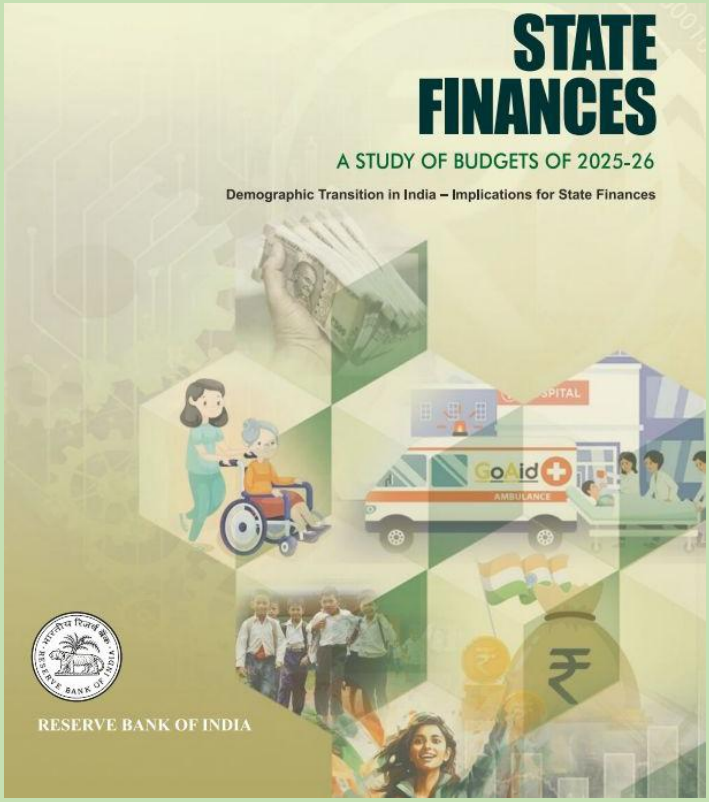
Tamil Nadu Economy: Fiscal Constrains and Structural Transitions
By Baskar R



State Finances: A Study of Budgets

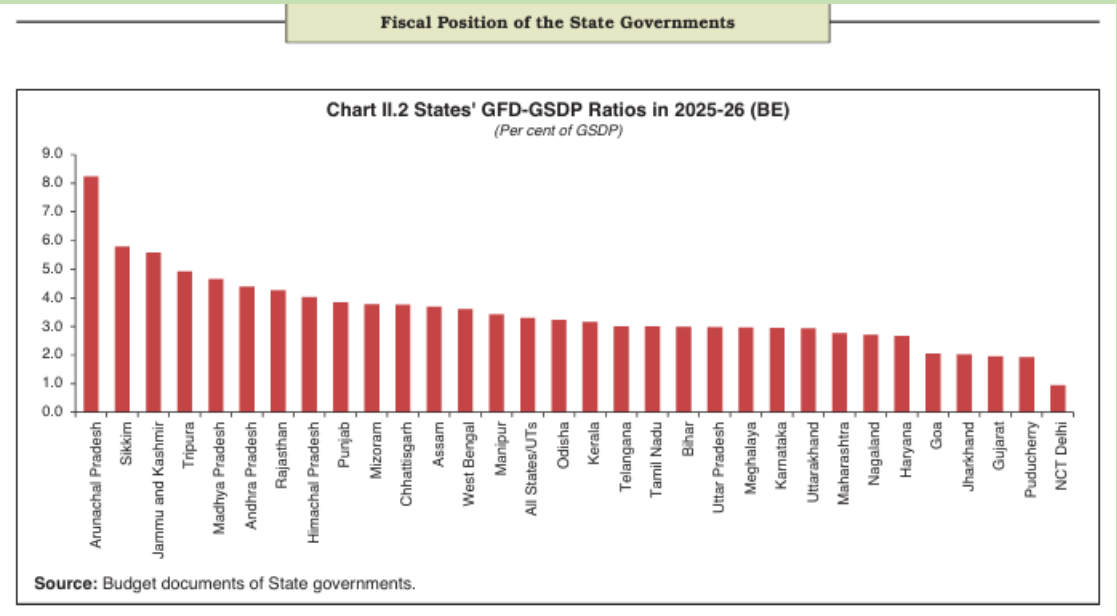
RBI has recently released its annual publication on State Finances: A Study of Budgets of 2025-26 analysing the latest fiscal position of State Governments across India. The report has a separate chapter on India's demographic transition and its implication for State finances.

