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Fiscal Deficit and Its Implications for Sustainable Development in India: Balancing Growth, Stability, and Equity

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Abstract:
The fiscal deficit is crucial in determining the economic path of a developing nation such as India. Although deficit financing can serve as an effective mechanism to boost economic growth, particularly during recessions or times of insufficient investment, its long-term effects on macroeconomic stability and fair development are concerning. This paper investigates the multifaceted effects of India's fiscal deficit on the three fundamental aspects of sustainable development: eco\nomic growth, financial stability, and social equity. By utilizing historical data and recent fiscal statistics, the research evaluates the structural characteristics of India's deficit, the breakdown of government expenditures, and the evolving fiscal environment following COVID-19. It examines how substantial fiscal deficits—caused by revenue deficiencies and heightened spending obligations—can enhance short-term demand but may also lead to increased inflation, escalating debt-to-GDP ratios, and the displacement of private investment. Additionally, the research emphasizes the trade-offs between fiscal consolidation and the necessity for inclusive welfare spending, particularly in a scenario where significant portions of the population rely on government assistance for education, healthcare, and job opportunities. The discussion also includes the significance of fiscal federalism, the efficacy of fiscal regulations such as the FRBM Act, and the growing demand for environmentally sustainable and gender-sensitive budgeting. The paper concludes by promoting a balanced fiscal approach that emphasizes the quality of expenditures, improves tax efficiency, and aligns budgetary objectives with the overarching goals of the Sustainable Development Goals (SDGs). It contends that such a strategy is vital to ensure that fiscal policy serves not only as a means for economic growth but also for inclusive and resilient development.

1. Introduction

The fiscal deficit of a nation indicates the gap between its government's total spending and the total revenue (excluding borrowings) it generates. This concept transcends mere accounting; it serves as a vital economic indicator that affects a country's macroeconomic stability, investment environment, and developmental path. In the context of India—a lower-middle-income nation with a large population, significant development needs, and structural economic issues—the fiscal deficit takes on even greater importance. [1]. Fiscal policy in India has frequently had to balance the intricate relationship between fostering economic growth, maintaining macroeconomic stability, and encouraging inclusive development. In this context, comprehending the implications of the fiscal deficit for sustainable development is not only pertinent but essential.[2].

India's developmental goals are vast with a population exceeding 1.4 billion. The country confronts urgent challenges such as poverty reduction, job creation, infrastructure enhancement, environmental sustainability, and the mitigation of regional and social inequalities.[3]. The government's budgetary decisions, particularly regarding the size and structure of the fiscal deficit, play a crucial role in determining how effectively these challenges are met. A well-planned and sufficiently funded fiscal expansion can stimulate

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economic activity, enhance public service delivery, and bolster essential sectors like health, education, and infrastructure. Conversely, excessive and mismanaged deficits may result in macroeconomic instability characterized by inflationary pressures, increasing interest rates, and unsustainable levels of public debt. Such deficits can also restrict the fiscal space available for future investments, limit counter-cyclical policy measures, and impose an undue burden on subsequent generations.[4].

In recent decades, India has undergone substantial changes in its fiscal policy framework. Following the economic liberalization of the 1990s, the government implemented various fiscal consolidation measures aimed at reducing deficits and improving macroeconomic discipline. The introduction of the Fiscal Responsibility and Budget Management (FRBM) Act in 2003 represented a crucial advancement in institutionalizing fiscal discipline, with the objective of decreasing the fiscal deficit and systematically eliminating the revenue deficit. Nevertheless, the actual enforcement of fiscal regulations has encountered numerous obstacles, such as political pressures, economic shocks, and the need for social spending. The global financial crisis of 2008 and, more recently, the COVID-19 pandemic compelled governments worldwide, including India, to relax strict fiscal targets in favour of economic stimulus initiatives, leading to a notable increase in fiscal deficits. [5-8].

In India, the fiscal deficit soared to an unprecedented 9.3% of GDP in FY 2020–21, primarily due to expenditures related to the pandemic and revenue shortfalls. [9-11]. While such a deficit was arguably essential to support the economy during a once-in-a-century crisis, it also underscored the structural vulnerabilities within the country’s public finance system—especially the limited tax base, reliance on indirect taxation, and inefficiencies in expenditure management. As the economy begins to recover, there is a renewed emphasis on returning to a trajectory of fiscal prudence. However, this must be accomplished without undermining the broader objectives of sustainable development, particularly in the realms of poverty alleviation, climate action, and social equity.[12].

