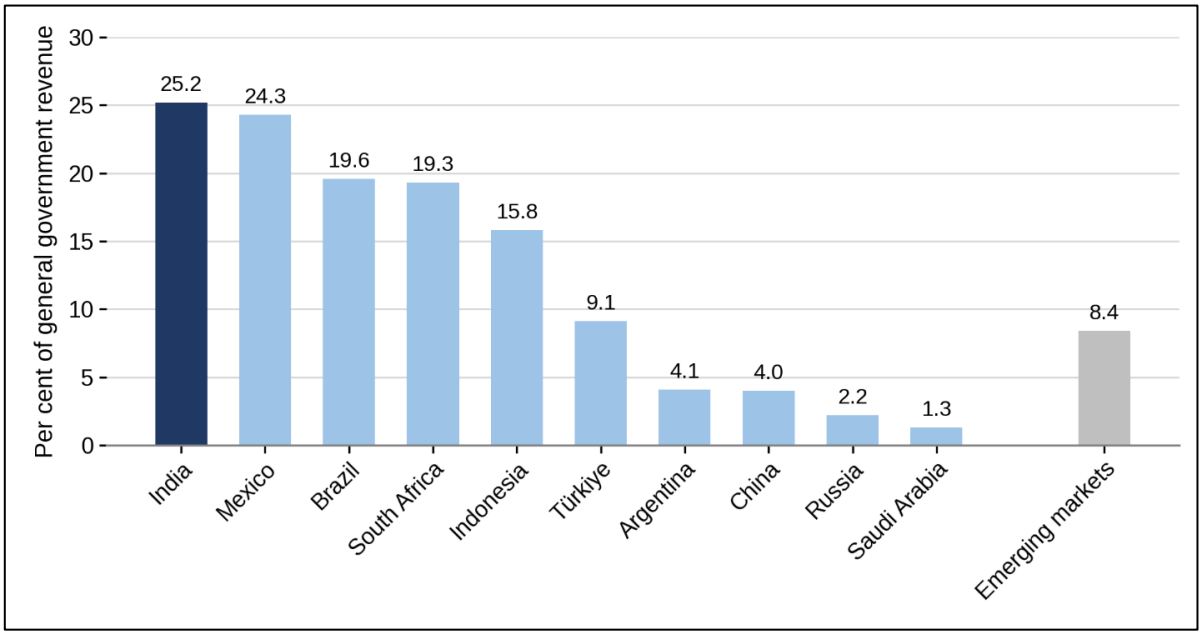


Source: Database on Indian Economy (RBI) and Controller General of Accounts.

Note: For the Centre, 2025-26 figures are provisional actuals (Controller General of Accounts). For general government, which combines states' accounts, the latest compiled figures for 2025-26 are budget estimates.

Interest payments at the Centre are projected to reach 40 percent of revenue receipts and 26 percent of total expenditure in 2026-27, more than the Centre's entire capital outlay. At the general government level, interest absorbed 25.2 percent of revenue in 2025, the highest share among the ten emerging-market G20 economies (Figure 2).

Figure 2: Interest payments, 2025 (% of general government revenue)



Source: IMF Fiscal Monitor, April 2026, Tables A9, A10 and A13; authors' calculations.

Note: (i) Interest payments are derived as the difference between the general government primary and overall balances, and are therefore subject to rounding in the underlying series. The derivation gives gross interest for most countries, but approximates net interest for those with large interest receipts on government financial assets, which understates the figures for Saudi Arabia and Russia.

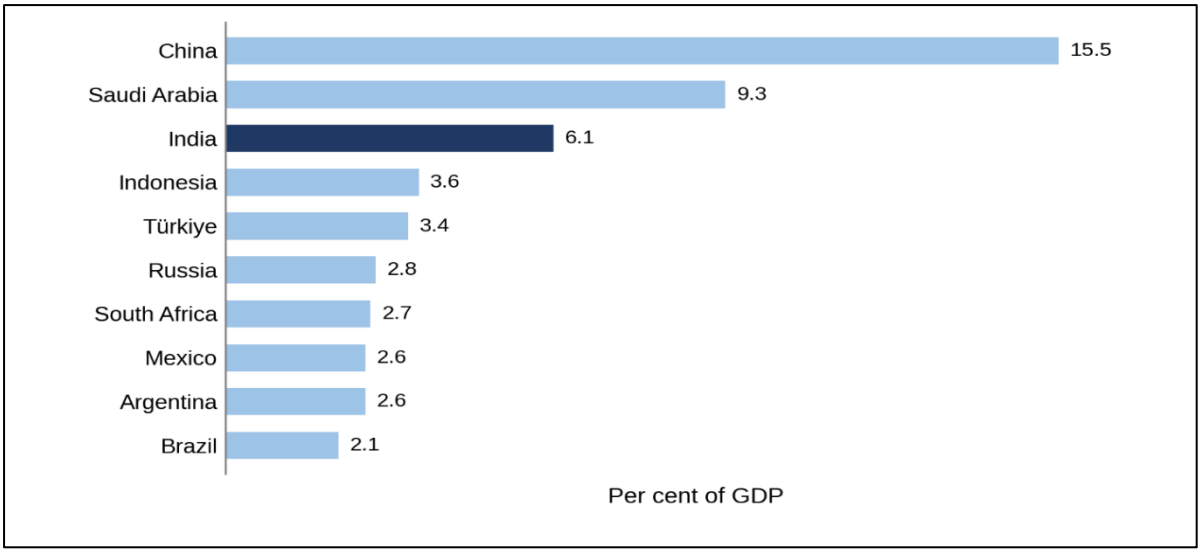
(ii) Fiscal coverage differs across countries.

(iii) The bar for emerging markets represents the average across emerging market economies.

(iv) All figures refer to the general government for a single year, 2025, and are not comparable with the World Bank's series on interest payments as a share of revenue, which covers the central government alone and reports a different latest year for each country.

A large interest bill leaves less room for spending that supports growth and living standards. But India has protected public investment, which is high by the standards of its peers (Figure 3). This figure covers general government investment alone. Total investment in the economy, public and private, is 32 percent of GDP and is not comparable with the figures shown here. This comparison predates the rise shown in Figure 4: capital outlay at the Centre reached 17.9 percent of total expenditure in 2025-26, the highest in the series, so India's current position is stronger than 2019 suggests.

Figure 3: Gross Fixed Capital Formation, General government (% of GDP), 2019



Source: IMF Investment and Capital Stock Dataset (ICSD).