Key Takeaways for Tamil Nadu

Tamil Nadu has been identified as an ageing state – where the demographic share of working age population (15-59 years) begins to decline. This leads to shrinking tax bases and rising committed expenditure in pensions and healthcare. Compared to peer states, Tamil Nadu operates with the highest committed expenditure burden at 36% of revenue expenditure and high revenue deficit of 1.2%, highlighting structural imbalance between revenue spends and earnings.

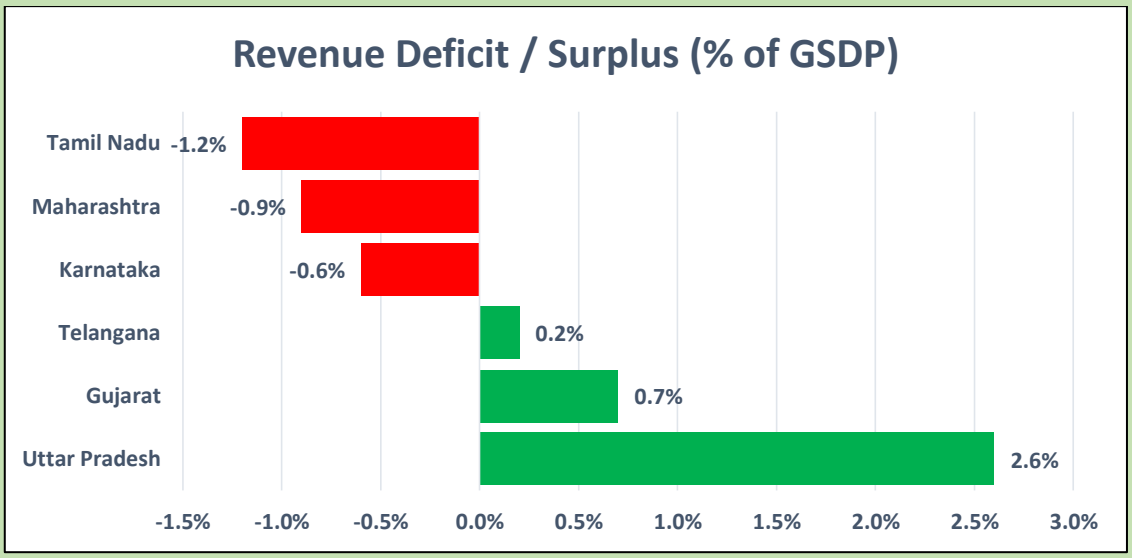
Fiscal Deficit

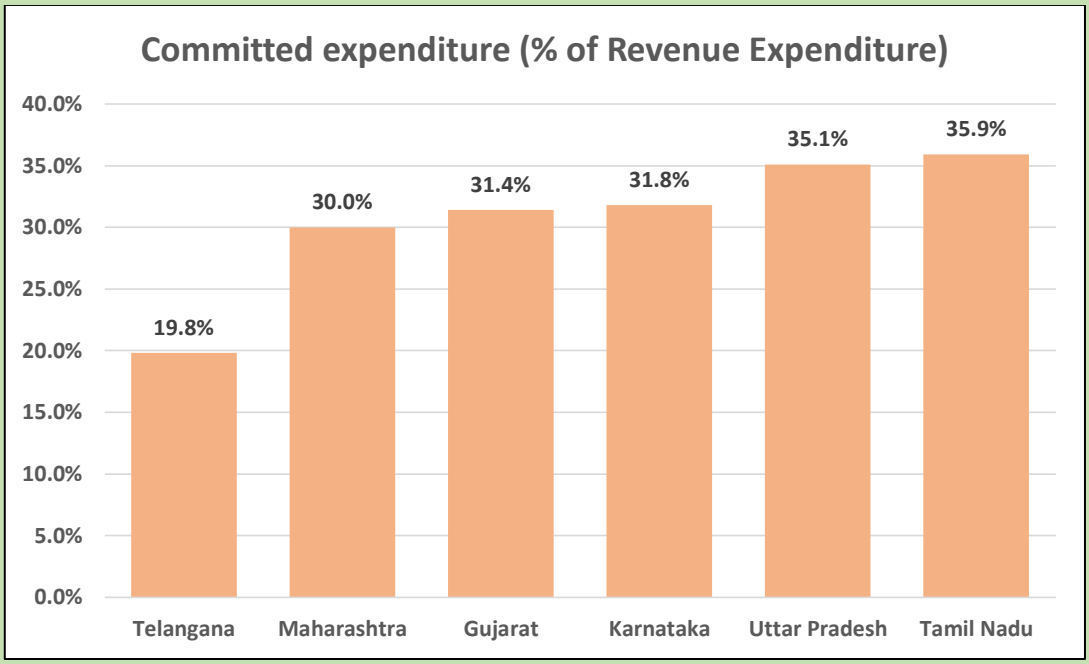
GFD-GSDP ratio for Tamil Nadu stays within the Centre's prescribed ceiling of 3.5%. Against 2024-25, it has also improved by 0.3% points. It's closer to the average all-States' mark but is above the best performers like Gujarat and Maharashtra.



