Growth, Taxes, and Investment

Posted at: 06/02/2025

Growth, Taxes, and Investment: A Budget That is Mostly Good but With One Wrong Move

The **Union Budget** is a critical document that sets the financial agenda for the country, outlining the government's priorities and financial plans for the coming year. It plays a significant role in shaping the economic trajectory of the nation, influencing growth, investments, and the overall economic direction. The **2025-26 Budget** aims to **accelerate growth**, **improve tax structures**, and promote **fiscal consolidation**, all while addressing emerging challenges in the economic landscape. In understanding this budget, it is essential to examine key aspects such as **GDP projections**, **government expenditure**, **tax revenues**, and **fiscal transparency**.

Key Aspects of the Budget

Economic Growth and Capital Expenditure

- **Nominal GDP Growth Projection**: The Budget projects a **nominal GDP growth** of **10.1%** for 2025-26, which aligns with the **Economic Survey's** estimate of **real GDP growth** between **6.3% and 6.8%**.
- **Capital Expenditure**: A key focus is on **increasing capital expenditure**, vital for economic development. The Budget allocates ₹**11.2 lakh crore** for capital expenditure, a slight increase from ₹**11.1 lakh crore** in the previous Budget. The goal is to sustain growth through **infrastructure** and **industrial investments**. However, to meet India's aspirations of becoming a developed economy, the **real GDP growth rate** must rise to around **8%**.
- **Stimulating Economic Activity**: While several measures are introduced to stimulate economic activity, some could have been implemented earlier for a more significant impact.

Tax Revenues and Structural Shifts

- **Shift in Tax Structure**: One of the standout features of the Budget is the shift from **indirect taxes** to **direct taxes**, with the share of **direct taxes** in **Gross Tax Revenues (GTR)** rising from **52%** in 2021-22 to **59%** in 2025-26.
- **Declining Tax Revenue Growth**: Despite this positive structural shift, tax revenue growth has shown a decline:
  - **GTR Growth** has slowed from **13.5%** in 2023-24 to **10.8%** in 2025-26.
  - **GST Revenue Growth** fell from **12.7%** in 2023-24 to **10.9%**.
  - **Personal Income Tax** growth has slowed from **25.4%** in 2023-24 to **14.4%** in 2025-26, partly due to new tax concessions.

- **Corporate Income Tax** growth, which was **7.6%** in 2024-25, is projected to recover to **10.4%** in 2025-26.

Government Expenditure and the Need for AI Investment

- **Fiscal Consolidation**: The Budget focuses on **fiscal consolidation**, reducing government expenditure as a percentage of GDP from **14.6%** in 2024-25 to **14.2%** in 2025-26.
- **Improved Quality of Expenditure**: The total expenditure growth is **7.6%**, which is lower than the projected **GDP growth** of **10.1%**, but the quality of expenditure is improving.
- **Investment in Artificial Intelligence**: A critical investment area highlighted in the Budget is **Artificial Intelligence (AI)**. The government recognizes the need to develop **AI infrastructure** to remain globally competitive. With countries like the **US** and **China** leading in AI investment, India needs to prioritize AI to stay ahead. The government should incentivize AI research and development through **tax concessions** and **public-private partnerships**.

Concerns Over Fiscal Transparency

Departure from the Fiscal Deficit Glide Path

- The **Fiscal Deficit** is a key indicator of the government's financial health. In the **2024-25 Budget**, the government set a target to reduce the fiscal deficit to **below 4.5% of GDP** by **2025-26**.
- However, in the **2025-26 Budget**, this explicit target is abandoned. The focus shifts to reducing the **debt-to-GDP ratio** annually, which creates uncertainty about the government's fiscal strategy.

Ambiguity in Debt Reduction Strategy

- The new approach involves three different scenarios for reducing the **debt-to-GDP ratio**, based on varying **GDP growth assumptions** (10.0%, 10.5%, and 11.0%) and different levels of **fiscal consolidation** (mild, moderate, and high).
- This uncertainty makes it difficult to evaluate the government's fiscal performance. The reliance on optimistic GDP growth assumptions introduces the risk that **debt reduction projections** may not materialize if actual growth falls short.

Risks of High Government Borrowing and Crowding Out Private Investment

- One of the primary concerns is the potential for **higher government borrowing**, which can lead to the "crowding out" of private investment. When the government borrows more, it reduces the pool of funds available for private companies, resulting in higher borrowing costs.
- This could lead to reduced private sector investment, particularly in key sectors like **infrastructure**, **manufacturing**, and **technology**, thereby slowing economic growth.

Impact on India's Credit Ratings

- **Fiscal transparency** is closely monitored by international credit rating agencies like

Moody's, **S&P**, and **Fitch**. A lack of clear fiscal deficit targets can be seen as a weak commitment to **fiscal discipline**.

- If fiscal transparency is not reinstated, it could negatively impact **India's credit rating**, leading to **higher borrowing costs** for the government, businesses, and consumers, and could divert funds from essential expenditures like **infrastructure**, **healthcare**, and **education**.

Recommendations for a More Transparent Fiscal Policy

- **Reintroduce a Clear Fiscal Deficit Target**: The Budget should restore clear annual fiscal deficit goals, ensuring better accountability.
- **Provide a Detailed Debt Reduction Strategy**: Instead of presenting multiple uncertain scenarios, a clear plan for reducing debt levels should be outlined.
- **Ensure Realistic GDP Growth Assumptions**: Fiscal planning should avoid overestimation and be based on more conservative growth projections.
- **Limit Government Borrowing**: Prioritize fiscal consolidation and reduce excessive borrowing to avoid stifling private investment.
- **Strengthen Transparency in Budgetary Disclosures**: More detailed breakdowns of expenditure, revenue forecasts, and borrowing plans will enhance public trust and investor confidence.

Conclusion

The **Union Budget for 2025-26** presents a well-thought-out approach to fostering **economic growth**, reforming the **tax structure**, and ensuring **fiscal consolidation**. While the **GDP growth projections** appear reasonable, the government must increase **capital expenditure** further to sustain long-term economic development. The departure from transparent fiscal deficit targets raises concerns about **fiscal accountability**. A more transparent fiscal policy, with clear targets and realistic assumptions, is essential for ensuring **sustained growth** and maintaining **investor confidence**.