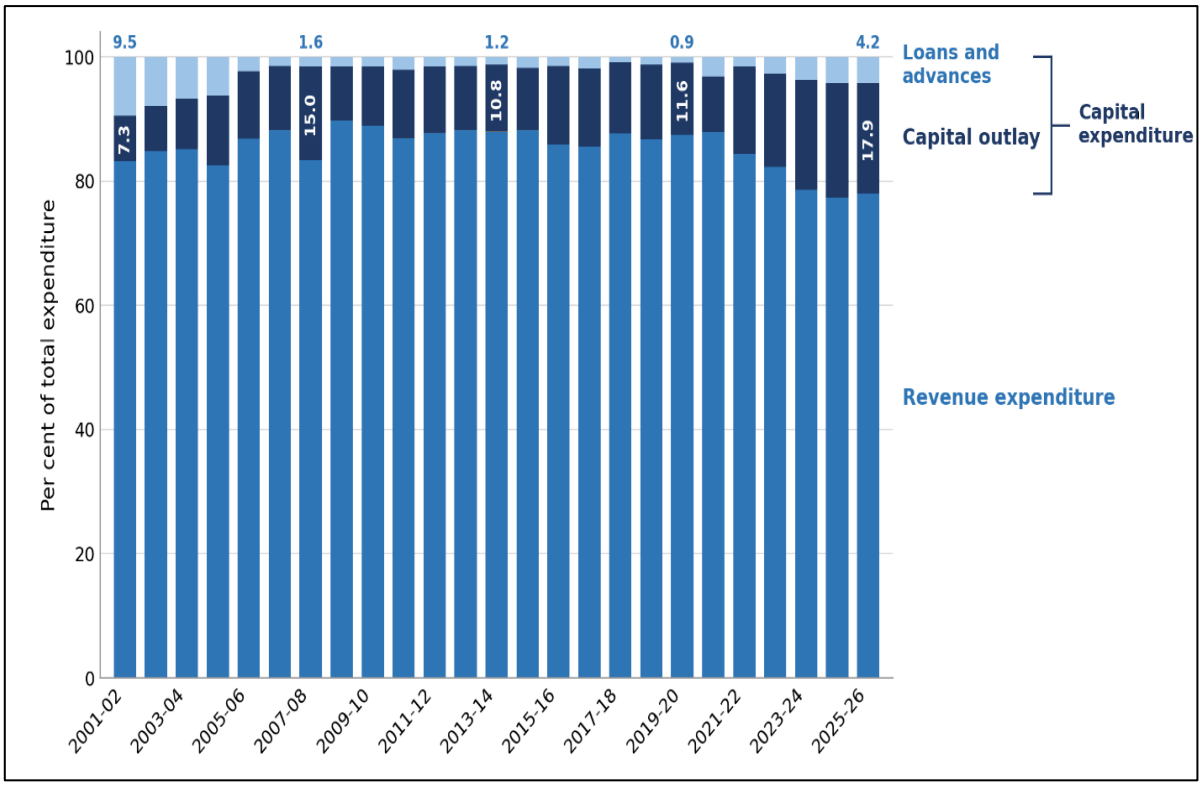
Note: 2019 is the latest year available. Article IV and national accounts estimates differ widely in coverage across countries. IMF-ICSD is the only consistent cross-country source.

The share of capital expenditure in the Union government's total expenditure has risen from 12-13 percent through most of the 2010s to about 21-23 percent in recent years (Figure 4). Capital expenditure at the Centre includes loans and advances, most of which are now loans to states for capital investment. Separating capital outlay from loans and advances shows how much the composition of spending has changed. In 2001-02, capital expenditure was 16.8 percent of total expenditure, but more than half of this was loans and advances (9.5 percent), and capital outlay was only 7.3 percent. The Centre then acted as an intermediary for state borrowing. That role ended when plan loans to states were discontinued from April 2005 on the recommendation of the Twelfth Finance Commission. In 2025-26, capital outlay reached 17.9 percent of total expenditure, the highest in the series. Measured by capital outlay, the shift toward investment since the early 2000s is, therefore, much larger. This is a real improvement. The Centre has raised capital spending at the same time as it has reduced the deficit, so the composition of the adjustment since 2020-21 has favoured investment.

This matters because capital spending raises output more than revenue spending. RBI estimates put the Union government's capital expenditure multiplier at 2.45 in the year of spending, rising to 3.14 a year later, compared with 0.45 for revenue expenditure (Agarwal, et. al., 2020). These estimates are well above most international evidence. For developing countries, Ilzetzki, Mendoza and Végh (2013) estimate 0.6 in the year of spending, rising to 1.6 in the long run (World Bank, 2024, Box 3.2).[3] The RBI estimates should therefore be read as indicating that capital spending is more growth-friendly, rather than as a precise measure of its effect.

[3] Why India's estimates are so high is unclear. Possible explanations include imprecision in estimates based on short annual samples, differences in the horizon measured, and limited crowding out through interest rates where banks are required to hold government securities.

Figure 4: Composition of Union Expenditure (% of Total Expenditure)



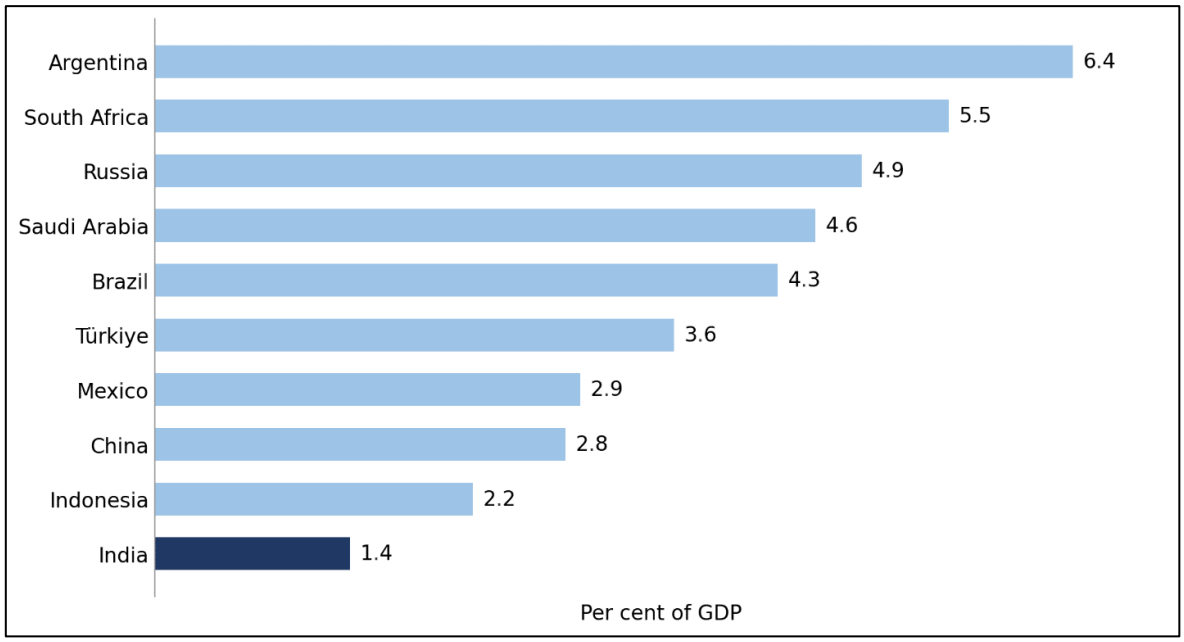
Source: Union Budget documents (various years); authors' calculations.

Note: The 2025-26 figures are revised estimates.