The notion of sustainable development, as defined by the United Nations, is founded on three interconnected pillars: economic growth, social inclusion, and environmental sustainability. Fiscal policy, along with the fiscal deficit, affects all three aspects. Economically, a well-managed fiscal deficit can stimulate growth by funding productive investments, particularly in times of weak private investment. Government expenditure on infrastructure, education, and technology can encourage private investment and enhance the economy’s productive capacity. Nevertheless, prolonged high deficits may result in increased inflation and borrowing costs, which can diminish competitiveness and jeopardize long-term growth prospects. [13-15]. From a stability standpoint, a consistently high fiscal deficit raises alarms regarding debt sustainability. As the government borrows more to cover its deficit, public debt increases, leading to escalating interest payments. This establishes a detrimental cycle where an increasing share of government revenue is allocated to debt servicing, thereby limiting the funds available for development spending. Additionally, substantial public borrowing can displace private investment by elevating interest rates, consequently hindering entrepreneurial endeavours and innovation. It also makes the economy vulnerable to external shocks and credit rating downgrades, which can adversely affect foreign investment inflows and the expenses associated with external borrowing.[16]. Equity, recognized as the third pillar of sustainable development, is significantly shaped by the structure of the fiscal deficit—specifically, the manner in which borrowed funds are utilized. If the deficit is utilized to support poorly targeted subsidies or to implement regressive tax reductions, it may lead to increased income inequality and heightened social exclusion. Conversely, if deficit spending is allocated to social sectors such as health, education, rural employment, and gender equality, it can contribute to diminishing disparities and fostering inclusive growth. Therefore, it is not merely the magnitude of the deficit that is crucial, but rather the quality of the deficit that influences its developmental consequences. [17].

Consequently, the challenge resides in achieving a balance between the necessity for fiscal expansion to facilitate economic recovery and development objectives, and the essential requirement of preserving macroeconomic stability and long-term sustainability. India's demographic characteristics, urbanization patterns, climate vulnerabilities, and infrastructure shortfalls necessitate significant and ongoing public investment. Simultaneously, the government must be vigilant against fiscal irresponsibility and ensure that borrowing does not jeopardize the nation's financial integrity. This balancing act becomes particularly intricate within a federal framework like that of India, where both the Union and state governments share fiscal duties but frequently possess unequal revenue-generating capabilities and spending responsibilities. [18]. In recent years, there has been a growing acknowledgment of the necessity to realign fiscal policy with sustainable development goals (SDGs). This involves the incorporation of environmental and social criteria into budgetary planning, the encouragement of green public investments, and the implementation of performance-based budgeting systems. India has made preliminary progress in this area through initiatives such as gender budgeting, climate budgeting, and the localization of budgets concerning SDGs by various states. Nevertheless, these initiatives require expansion and integration into the overall fiscal framework.

In this context, this paper intends to investigate the intricate relationship between fiscal deficit and sustainable development in India. It analyzes the evolution of fiscal deficit over time, the factors influencing its variations, and its effects on economic growth, macroeconomic stability, and social equity. The paper also addresses the trade-offs and synergies among these aspects and assesses the efficacy of current fiscal frameworks in fostering sustainable development. Through this examination, the paper aims to offer policy recommendations that can assist India in formulating a more balanced and forward-thinking fiscal strategy—one that guarantees economic resilience, encourages inclusive growth, and fulfills the sustainable development goals of its populace.

In pursuing this objective, the paper engages with both theoretical discussions and empirical data, utilizing national and international case studies. It underscores the significance of institutional reforms, fiscal transparency, and the strategic prioritization of expenditures. Ultimately, the paper contends that fiscal deficits, when managed prudently, can catalyze development rather than a risk to stability—on the condition that the emphasis is placed not solely on the headline deficit figures, but on the wider developmental outcomes that fiscal policy aims to achieve.