Revenue Deficit

For 2025-26 BE Revenue deficit of Tamil Nadu is at 1.2% of GSDP and committed expenditure as % of revenue expenditure is high at 35.9%, at an increasing trend over last 3 years. Both indicators, highlight Tamil Nadu is faring behind its major peer states used for benchmarking. Revenue growth is important to fund its growth and the pressures from handling committed expenditure on salaries, pensions and healthcare in an ageing demographic context is a serious problem.

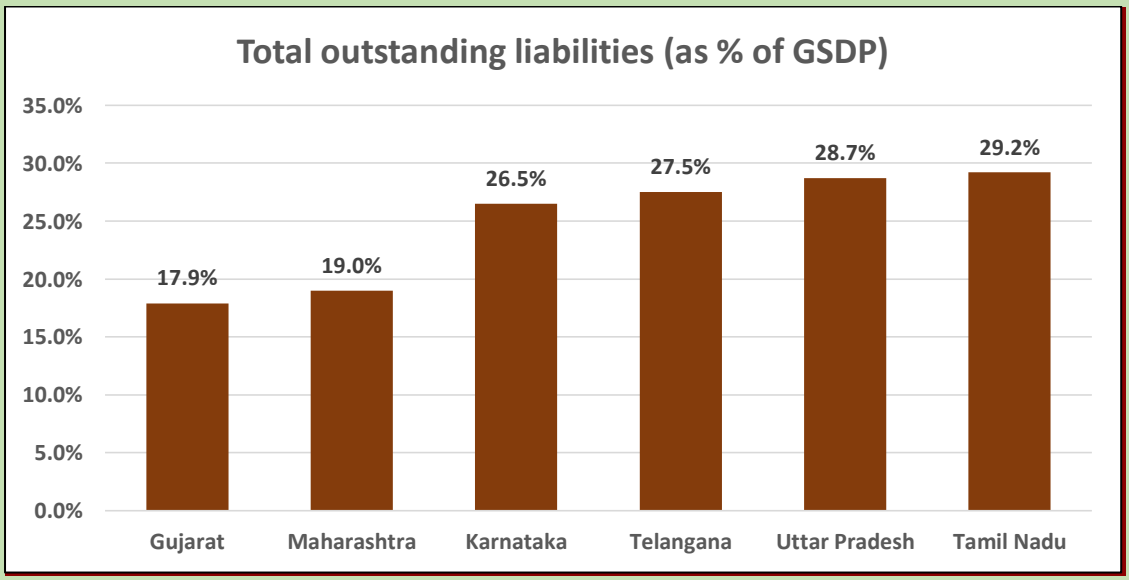




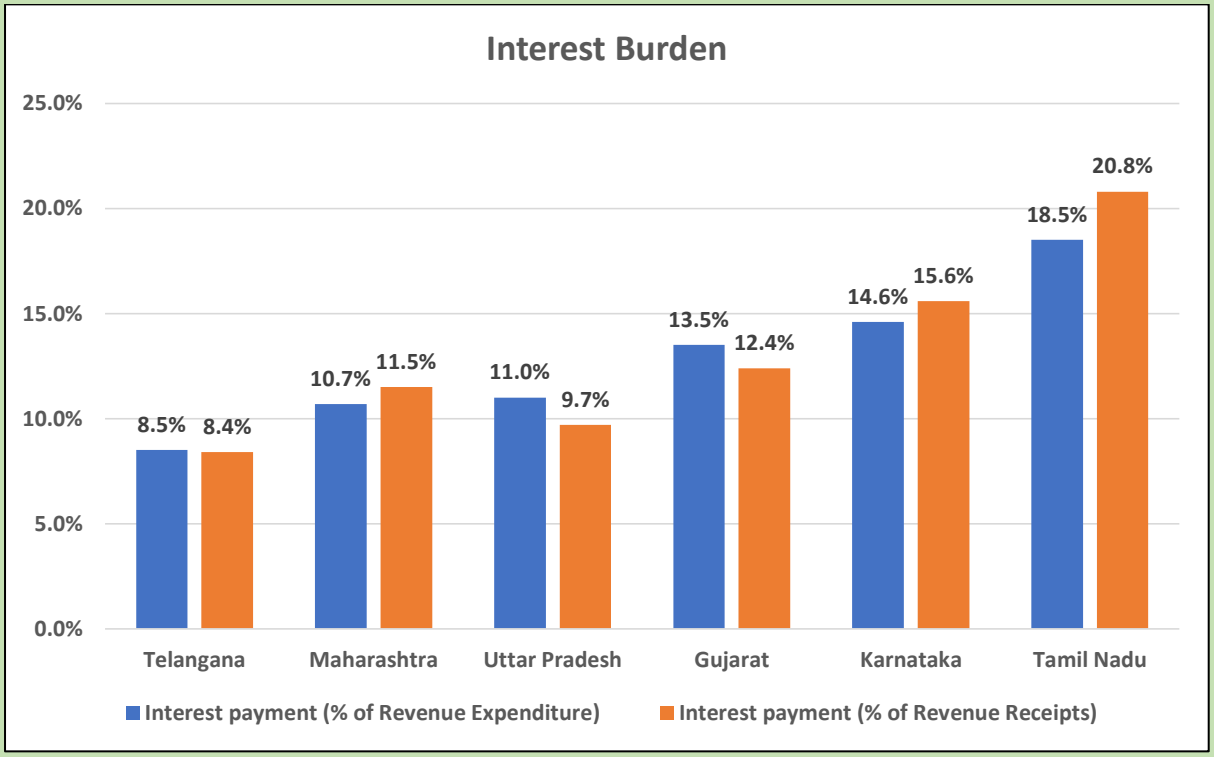
Outstanding Liabilities and Interest Payments

Outstanding liabilities by State are typically available only as part of the RBI study and isn't part of respective State Budgets. The report for 2025-26 helps compare States' performance uniformly. The key components of outstanding liabilities are State Development loans, loans from institutions, UDAY, NSSF, loans from Centre, PF, Reserve Fund, deposits and advances, etc.

Tamil Nadu is the only State which has crossed Rs. 10 lakh crores of outstanding liabilities and has been on increasing trend in recent years. As % of GSDP it is at 29.2% higher than its peer states.



RBI compares interest payment of states against their revenue receipts to assess how much of state's own revenue is consumed by debt servicing before any discretionary spending and against revenue expenditure to see how much of it is spent on interest as against services (education, health and salaries) on recurring activities. Comparing interest as % of GSDP would mask underlying revenue capacity constraints.