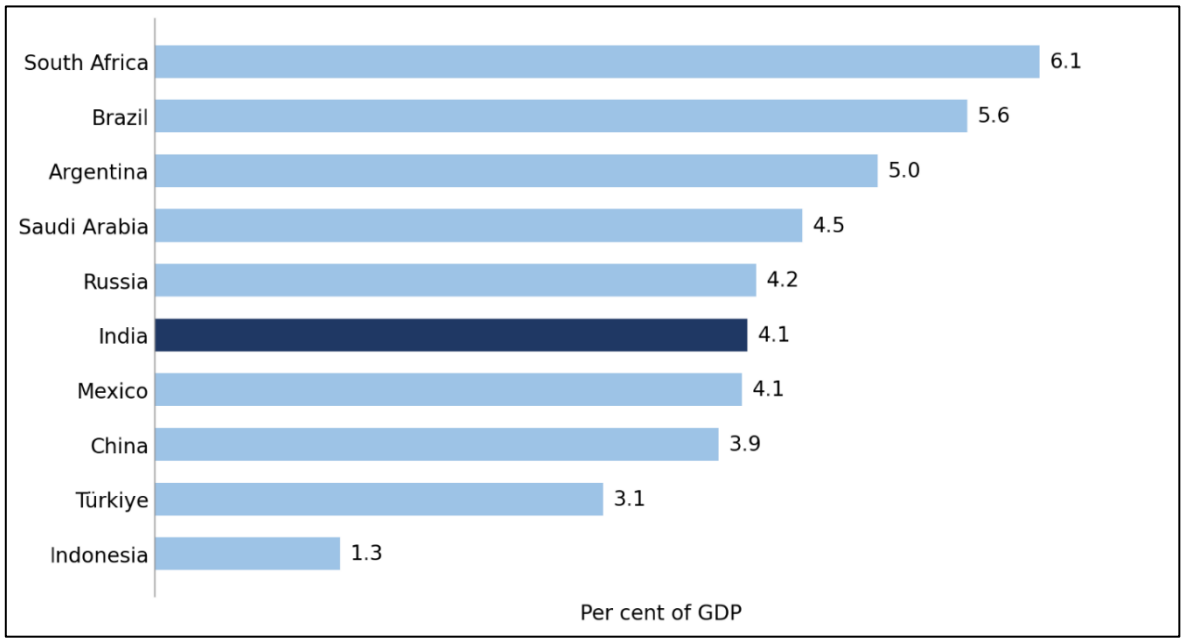
Spending on health and education has not kept pace: India's general government spending on health is the lowest in the group, and its spending on education is around the group median (Figure 5). Part of this gap reflects the larger role of the private sector. In 2022-23, government spending accounted for 43.7 percent of total health expenditure while households paid 43.4 percent out of pocket (MoHFW, 2026). Total health expenditure, public and private, was about 3.3 percent of GDP in 2022-23, well below most large emerging markets. High out-of-pocket costs also fall heavily on the poor: they pushed an estimated 55 million people into poverty in 2011-12, 38 million of them because of spending on medicines alone (Selvaraj, Farooqui & Karan, 2018). In education, how well money is spent matters as much as how much: nearly a quarter of teachers in rural public schools were absent during unannounced visits (Muralidharan et al., 2017).

Figure 5: Domestic General Government Expenditure on Health and Education (% of GDP), 2023

Panel A: Health



Panel B: Education



Source: World Bank.

3. Budgetary Subsidies

Subsidy reform offers one of the largest opportunities to reallocate spending within the Union budget. Fertiliser and LPG subsidies are delivered mainly by holding the retail prices of urea

and domestic LPG below cost, which leaves the budget exposed to swings in international prices. In 2026-27, the West Asia conflict has pushed both bills well above their budget provisions. According to press reports, the Department of Fertilisers has asked for its allocation to be doubled. Keeping petrol and diesel prices largely unchanged also has a fiscal cost. Gupta and Tiwary (2026) estimate this additional cost at 0.6 percent of GDP in 2026-27, which is larger than the central government's allocation for agriculture and for health.

Fertiliser subsidy is the clearest candidate for rationalisation (Gulati & Banerjee, 2015; Juneja et al., 2026). The 2026-27 Budget provides about 0.4 percent of GDP for it, roughly one-seventh of budgeted capital expenditure. Around two-thirds of the allocation is for urea.

Actual spending has often exceeded the budget. In 2022-23, after global fertiliser prices surged following Russia's invasion of Ukraine, the revised estimate was 0.8 percent of GDP, more than double the 0.4 percent budgeted.

Because the retail price of urea has not changed in more than a decade, while prices of phosphatic and potassic fertilisers move largely with costs, nitrogen has become cheap relative to the other nutrients and farmers overuse it.[4] In 2024-25, the ratio of nitrogen, phosphorus and potassium in fertiliser consumption was 9.3:3.5:1, compared with the commonly cited benchmark of 4:2:1.[5] This imbalance reflects the lower relative price of nitrogenous fertilisers, although the appropriate nutrient mix varies by crop and agro-climatic conditions. Crops absorb well under half of the nitrogen applied, so the current structure costs the budget and damages soils.

The Economic Survey 2025-26 (Ministry of Finance, 2026) proposes a modest increase in the retail price of urea, offset by a per-acre transfer to farmers. Farmers would keep the same overall purchasing power, but nitrogen would become more expensive relative to other nutrients, which would discourage overuse. The fiscal savings would build up over time as urea use falls. Because transfers based on land records go to landowners, the design would also need a way to reach tenant farmers.

Petroleum subsidies are smaller in the budget, but their cost depends heavily on international prices**.** When international prices rise and retail prices are held, oil marketing companies absorb the losses and the government compensates them later, outside the original budget. It has done so twice in recent years, most recently in August 2025.

Retail LPG prices should follow international prices, with support for poor households delivered through the existing direct benefit transfer (Gupta & Tiwary, 2026). Petrol and diesel prices are formally market-determined, but in practice they are often held when costs

[4] Urea, which supplies most of the nitrogen used in India, has a retail price fixed by the government. Phosphatic and potassic fertilisers such as Di-Ammonium Phosphate (DAP) and MOP receive a fixed subsidy per kg of nutrient, so their retail prices move largely with costs. In Kharif 2025, the subsidy covered 80–85 percent of the cost of urea, compared with 45 percent for phosphatic and 5 percent for potassic fertilisers (Juneja et al., 2026). As a result, nitrogen has become cheap relative to phosphorus and potassium.

[5] Department of Fertilizers, Ministry of Chemicals and Fertilizers, Government of India, 2026.

rise. Any compensation to oil marketing companies should be provided in the budget at the start of the year, so that the cost of holding prices down is visible when the decision is taken.

4. Debt dynamics: A narrowing cushion

Rapid growth has generally exceeded the interest rate on India's government debt, helping to contain the debt ratio. Blanchard (2019) argued that when the interest rate is below the growth rate, debt can stabilise or even fall while the government runs a modest primary deficit. This matters for India, which continues to run a primary deficit: the decline in its debt ratio rests largely on this favourable gap. But the gap is not guaranteed to last, and in emerging markets it has at times reversed abruptly (Mauro & Zhou, 2021). The reversal has not been confined to emerging markets: the decade of very low borrowing costs in advanced economies has ended. In the United States, general government interest payments reached 4.3 percent of GDP in 2025, 1.5 percentage points above their 2019 level. In Japan, ten-year bond yields rose to about 2 percent in December 2025, the highest in nearly two decades (IMF, 2026). India's borrowing costs have been held down partly by the requirement that banks hold government securities under the statutory liquidity ratio. As that requirement has eased and foreign holdings have grown following India's inclusion in global bond indices, borrowing costs are likely to become more sensitive to international market conditions.

The broader literature also counsels caution regarding debt dynamics. Bohn (1998) showed that debt is sustainable only if governments strengthen the primary balance as debt rises. Ghosh et al. (2013) found that this response weakens at high debt levels, and that interest rates can then rise sharply, eroding the favourable gap. Eichengreen and Panizza (2016) showed that the large primary surpluses needed to correct course, sustained over many years, are historically rare. A debt strategy that relies on a continued favourable interest–growth gap therefore carries significant risk.

The interest-growth differential is only partly under the government’s control. Policy can influence growth, and fiscal discipline can help keep borrowing costs down, but interest rates are largely set in financial markets. The differential has already narrowed. On two measures, one using the average interest cost of general government debt and the other the yield on new government securities, it averaged about -5 percentage points between 2008-09 and 2018-19, compared with under -3 points since 2019-20. Since the post-pandemic rebound in 2021-22, it has narrowed every year, to about -1.6 to -1.9 points in 2025-26 (BE). This narrowing has come from slower nominal growth rather than higher interest rates: the effective interest rate has stayed close to 7 percent, while nominal GDP growth has fallen from about 13 percent in 2008-19 to under 9 percent. A narrower differential allows a smaller primary deficit before debt starts to rise. At the current differential, the general government's debt ratio stabilises with a primary deficit of only about 1.2-1.4 percent of GDP. At today’s debt ratio, the 2008-19 differential would have allowed a primary deficit of about 3.5-4 percent. The current primary deficit, about 1.9 percent of GDP, is above the debt stabilising level, so on present policies the debt ratio would rise by roughly half a percentage point of GDP every year.