2. Theoretical and Empirical Perspectives on Fiscal Deficit and Sustainable Development

The connection between fiscal deficit and sustainable development has been widely discussed in both theoretical and empirical economic literature. Classical and neoclassical economists frequently contend that ongoing fiscal deficits disrupt resource allocation, displace private investment, and generate inflationary pressures that obstruct long-term growth and macroeconomic stability. Conversely, Keynesian theory asserts that deficit spending, particularly during times of economic slack, can invigorate aggregate demand, lower unemployment, and promote economic recovery. Recent research has shifted focus towards the quality and composition of deficit-financed expenditures, stressing that investments in human capital, infrastructure, and green technology can improve long-term productivity and sustainability. In the context of India, studies have investigated the effects of fiscal deficit on growth, inflation, and public debt dynamics, revealing mixed outcomes that vary with the time period and policy context. Numerous analyses have also examined how fiscal consolidation measures, such as the enactment of the Fiscal Responsibility and Budget Management (FRBM) Act, have impacted India's macroeconomic performance. Nevertheless, there exists a scarcity of literature that systematically links trends in fiscal deficit with broader sustainable development goals (SDGs), especially regarding social equity and environmental sustainability. This paper aims to fill that void by incorporating economic, social, and ecological viewpoints into the fiscal policy discussion in India. [19].

3. Fiscal Deficit Trends and Composition in India: An Empirical Overview

India's fiscal deficit has experienced considerable variations over the last thirty years, influenced by both structural elements and policy reactions to macroeconomic disturbances. After the economic liberalization in 1991, fiscal reforms were implemented to manage unsustainable borrowing. Nevertheless, instances of global crises, such as the financial crash of 2008 and the COVID-19 pandemic, resulted in significant increases in deficit levels. In the fiscal year 2020–21, India's fiscal deficit reached a peak of 9.3% of GDP, indicative of substantial expenditures related to the pandemic and revenue shortfalls. Since that time, the government has pursued a gradual consolidation strategy, with the deficit projected at 5.6% for FY 2023–24 and 5.1% for FY 2024–25. A detailed analysis shows that a considerable portion of India's fiscal imbalance is attributed to a high revenue deficit, indicating that borrowings are frequently utilized to cover current (non-asset-creating) expenditures instead of capital investments. Additionally, increasing interest payments and off-budget borrowings have further limited fiscal capacity. Although there has been a recent emphasis on capital expenditure—particularly in infrastructure and green energy—the sustainability of this approach relies on strong revenue generation and fiscal discipline. This section explores India's fiscal deficit concerning its size, composition, and financing patterns, laying the groundwork for evaluating its implications for sustainable development.[20].

Financial Year	**Fiscal Deficit (% of GDP)**	**Revenue Deficit (% of GDP)**	**Effective Revenue Deficit (% of GDP)**	**Target/ Estimate for Next Year**	**Sources**
FY 2022-23	~6.4 %	~3.9 %	~2.8 %	-----	Business today
FY 2023-24	~5.63 %	~2.6 %	~1.6 %	FY25 target: ~5.1 %	Mint
FY 2024-25 (Estimate)	~4.8-5.1 %	--------	--------	FY26 target: ~4.5 %	Business Standard

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Table 1: India – Fiscal & Revenue Deficit (% of GDP) and Key Related Indicators

4. Analysis of Fiscal Trends and Their Implications

The information provided in the previous table illustrates a gradual process of fiscal consolidation in India, following the peak deficit levels encountered during the COVID-19 pandemic. The fiscal deficit, which reached a high of 9.3% of GDP in FY 2020–21, has been decreased to 5.63% in FY 2023–24, with further reductions planned for the upcoming years. This declining trend reflects the government's commitment to fiscal responsibility while still promoting public investment and social expenditure. Importantly, the decrease in both revenue deficit and effective revenue deficit signifies a transition towards more capital-intensive, growth-focused spending—such as infrastructure development and asset creation—rather than unsustainable revenue expenditures. Nevertheless, there are ongoing concerns regarding the structure of this fiscal adjustment. Although capital expenditure has risen, revenue receipts are still hampered by a limited tax base, tax evasion, and reliance on indirect taxes like GST, which are often regressive. Additionally, the burden of increasing interest payments and off-budget liabilities continues to limit the government's fiscal capacity. As India aims for a fiscal deficit of 4.5% of GDP by FY 2025–26, the challenge will be to maintain economic recovery and inclusive growth without jeopardizing macroeconomic stability or reducing vital welfare spending. [21-23]