This table shows Telangana managing its fiscal space well with a very low burden and Tamil Nadu has the highest burden, calling for urgent revenue mobilisation and structural reforms. 15% is the threshold suggested by IMG and RBI research for interest payments as % of revenue receipts. This indicates Karnataka is at border line and Tamil Nadu is at risk of debt unsustainability.

Capital Outlay

While Tamil Nadu budgeted Rs 57,231 crore for capital outlay in 2025-26—a 22% increase from revised estimates—the absolute allocation remains constrained relative to fiscal deficit size. This capex also includes Rs. 5,000 crore of equity infusion into Tamil Nadu Power Distribution Corporation Limited, though essential for power sector stabilisation, is a transfer of fiscal resources to address accumulated operational deficits rather than new Greenfield investment.

State	Capital Outlay (Rs. Crs)	% Growth YoY	Remarks
Uttar Pradesh	1,65,243	+9%	Massive allocation
Gujarat	95,472	+36%	Strong growth focus
Maharashtra	84,457	-11%	Contraction
Karnataka	68,172	+25%	Solid growth
Tamil Nadu	57,231	+22%	Below peers despite growth
Telangana	36,504	+10%	Modest allocation

Revenue Mobilisation

Tamil Nadu projects 13% growth in total revenue receipts (Rs 3,31,569 crore), with own tax revenue increasing by 15% to Rs 2,20,895 crore. State GST revenue—the largest component—is budgeted to grow 23%, from Rs 76,163 crore to Rs 93,620 crore.

Expenditure Pattern – Development Expenditure

Key Development Expenditure (DEV) pattern and Social Sector Expenditure (SSE) across the major States reflect a mixed pattern. Uttar Pradesh and Telangana does predominantly well on key indicators under this metric. Tamil Nadu is consistently below peers and needs to revisit the quality of its spending.