Furthermore, the differential can narrow quickly when the economy faces external shocks. Tighter global financial conditions raise bond yields in emerging markets and can trigger capital outflows, and this risk grows as foreign investors hold more government debt. Commodity price shocks add to the pressure. For a large importer of oil, gas and fertilisers such as India, these shocks raise consumer prices and slow growth at the same time. Monetary policy typically tightens in such episodes, and bond markets become volatile. If these pressures persist, borrowing costs rise while nominal growth slows, and the differential narrows from both sides. Because India's debt has long maturities, higher yields feed into the average interest cost only gradually, but slower nominal growth affects the debt ratio at once. A debt path that depends on a differential while the primary balance remains in deficit is exposed to such episodes.

5. Recent Fiscal Consolidation Episodes

The literature usually measures improvements in a country's fiscal position by changes in the cyclically adjusted primary balance (CAPB) as a share of potential GDP. Because the CAPB removes the effects of the business cycle on revenue and spending, changes in it mainly reflect deliberate policy choices. Studies differ on how large an improvement counts as a consolidation. Giavazzi and Pagano (1996) set a high bar, requiring an improvement of at least 3 percentage points of GDP or larger cumulative improvements over two to four years. Alesina and Ardagna (1998) require at least 2 percentage points of improvement in one year, or an average of 1.5 percentage points a year over two years. A less demanding and more widely used threshold is an improvement in the CAPB of at least 0.5 percentage points of GDP in each of two consecutive years (Baldacci, Gupta & Mulas-Granados, 2015; Clements et al., 2025).[6] We adopt this threshold because India's adjustments have tended to be gradual.

Following Clements et al. (2025), an episode is classified as expenditure-based if the fall in primary expenditure accounts for at least two-thirds of the improvement in the CAPB, with both measured as shares of GDP and summed over the years of the episode. It is classified as tax-based if primary expenditure rises over the episode, or if the rise in revenue accounts for at least two-thirds of the improvement[7]. In advanced economies, some studies find that expenditure-based consolidations built on permanent spending cuts are more durable

[6] It has been argued that this measure of CAPB could be biased as changes in cyclically adjusted fiscal variables are often influenced by developments that cannot be attributed to changes in economic policy (such as a boom in the stock market that improves tax revenues or other developments that raise private consumption and investment) (Carrière-Swallow et al., 2018). These authors use the narrative approach which identifies consolidations from tax and spending measures recorded in budget documents in 14 Latin American and Caribbean economies. They found that the narrative method and the CAPB approach are strongly correlated.

[7] The Fiscal Monitor does not publish potential output for India. We infer the output gap from the IMF's cyclically adjusted balance, assuming that revenue moves one-for-one with output and that primary spending does not respond to the cycle, a standard assumption for emerging markets. The implied gap lies between about −2.5 and +2.7 percent in most years; the exceptions are the pandemic years 2020-21 and 2021-22. We then compute cyclically adjusted revenue and primary spending on the same basis as the Fiscal Monitor primary balance. We repeat the higher revenue elasticities. With a revenue elasticity of 1.5, no episode changes classification. With an elasticity of 2, the spending share of the 2011-14 episode falls to 67 percent, just above the two-thirds threshold, so it remains expenditure based.

(Alesina & Ardagna, 2013). This is often attributed to investors having more confidence that the fiscal improvement will last when it comes from spending cuts.

The evidence for emerging market economies is different. Revenue increases are associated with more durable consolidations in emerging markets, as are cuts in current spending such as subsidies and transfers when capital spending is protected (Gupta et al., 2005). Revenue-raising measures also tend to last longer where revenue is low to begin with; spending-based adjustments prove more lasting mainly where tax revenue exceeds about 25 percent of GDP (Balasundharam et al., 2023). India's tax revenue, at about 19 percent of GDP, is well below that level.

On the basis of the definition used in Clements et al. (2025), India has had three consolidation episodes since 1996-97 (Figure 6).

- **1999-00 to 2000-01.** The CAPB improved by 1.9 percentage points, nearly three-quarters of it from higher revenue. All of it was lost in 2001-02. The episode is classified as tax-based.
- **2004-05 to 2007-08.** This was the largest and longest episode. The CAPB improved by 5.0 percentage points[8], about three-quarters of it from higher revenue. The improvement came alongside the FRBM Act at the Centre and fiscal responsibility laws in the states, which the Twelfth Finance Commission made a condition for debt relief for states. The episode is classified as tax-based. Spending in these years was understated by off-budget financing of oil and food subsidies, so the revenue share may be somewhat overstated. The reversal of the 2004–08 gains reflected a deliberate fiscal response to the global financial crisis.
- **2011-12 to 2013-14.** The CAPB improved by 2.6 percentage points, about four-fifths of it from lower primary spending. About 0.6 percentage points of this was lost over the next three years. The episode is classified as expenditure-based. The classification holds for revenue elasticities up to about 2.0[9], well above the values usually assumed for India (see footnote 7). The durability of the 2011-14 episode owed much to fuel subsidy reform and lower oil prices.

The post-pandemic adjustment should be judged against this record. The general government deficit fell by about 5.9 percentage points of GDP between 2020-21 and 2025-26, and the Centre met its announced deficit path in each of those years. Most of the fall came from the unwinding of pandemic support and from the recovery in revenue as growth returned. In

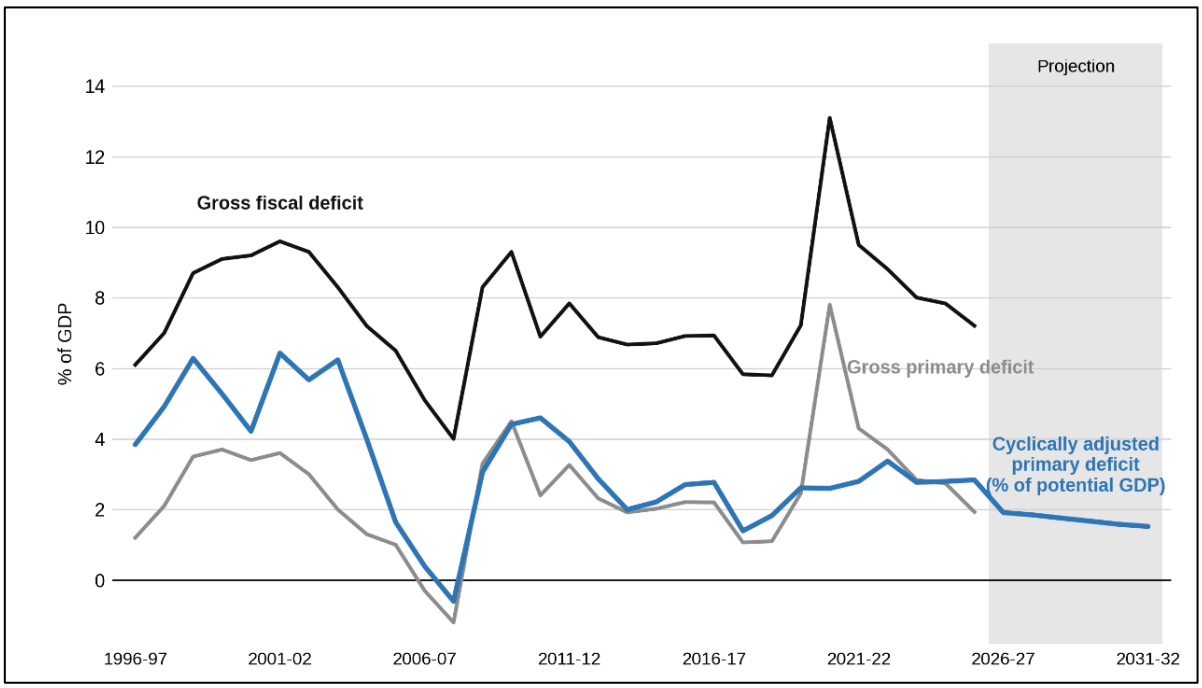
[8] Before 2010-11, the published CAPB is not on the same basis as the Fiscal Monitor primary balance: the interest payments implied by the two series differ. We therefore measure all episodes on a consistent basis. On this basis, the CAPB improved by 1.9 percentage points in 1999-01 rather than 2.1, and by 5.0 rather than 6.8 in 2004-08. Figure 6 shows the published series.