5. Implications of Fiscal Deficit for Sustainable Development in India

The fiscal deficit in India is pivotal in determining the nation’s sustainable development path, influencing economic growth, macroeconomic stability, and social equity. On one side, moderate fiscal deficits can empower the government to fund crucial infrastructure initiatives, health care, education, and social welfare programs, which are essential for inclusive growth and poverty reduction. Enhanced capital expenditure through deficit financing bolsters long-term productive capacity, promoting economic growth and job creation. Conversely, ongoing and elevated fiscal deficits present risks to macroeconomic stability, as they may result in escalating public debt, increased interest payments, and inflationary pressures that can erode investor confidence and displace private investment. Such fiscal discrepancies can limit the government’s capacity to finance essential social services, disproportionately impacting vulnerable groups and worsening inequalities. Additionally, the nature of deficit spending is vital for sustainable development: financing deficits for capital investments that align with environmental sustainability can encourage green growth, whereas subsidies for fossil fuels or regressive tax systems can obstruct climate objectives and social equity. India faces the challenge of reconciling the necessity for fiscal expansion to facilitate recovery and development with responsible fiscal management to uphold stability. Enhancing fiscal institutions, boosting tax compliance, streamlining subsidies, and implementing transparent budgeting practices—including green and gender-responsive budgeting—are crucial. Ultimately, a strategic fiscal framework that aligns deficit management with the Sustainable Development Goals (SDGs) will be essential in ensuring that fiscal policy fosters growth that is not only strong but also equitable and environmentally sustainable. [24-25].

5.1 Fiscal Deficit and Economic Growth

The fiscal deficit can serve as an effective mechanism for promoting economic growth when strategically employed to fund productive investments. In India, deficit financing has frequently been leveraged to support infrastructure development, social welfare initiatives, and capital projects that enhance the nation’s productive capacity. Such investments can produce multiplier effects, resulting in job creation, increased incomes, and heightened demand, all of which contribute to elevated GDP growth. For instance, enhanced expenditure on transportation, energy, and digital infrastructure can significantly improve efficiency and competitiveness across various sectors. Nevertheless, the growth-promoting effects of fiscal deficits are largely contingent upon the nature of the expenditures and the overarching macroeconomic context. Deficits that mainly finance consumption or non-productive spending may yield limited or even adverse growth results by displacing private investment due to rising interest rates or by exacerbating inflation. Furthermore, excessive deficits can erode investor confidence, leading to increased borrowing costs and diminished capital inflows. In the context of India, striking a balance between the necessity for deficit spending to foster development and the need for fiscal prudence poses a significant challenge. The fiscal stimulus implemented post-COVID highlighted the essential role of deficit financing in revitalizing the economy; however, achieving sustainable growth will necessitate disciplined fiscal management to ensure that borrowing facilitates long-term capital formation without jeopardizing macroeconomic stability.[26].

5.2 Fiscal Deficit and Macroeconomic Stability

The fiscal deficit significantly influences India's macroeconomic stability. While moderate deficits can facilitate growth, consistently high deficits may result in escalating public debt, raising concerns regarding debt sustainability and fiscal vulnerability. A substantial fiscal deficit often necessitates extensive government borrowing, which can elevate interest rates and potentially displace private investment, crucial for long-term growth. Additionally, excessive financing of deficits may induce inflationary pressures if it is financed through central bank borrowing, jeopardizing price stability and diminishing purchasing power, particularly for low-income households. The increasing interest payments in India consume a considerable share of the budget, restricting the government's capacity to direct funds towards developmental priorities. This structural fiscal burden can diminish fiscal space during economic shocks or crises. Furthermore, ongoing deficits may adversely impact investor confidence, resulting in downgrades by rating agencies and higher risk premiums on government bonds, which further escalate borrowing costs. Nevertheless, India has implemented measures such as the Fiscal Responsibility and Budget Management (FRBM) Act to uphold fiscal discipline and manage deficits. The ongoing challenge is to reconcile the necessity for fiscal expansion to foster development and counter-cyclical policies with the critical need to sustain macroeconomic stability, which is vital for enduring growth and equitable development.[27].