States	Social Sector Expenditure	Medical and Public Health and Family Welfare	Education	DEV/GSDP	SSE/GSDP
	% of Total Disbursement	% of Aggregate Expenditure	% of Aggregate Expenditure	%	%
Gujarat	40.2	6.2	13.3	8.2	4.9
Karnataka	40.7	4.6	10.0	8.5	5.4
Maharashtra	40.6	4.6	14.0	9.2	6.2
Tamil Nadu	33.6	4.4	11.9	7.5	4.6
Telangana	46.2	4.2	7.8	13.0	7.8
Uttar Pradesh	37.9	6.1	13.0	15.5	9.8

Own Tax Revenue as % of GSDP (2025-26 BE)

State	Own Tax/GSDP	Trend	Tax Mobilization Capacity
Uttar Pradesh	9.6%	Highest effort	Robust
Telangana	8.1%	Strong mobilization	Above average
Maharashtra	7.8%	Competitive	Above average
Karnataka	6.8%	Moderate	Average
Tamil Nadu	**6.2%**	**Below peers**	**Below average**
Gujarat	5.3%	Lowest	Special case (VAT-based)

Despite being India's second-largest economy by GSDP and a major industrial state, Tamil Nadu's own tax-to-GSDP ratio (6.2%) lags Telangana (8.1%), Maharashtra (7.8%), and even Uttar Pradesh (9.6%). This suggests constrained revenue mobilisation capacity relative to expenditure needs—a structural vulnerability exacerbated by the state's ageing demographic profile, which reduces the tax-contributing population base. For Gujarat, compared to its peers, its SOTR is lower with the impact of prohibition related loss of Government revenue.

RBI's Demographic Framework: Tamil Nadu as an "Ageing State"

The RBI's 2025-26 report introduces a pivotal analytical framework: demographic transition shapes state fiscal positions. The demographic transition in India is being shaped by two major factors - falling fertility rate and increasing life expectancy. To assess the demographic profile of Indian States, a modified version of the standard International Labour Organisation (2023) classification has been adopted. In this approach, a State is classified as ageing if the share of population aged 60 years and above is 15% or more, intermediate if it is 10% to below 15%, and youthful if it is below 10%.

Tamil Nadu is classified as an "ageing state" alongside Kerala—having crossed the demographic turning point where the working-age population (15-59 years) share begins to decline.

Fiscal Implications for Ageing States (as per RBI):

1. Shrinking Tax Base: Decline in working-age population reduces revenue-generating population
2. Rising Committed Expenditure: Healthcare, pensions, elderly care increase automatically
3. Crowding Out of Capital: Mandatory spending limits investment capacity
4. Structural Fiscal Pressures: Cannot rely on nominal GDP growth to ease ratios.

The RBI Report explicitly states: "Ageing states face a narrowing window, with fiscal pressures arising from shrinking tax bases and rising committed expenditure, calling for higher revenue capacity and reforms in healthcare, pensions and workforce policies."

Category	Characteristics	Examples	Fiscal Implications
Youthful States	Expanding working-age population; demographic dividend window open	Bihar, Uttar Pradesh, Madhya Pradesh	Wider fiscal space; investment in human capital prioritized
Intermediate States	Transitioning; current growth balanced with future ageing prep	Maharashtra, Karnataka, Telangana, Gujarat	Balanced policies; early structural reforms needed
Ageing States	Working-age share declining; crossed demographic turning point	**Tamil Nadu, Kerala**	**Narrowing fiscal window; rising committed expenditure; shrinking tax base**

In 2016, all the Indian States remained in the youthful or intermediate category (Table III.2). By 2026, Kerala and Tamil Nadu are expected to enter the ageing category, with more than 15% of their population above 60 years of age. Most of the remaining States will be in the intermediate category and a few States under the youthful category during this period. By 2036, however, more than half of the States will be ageing and the rest will fall under the intermediate category with no States remaining in the youthful category.

A country's demographic dividend peaks when its working-age population is at its highest. The share of working age population in India is projected to rise from 64.8%

in 2026 to 65.1% in 2031 and then decline to 64.95 by 2036 (Table III.3). India may, however, continue to enjoy demographic dividend for a longer period than other countries due to significant regional heterogeneity in the process of demographic transition.

Demographic transitions alter established patterns of public outlays and compel governments to recalibrate priorities. Expenditure priorities must adapt to the demographic contours of each State and the pace at which they unfold. Youthful States are expected to emphasise education and skilling to harness their demographic dividend. In contrast, ageing States will require greater public spending on healthcare, pensions, and social security.