[9] Raising the threshold to 0.75 percentage points of GDP a year leaves the 1999-01 episode unchanged and shortens the 2011-14 episode to 2012-14, with no change in classification. The 2004-08 episode shortens to 2004-06, because the improvement in 2006-07 is 0.745 percentage points, however, only marginally below the threshold. Over this shorter window the spending share rises to 71 percent, so the episode would be classified as expenditure-based. On the published CAPB series, every year of 2004-08 clears 0.75 and the episode is unchanged.

cyclically adjusted terms, however, the general government's primary position in 2025-26 is slightly weaker than in 2019-20, and its interest bill is larger.

The IMF projects the CAPB to improve by 0.9 percentage points in 2026-27 but these projections were prepared in the early weeks of the West Asia conflict, which began at the end of February 2026. They are therefore unlikely to capture the full fiscal cost of higher fertilisers and petroleum prices (as noted in section on budgetary subsidies). Two costs stand out. A doubling of fertiliser subsidies would add about 0.4 percent of GDP to spending. Keeping petrol and diesel prices largely unchanged would cost about 0.6 percent of GDP. Oil marketing companies bear this cost at first, but it reaches the budget if the government compensates them or receives lower dividends and taxes from them. A lowering of excise duties on petroleum products can add to budgetary costs. The fertiliser overrun alone would cut the projected improvement in the CAPB for 2026-27 by about half. If the petroleum cost also came onto the budget, the improvement would disappear, and the cyclically adjusted primary deficit would stay close to its 2025-26 level. Either way, the medium-term path would start from a weaker position than the IMF projects.

Figure 6: Cyclically Adjusted Primary Deficit (% of Potential GDP)



Source: IMF Fiscal Monitor, April 2026 and RBI.

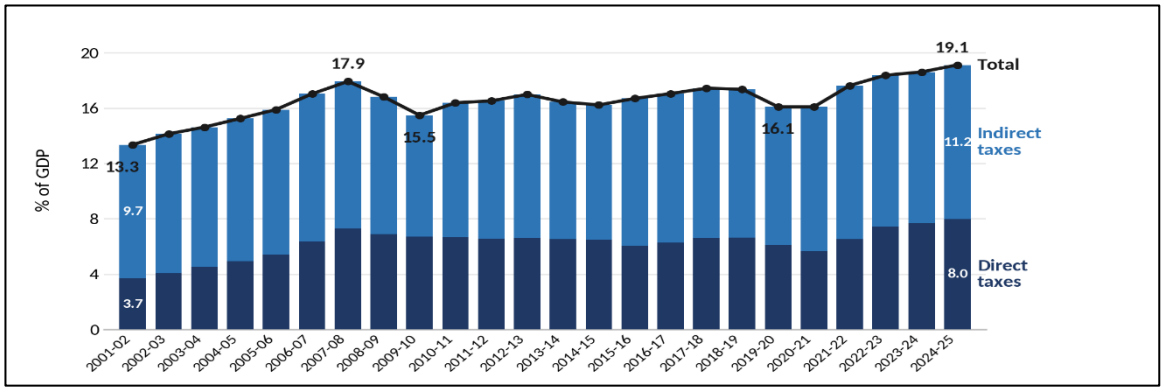
Note: Before 2010, the CAPB series is not on the same basis as the IMF Fiscal Monitor's primary balance, so values before and after that year are not strictly comparable (see footnote 8).

6. The Revenue Side: Improved, but Narrow and Less Predictable

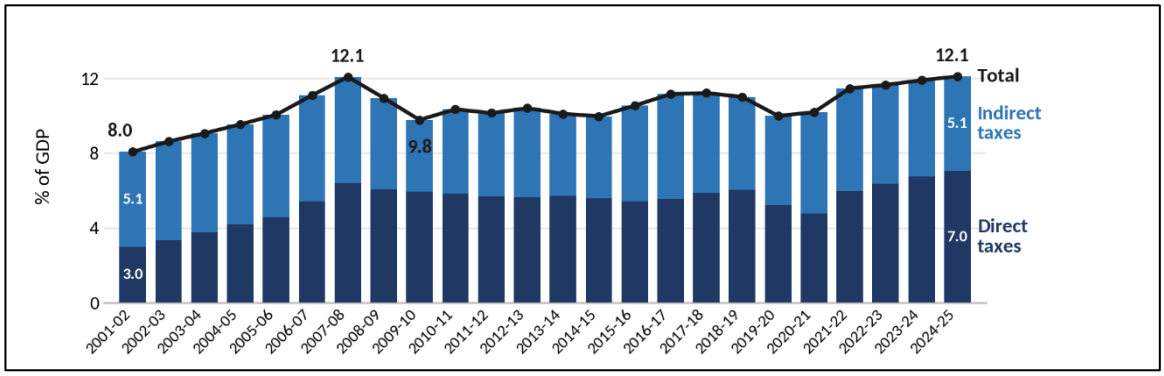
India's tax effort has improved substantially over the past two decades. General government gross tax revenue rose from 13.3 percent of GDP in 2001-02 to 19.1 percent in 2024-25 (Figure 7, Panel A).[10]

Figure 7: Gross Tax Revenues (% of GDP)

