
The objective of this study is to assess the key components of a state’s fiscal accounts and how they respond to the reforms and shocks, in a federal polity. Thus, the focus of fiscal sustainability analysis is not on default itself but on the feasibility, types and consequences of fiscal policy reforms needed to avoid default on sub national government debt in the future.

The authors present a framework for substantial fiscal sustainability analysis with reference to the case study of Tamil Nadu, which experienced an unprecedented fiscal deterioration in late 1990s.

The methodology applied in this study is to select the inter-temporal financing constraint of the sub national government and for the policy analysis it is important to represent debt and the sub national government budget constraints in percentages of GSDP and disentangle the growth and inflation on indebtedness of the sub national government. With a consistent set of projections for interest rates, primary balance, growth and inflation rates the authors further assessed the debt sustainability under different sensitivity tests, for this a baseline covering the period 2003-04 to 2026-27 has been chosen. While defining the concept of sustainability as the ability of the sub national government to sustain its fiscal policies in the long run while remaining solvent, this paper differentiates between national and sub national fiscal sustainability in number of ways. The paper finally concludes by illustrating the risks to the State’s fiscal outlook involves interest rate shocks, pressures on the primary balance and contingent liabilities, thereby reflecting the interplay of sub national and national policies.

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