5.3 Fiscal Deficit and Social Equity

Fiscal deficit policies have profound effects on social equity in India, shaping the allocation of resources to welfare initiatives and public services aimed at vulnerable groups. When deficit spending supports social sectors such as health, education, rural employment programs like MGNREGA, and social protection initiatives, it has the potential to alleviate poverty and reduce inequality by enhancing access to essential services and generating economic opportunities for marginalized communities. Nevertheless, the impact on equity is largely contingent upon the efficiency with which the borrowed funds are utilized. A significant portion of India's fiscal deficit is directed towards subsidies and transfers; however, there are ongoing concerns regarding their targeting and effectiveness, as some benefits may disproportionately favor wealthier segments or be lost due to leakages. Furthermore, the dependence on indirect taxes such as GST to boost revenue can be regressive, imposing a greater relative burden on low-income households and potentially worsening inequality. Ongoing fiscal deficits that allocate resources to interest payments instead of productive social investments threaten to undermine efforts aimed at enhancing social equity. Consequently, the structure and quality of fiscal deficit financing are of utmost importance. Improving transparency, refining the targeting of subsidies, and broadening direct benefit transfers can contribute to ensuring that fiscal policy fosters equitable growth. India must integrate social equity objectives into fiscal management to attain inclusive and sustainable development outcomes.

5.4 Fiscal Deficit and Environmental Sustainability

The management of fiscal deficits carries significant implications for environmental sustainability in India, particularly as the nation strives to reconcile its growth aspirations with its climate obligations. When deficit financing is directed towards green infrastructure, renewable energy initiatives, and climate resilience projects, it can expedite the shift towards a low-carbon economy while promoting sustainable development. For example, increased public investment in solar and wind energy, clean transportation, and water management can yield long-term environmental advantages alongside economic growth. Conversely, if fiscal deficits are primarily allocated to support subsidies for fossil fuels or industries that harm the environment, they may worsen environmental degradation and elevate carbon emissions, thereby jeopardizing India's climate objectives. Furthermore, the absence of dedicated fiscal frameworks to monitor and prioritize green expenditures diminishes transparency and accountability. Recent initiatives in India, such as the implementation of green budgeting practices and the issuance of green bonds, signify positive advancements towards aligning fiscal policy with environmental goals. However, ensuring that deficit financing fosters sustainable development necessitates a strategic realignment of budget priorities, improved monitoring of environmental outcomes, and the incorporation of environmental risks into fiscal decision-making. Ultimately, effective fiscal management that prioritizes environmentally responsible investments will be crucial for achieving India's sustainable development objectives while ensuring fiscal stability.[28]

6. Challenges in India's Fiscal Management

India's fiscal management encounters numerous significant challenges that hinder efforts to achieve a balance between growth, stability, and equity. A primary concern is the consistently low tax-to-GDP ratio, which restricts government revenue and fiscal capacity. Despite reforms such as the implementation of GST, tax compliance remains inconsistent, and the informal sector continues to avoid taxation, limiting resources available for public investment. Furthermore, populist pressures frequently result in increased subsidies and welfare expenditures, often lacking adequate targeting, which leads to inefficient fund utilization and heightened fiscal deficits. The escalating burden of interest payments on public debt further constrains budget allocations for developmental priorities. Fiscal federalism presents another obstacle, as the coordination between central and state governments regarding borrowing limits and expenditure responsibilities is intricate, sometimes resulting in overlapping deficits and less-than-optimal outcomes. Off-budget borrowings and contingent liabilities also diminish transparency and complicate fiscal oversight. Additionally, the institutional framework for fiscal discipline, exemplified by the Fiscal Responsibility and Budget Management (FRBM) Act, necessitates regular updates to respond to evolving economic conditions and to maintain flexibility without sacrificing accountability. Enhancing tax administration, improving expenditure efficiency, increasing transparency, and promoting better coordination between the Centre and States are essential for addressing these challenges and achieving sustainable fiscal management in India.[29].