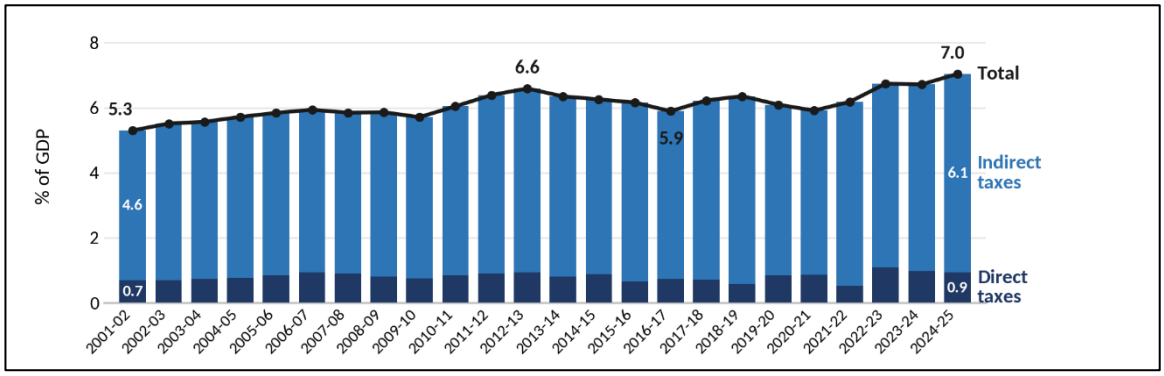
Panel A: General Government



Panel B: Union Government



Panel C: State Governments



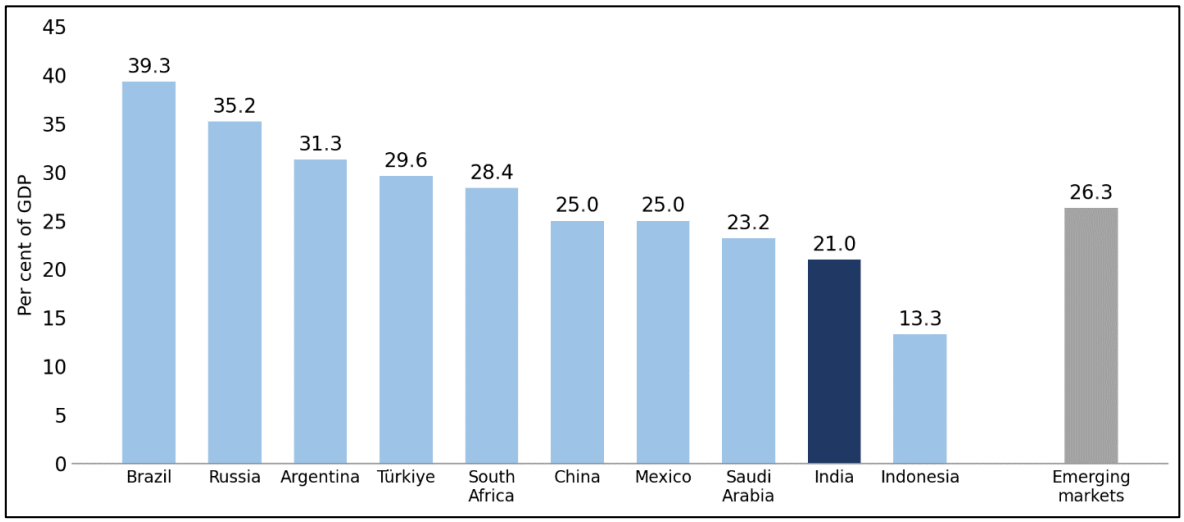
Source: Union Budget documents, RBI, and authors' calculations.

Note: Figures for 2024-25 are Revised Estimates.

[10] Tax-to-GDP ratios after 2022-23 use GDP estimations based on new methodology proposed in February 2026. The new series pushes the ratios upwards.

About 4.3 percentage points of this increase came from direct taxes. Indirect taxes contributed relatively little: 1.5 percentage points, even though the period included the introduction of GST in 2017. Yet India's revenue performance lies below all G20 emerging market economies except Indonesia, partly because of its relatively low per capita income (Figure 8).

Figure 8: General Government Revenue (% of GDP), 2025



Source: IMF Fiscal Monitor, April 2026.

Note: Fiscal coverage differs across countries, and figures for India refer to the Centre and states only, excluding local bodies.

The gains have also been uneven across levels of government and over time. The Centre's tax ratio rose sharply until 2007-08 but is no higher today. Since then, the entire increase in the general government ratio has come from the states, mainly through indirect taxes (Figure 7, Panel C). The Centre's indirect taxes have fallen over the same period, from about 5.7 percent of GDP in 2007-08 to 5.1 percent in 2024-25 (Figure 7, Panel B). Part of this decline reflects lower customs duties following tariff cuts; the rest reflects the taxes that GST replaced and changes in excise duties on fuel.

Two implications follow. First, the Centre's direct tax gains rest on a narrow base relative to the population and the formal workforce, so further gains will depend on widening that base. Second, indirect taxes, which have the broadest base, are a smaller share of GDP at the Centre than in 2007-08, and the September 2025 GST rate cuts are likely to reduce them further.

A central question is why GST, which covers most consumption, raises no more revenue for the Centre than the indirect taxes it replaced. One way to judge a consumption tax is its C-efficiency: actual collections as a share of what the standard rate would raise if applied to all consumption. An IMF study puts average C-efficiency in 2018-2021 at 0.61 in advanced economies and 0.57 in emerging market and middle-income economies (Okello et al., forthcoming). Measured against India's 18 percent standard rate, Mukherjee (2023)

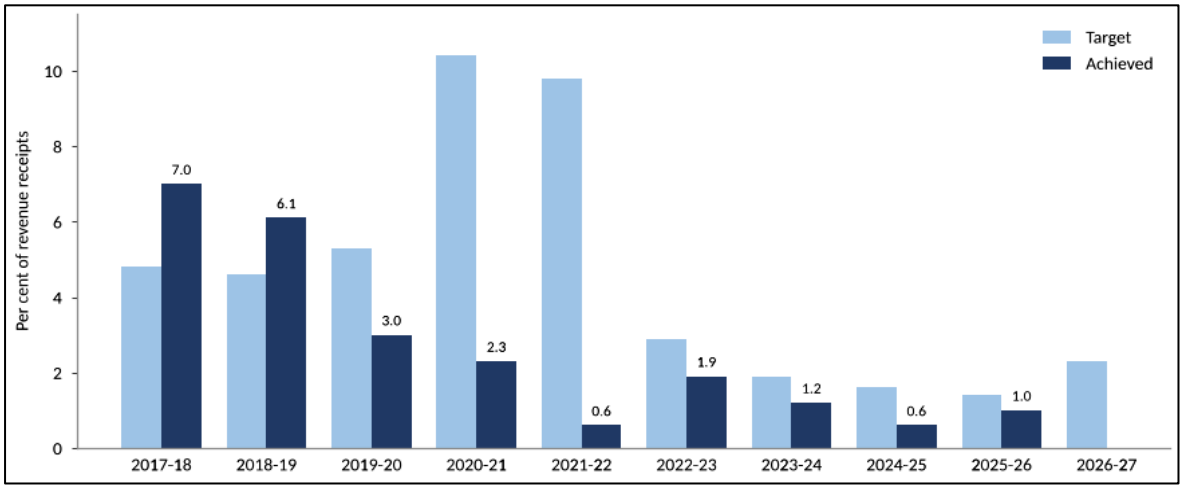
estimates imply a C-efficiency of about 0.30-0.39 for GST on domestic supplies.[11] Including GST on imports would raise this somewhat, but India still appears to be well below the emerging-market average.

The main reason is the narrow base, not evasion. Mukherjee (2023) finds that the revenue lost through exemptions, reduced rates and exclusions (the policy gap, about 42 percent) is roughly five times the revenue lost through non-compliance (about 8 percent). Measures since 2017, such as e-way bills and e-invoicing, have mainly targeted evasion, which accounts for the smaller share of the loss. Bringing petroleum products, electricity and real estate into GST would address the larger loss from the narrow base. It would also let businesses that use these inputs claim credit for the tax paid on them.[12]

Besides taxes, the Centre raises funds by selling its stakes in public sector enterprises. These disinvestment receipts are recorded as non-debt capital receipts, not as revenue, so they are not included in the revenue figures above. They do, however, reduce the fiscal deficit, which is why shortfalls against the disinvestment target matter for the budget.

Disinvestment targets have been missed every year since 2019-20. The largest shortfalls were in 2020-21 and 2021-22, when receipts came to about a sixth and under a tenth of the targets (Figure 9).

Figure 9: Disinvestment – Target versus Realisation (% of Revenue Receipts)



Source: Department of Investment and Public Asset Management; Union Budget documents; authors' calculations.

Note: 2026-27 shows the budgeted target; realisations for the year were in progress at the time of writing.