7. Policy Recommendations

In order to tackle the fiscal challenges that India encounters while fostering sustainable development, a comprehensive policy approach is crucial. Firstly, it is imperative to prioritize the expansion of the tax base and the enhancement of tax compliance to boost government revenue without placing undue strain on the informal sector or lower-income demographics. Strengthening direct taxes through improved enforcement and the simplification of the tax system can facilitate the achievement of this objective. Secondly, optimizing subsidies by more effectively targeting them towards vulnerable groups will enhance fiscal efficiency and equity. The expansion of direct benefit transfer (DBT) programs and the utilization of technology can minimize leakages and ensure that fiscal resources are directed to the intended recipients. Thirdly, the government ought to institutionalize budgeting frameworks that are responsive to both green initiatives and gender considerations, aligning fiscal policy with goals of environmental sustainability and social equity. This would promote the allocation of deficit financing towards initiatives that support clean energy, climate resilience, and inclusive growth. Fourthly, it is essential to enhance fiscal transparency; this encompasses improved accounting of off-budget borrowings and contingent liabilities to present an accurate depiction of fiscal health. Additionally, it is necessary to strengthen the fiscal responsibility framework by revisiting the Fiscal Responsibility and Budget Management (FRBM) Act to allow for flexibility during economic downturns while upholding fiscal discipline. Lastly, enhancing coordination between the central and state governments in fiscal management will mitigate inefficiencies and encourage balanced regional development. By implementing these strategies, India can strategically utilize fiscal deficit to finance growth, ensure macroeconomic stability, and promote sustainable and equitable development. [30-31].

8. Conclusion

In conclusion, the fiscal deficit in India represents a multifaceted yet essential element of the nation's quest for sustainable development. It is not inherently harmful nor universally advantageous; instead, its effects are largely contingent upon the management of the deficit, the structure of government spending, and the wider macroeconomic environment. This study has illustrated that fiscal deficits, when effectively directed towards productive capital investments such as infrastructure, healthcare, and education, can serve as catalysts for economic growth and social advancement. These investments not only generate immediate job opportunities but also lay the groundwork for long-term development by improving productivity and competitiveness. The recent decline in revenue deficits and effective revenue deficits indicates a favorable shift towards emphasizing capital formation over consumption expenditure, a trend that is promising for India's sustainable growth path.

Nevertheless, ongoing fiscal deficits pose inherent risks to macroeconomic stability. High levels of public debt and rising interest payments can constrain the government's fiscal capacity, limiting its ability to react to economic shocks or invest in essential sectors. Inflationary pressures resulting from monetized deficits jeopardize price stability and disproportionately affect vulnerable groups. Furthermore, the crowding-out effect of government borrowing can suppress private sector investment, thereby hindering growth

potential. This intricate balance highlights the necessity of upholding fiscal discipline while strategically employing deficit financing.
Fiscal deficits carry considerable consequences for social equity. When government borrowing is directed towards funding welfare programs, rural employment initiatives, and social protection, it can effectively diminish poverty and inequality, provided it is implemented efficiently. Nevertheless, the regressive characteristics of certain indirect taxes and inadequately targeted subsidies may worsen disparities. To ensure that deficit spending is fair and inclusive, it is essential to enhance targeting mechanisms, increase transparency, and establish robust monitoring frameworks. Furthermore, environmental sustainability introduces an additional aspect to the management of fiscal deficits. India must align its fiscal policies with green growth strategies by allocating budgets specifically for renewable energy, climate resilience, and sustainable infrastructure to fulfill its climate obligations. On the other hand, ongoing subsidies for fossil fuels or industries that harm the environment can undermine progress, underscoring the necessity for fiscal reforms that prioritize ecological health alongside economic goals.

India encounters numerous challenges in fiscal management, such as a low tax-to-GDP ratio, pressures from populist spending, intricate dynamics of fiscal federalism, and a lack of transparency concerning off-budget liabilities. To tackle these issues, it is vital to strengthen tax administration, streamline subsidies, implement green and gender-responsive budgeting, and enhance coordination between the Centre and the States. In light of these insights, policy recommendations advocate for broadening the tax base, improving fiscal transparency, institutionalizing sustainable budgeting practices, and amending the Fiscal Responsibility and Budget Management Act to strike a balance between flexibility and discipline. These actions will empower India to utilize fiscal deficits as a mechanism for fostering inclusive growth, ensuring macroeconomic stability, and promoting environmental sustainability. Ultimately, India's capacity to manage fiscal deficits while pursuing sustainable development goals will be crucial in realizing the Sustainable Development Goals (SDGs) and promoting a resilient and equitable economy. A strategic and transparent fiscal policy, based on solid economic principles and social inclusivity, is essential for navigating this intricate landscape and ensuring that fiscal deficits have a positive impact on India's long-term prosperity and sustainability.

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