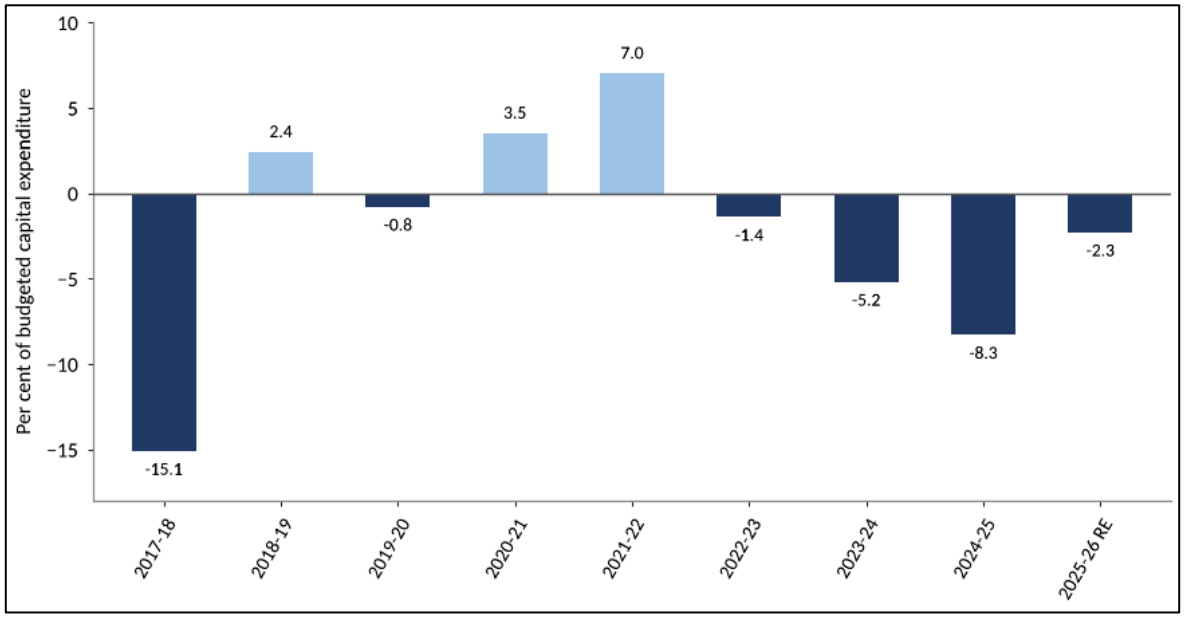
[11] Mukherjee reports a ratio of 0.54, but measures it against an effective tax rate of about 10–13 percent rather than the standard rate, so it is not comparable with the cross-country figures. Modi (2025) puts India at 0.42 in 2022-23. These differences mostly reflect the choice of standard rate and the measure of consumption used.

[12] What matters for the budget is GST collected after refunds. In August 2026, gross GST collections rose by about 15 percent from a year earlier, but refunds rose by about two-thirds, so net collections grew by only about 8 percent. Higher refunds partly reflect faster processing of refunds owed to exporters and businesses that pay more tax on inputs than on outputs. In that sense they show the system working as intended. But they also reflect the September 2025 rate cuts, which widened the gap between tax rates on inputs and outputs in some sectors. Either way, gross collections overstate the revenue available to the budget.

These shortfalls matter less for the receipts lost than for their effect on the year's budget. When budgeted receipts do not come in, the gap must be closed during the year, often by cutting or delaying other outlays, including for capital investments.

Figure 10 shows actual minus budgeted capital outlay. In 2020-21 and 2021-22, actual outlay exceeded the budget. Since 2022-23, it has fallen short every year, and the shortfall grew each year to a peak in 2024-25, which was an election year. The revised estimates for 2025-26 show a smaller but still sizeable shortfall.

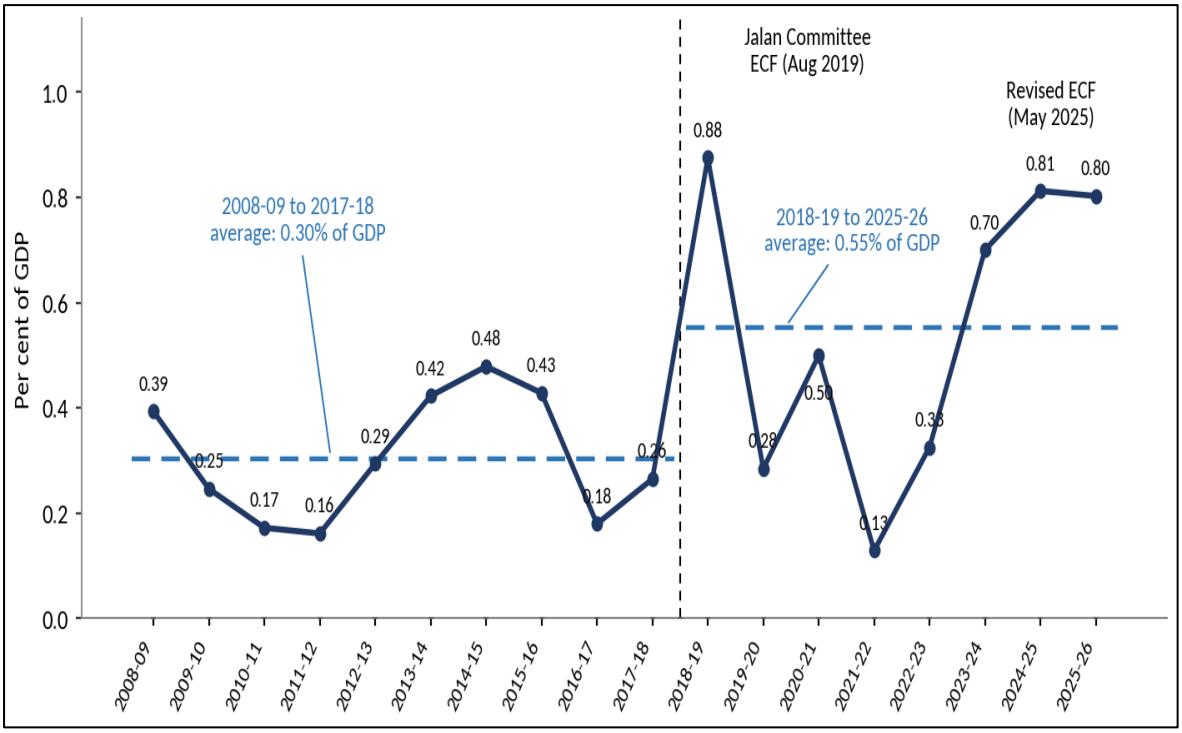
Figure 10: Budgeted versus Actual Capital Outlay, 2017-18 to 2025-26



Source: Union Budget Documents, Various Years.

Figure 11 plots the surplus transferred by the Reserve Bank of India to the Central Government as a share of GDP. Transfers averaged 0.3 percent of GDP from 2008-09 to 2017-18 and 0.55 percent from 2018-19 to 2025-26. In each of the last two accounting years, they reached about 0.8 percent of GDP.

Figure 11: RBI Surplus Transfer to the Central Government (% of GDP)



Source: RBI Annual Reports and press releases; MoSPI; authors' calculations.

Note: Years refer to the RBI's accounting year; the surplus for a given accounting year is credited to the Central Government in the following fiscal year.

Had transfers remained at their 2008-18 average of 0.3 percent of GDP, the Centre's 2025-26 fiscal deficit would have been about half a percentage point of GDP higher; even against the higher post-2019 average, the difference would be about a quarter of a point. Part of the recent improvement in the deficit has therefore come from outside the tax system, from a source that can vary from year to year. How much this matters for the durability of consolidation depends on how much of the higher level is likely to persist.

Three factors drive the surplus and their effects last for different lengths of time.

- **The size and composition of the Reserve Bank's balance sheet**. Most of its income is interest on domestic and foreign securities, so income rises with both the stock of assets and global interest rates. The increase since 2022 coincides with higher yields on the foreign currency assets.
- **The exchange rate**. Gains on the sale of foreign currency are booked as income. They depend on how much foreign currency is sold and on the difference between the sale rate and the average cost at which reserves were acquired. Heavy intervention to support a depreciating rupee can therefore generate large gains. This is one reason transfers are volatile and difficult to project.

- **Provisioning policy**. Since 2019, the Economic Capital Framework has set the range within which the Reserve Bank builds its risk buffers, but the choice within that range remains discretionary. The 2018-19 spike in Figure 11 largely reflects a one-time release of excess provisions when the framework was adopted. In recent years, the Reserve Bank has moved its buffer towards the upper end of the permitted range.

The RBI brought the closing date for FCNR(B) deposits forward from 30 September to 31 August, saying the facility had achieved its objective ahead of schedule. Banks mobilised about $133 billion in these deposits by that date. Including overseas bank borrowings and external commercial borrowings, total inflows under the scheme stood at about $144 billion as of 18 September 2026, and the window for the latter two remains open until the end of December. The 2013 swap window, by comparison, raised about $34 billion. These are three-to-five-year liabilities in foreign currency owed to non-residents, so the maturities fall due between 2029 and 2031. The Reserve Bank buys these dollars and agrees to sell them back at the same exchange rate, without charging the forward premium that banks would otherwise pay to hedge. It earns interest on the additional reserves at US rates but, to the extent it absorbs the resulting rupee liquidity, pays close to Indian interest rates. The difference, roughly the forgone premium, reduces its income until the swaps unwind over the next three to five years. On a rough estimate the cost is under 0.1 percent of GDP a year: small relative to recent transfers, but a further reason not to treat their current level as permanent.

Taken together, some of the increase reflects lasting changes, notably a larger balance sheet and a rules-based framework. Other parts, such as exchange rate gains and high foreign yields, are more likely to be temporary.

7. State Finances

State finances show a similar pattern, and in some respects a more acute one. In 2023-24, salaries, pensions, interest and subsidies together absorbed about three-fifths of states' revenue receipts (PRS Legislative Research, 2025). Punjab's spending on these items exceeded its revenue receipts, and Himachal Pradesh, Tamil Nadu, Kerala and Haryana each spent more than 70 percent of their revenue receipts. Interest payments alone took 13 percent of revenue receipts and have grown slightly faster than receipts since 2016-17, so the burden of servicing debt is gradually rising. States’ combined outstanding liabilities stood at 27.5 percent of GDP in March 2025, well above the 20 percent recommended by the FRBM Review Committee. Measured against their own GSDP, only Gujarat, Maharashtra and Odisha are within that limit. High debt in several states also limits their room for growth-enhancing spending, and lower-income states, whose incomes are not converging with richer ones, need more resources for investment and public services (Govil & Chauhan, 2024).

GST has also narrowed states' options for raising revenue. States gave up the power to set rates on the taxes that GST replaced, and rate decisions now rest with the GST Council.

Revenue has not risen to compensate. SGST has averaged 2.6 percent of state GDP in the seven full years since its introduction, slightly below the 2.8 percent that the replaced taxes yielded in the four preceding years. Until June 2022, the shortfall was made good by compensation from the GST cess, which guaranteed states 14 percent annual growth in GST revenue. Since compensation ended, states have borne the gap themselves.

As at the Union level, capital spending bears the brunt of adjustment during the year. Between 2015-16 and 2023-24, states' capital outlay fell short of budget by 20 percent on average (PRS Legislative Research, 2025). This suggests that capital expenditure remains the more flexible part of the budget when revenues or financing fall short.

The conclusion for the states is similar to that for the Union, but the constraints are tighter. Their own-revenue is limited, a large share of expenditures is committed, and capital expenditure is the easiest item to cut. The Sixteenth Finance Commission keeps the ceiling on state fiscal deficits at 3 percent of GSDP. It also recommends ending borrowing through state-owned entities whose debt the state repays from its budget, and counting all such borrowing in the state's deficit and debt. This would improve fiscal transparency. But it would also tighten the effective limit for states that have relied on off-budget borrowing, because that borrowing would now count against the same 3 percent ceiling. Without stronger revenue mobilisation the risk is that adjustment continues to fall on capital and development spending.

8. Policy Conclusions

India enters the next stage of consolidation from a stronger position than in 2020-21. Since then, the general government deficit has fallen by about 5.9 percentage points of GDP and debt by about 7.4 percentage points. At the Centre, capital outlay is now a larger share of total spending than at any time since 2021, and the fiscal framework now includes a debt anchor.

Debt nevertheless remains high, and the interest bill now absorbs a larger share of revenue than in any other emerging-market G20 economy. The Centre's new debt anchor gives further adjustment a clear objective. The question is how to reach it without repeating two features of past consolidations: gains that were later reversed and adjustments that fell on capital spending. The recommendations below address both.

Plan for a less favourable interest–growth gap. Much of the recent fall in the debt ratio has come from growth running ahead of interest rates. That gap has narrowed every year since 2021-22, mainly because nominal growth has slowed, and it could narrow further as banks' required holdings of government securities fall and foreign investors hold more of the debt. The medium-term fiscal framework should set out a path for the primary balance that reaches the debt anchor under less favourable conditions, not only under the baseline. At the current gap and primary deficit, debt would rise in relation to GDP.

Make revenue the main source of adjustment. An IMF study finds that countries with low revenue should rely more on revenue measures (Balasundharam et al., 2023). India's own record is mixed: the most durable episode, 2011-14, was expenditure-based, but its durability owed much to fuel subsidy reform and the fall in oil prices. With revenue well below emerging-market norms, the cross-country evidence points to revenue as the more lasting source of adjustment. There is room to raise more. Gupta and Jalles (2023) estimate that India collects about four-fifths of its tax capacity, leaving untapped potential of about 3.5 percent of GDP.[13] The Fifteenth Finance Commission put India's tax gap at more than 5 percent of GDP.[14] The priority is to broaden the GST base rather than raise rates. Bringing petroleum products, electricity and real estate into GST would reduce the policy gap, which is much larger than the losses from evasion, and would let businesses claim credit for the tax paid on these inputs. Reporting GST revenue against a medium-term benchmark alongside the fiscal deficit in each budget would make progress easier to track. On direct taxes, further gains will depend on widening a base that remains narrow relative to the formal workforce. Property taxes are another underused source. Municipal corporations collect about 0.1 percent of GDP in property tax, held down by undervaluation, incomplete property registers and weak administration (RBI, 2022). Updating registers and valuations would raise revenue for cities without raising central or state taxes, and would reduce their reliance on transfers from higher levels of government.

Distinguish lasting revenue from temporary receipts. Part of the recent improvement in the Centre's finances has come from RBI surplus transfers, some of which reflect temporary exchange rate gains and high foreign yields. The swap window opened in 2026 is likely to reduce these transfers in the coming years. The Budget could assume a conservative level of RBI transfers and treat anything above it as a windfall to be used for reducing debt. Disinvestment receipts should be budgeted on a similarly cautious basis. Consolidation that rests on one-off receipts or asset sales can be an illusion, improving the deficit without improving the government's net worth (Easterly, 1999).

Protect capital spending through realistic budgets. When receipts or financing fall short, capital outlay is the item most easily cut during the year, as the record since 2022-23 at the Centre and the states' persistent shortfalls show. More realistic revenue estimates, a small contingency reserve and budgeting for compensation to oil marketing companies at the start of the year would make capital spending less exposed. This matters because capital spending is likely to support growth more than revenue spending.

Reform subsidies to create room within the budget. The recent Economic Survey's proposal for a modest increase in urea prices, offset by a per-acre transfer designed to also reach tenant farmers, would cut both the fiscal and the environmental cost of overusing nitrogen.

[13] According to the same study, both China and Vietnam collect more revenues than India.

[14] The IMF's most recent review of India's economy makes the same point, recommending that fiscal buffers be rebuilt mainly through domestic revenue mobilisation (IMF, 2025)

LPG prices should follow international prices, with support for poor households through the existing direct benefit transfer. The space created should go first to health and education, where India's spending is low by the standards of its peers.

Strengthen state finances. States face tighter constraints than the Centre: committed spending absorbs much of their revenue, and GST has limited their ability to raise taxes. Bringing off-budget borrowing onto the budget, as the Sixteenth Finance Commission proposes, would improve transparency. Lasting consolidation will also need a stronger GST base, which benefits states as much as the Centre, so that adjustment does not continue to fall on capital and development spending.

The next phase of consolidation is likely to last longer if it rests on a broader tax base rather than on windfalls and in-year cuts to investment.

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