Table III.3: State-wise Share of Working Age Population 2026-2036

(Per cent)

State\Year	2026	2031	2036
1	2	3	4
Bihar	60.5	61.2	61.4
Kerala	62.0	60.8	59.5
Madhya Pradesh	62.7	63.8	64.5
Uttar Pradesh	62.8	64.8	66.1
Rajasthan	63.2	64.5	65.2
Chhattisgarh	63.9	64.6	64.9
Jharkhand	64.0	64.4	64.7
Gujarat	64.8	64.8	64.6
Odisha	65.2	64.8	64.1
Tamil Nadu	65.9	65.0	63.6
Haryana	65.9	66.5	66.6
Assam	66.1	65.7	65.2
Himachal Pradesh	66.6	65.9	64.7
Karnataka	66.6	66.5	65.6
Uttarakhand	66.6	66.5	66.4
Andhra Pradesh	66.9	66.4	65.4
Punjab	67.0	66.6	65.8
Maharashtra	67.3	66.9	66.2
West Bengal	67.7	66.7	65.5
Telangana	67.8	67.4	66.7
Delhi	68.9	68.3	67.3
Jammu and Kashmir	70.1	68.8	66.8
India	**64.8**	**65.1**	**64.9**

Source: Staff estimates.

Table III.7: State-wise Old-Age Dependency Ratio

State/Year	2011	2016	2021	2026	2031	2036
1	2	3	4	5	6	7
India	**13.8**	**14.6**	**15.7**	**17.6**	**20.1**	**23.0**
Jammu & Kashmir	11.9	12.9	14.1	16.0	19.2	23.2
Himachal Pradesh	16.3	17.7	19.7	22.4	26.0	30.3
Punjab	16.5	17.4	18.8	21.3	24.3	27.8
Uttarakhand	14.8	15.3	16.2	17.6	19.8	22.4
Haryana	13.9	14.3	15.0	16.5	18.5	21.0
Delhi	10.5	11.8	13.4	15.6	18.2	21.1
Rajasthan	12.3	12.9	13.9	15.5	17.4	19.7
Uttar Pradesh	13.1	12.9	13.2	14.3	15.8	17.9
Bihar	11.8	12.7	13.1	14.0	15.6	17.8
Assam	10.5	11.3	12.7	14.8	17.7	20.9
West Bengal	13.4	14.6	16.6	19.7	23.5	27.9
Jharkhand	11.4	12.6	13.5	14.9	16.8	19.0
Odisha	15.0	16.1	17.7	20.0	23.1	26.6
Chhattisgarh	12.6	12.9	13.8	15.7	18.1	20.6
Madhya Pradesh	12.7	12.9	13.6	15.3	17.4	19.8
Gujarat	12.6	13.9	15.7	18.2	20.9	23.9
Maharashtra	15.7	16.4	17.5	19.5	22.4	25.8
Andhra Pradesh	15.7	16.9	18.5	21.1	24.7	28.9
Karnataka	14.9	15.7	17.2	19.6	22.6	26.2
Kerala	19.8	22.7	26.1	30.1	34.3	38.3
Tamil Nadu	16.0	18.0	20.5	23.9	28.0	32.7
Telangana	14.5	15.2	16.3	18.4	21.5	25.7

Note: Green corresponds to lower dependency, yellow to moderate dependency, and red to higher dependency.
Source: Staff estimates.

Table III.2: State-wise Share of Population Above 60 Years of Age

(Per cent of Total Population)

State\Year	2011	2016	2021	2026	2031	2036
1	2	3	4	5	6	7
Kerala	12.7	14.5	16.5	18.7	20.9	22.8
Tamil Nadu	10.6	12.0	13.6	15.8	18.2	20.8
Himachal Pradesh	10.4	11.6	13.1	14.9	17.1	19.6
Punjab	10.5	11.4	12.6	14.3	16.2	18.3
Andhra Pradesh	10.1	11.2	12.4	14.1	16.4	18.9
West Bengal	8.6	9.7	11.3	13.3	15.7	18.3
Maharashtra	10.0	10.7	11.7	13.1	15.0	17.1
Odisha	9.3	10.3	11.5	13.0	15.0	17.0
Karnataka	9.6	10.3	11.5	13.0	15.0	17.2
Telangana	9.2	10.1	11.0	12.5	14.5	17.1
Uttarakhand	8.9	9.7	10.6	11.8	13.2	14.9
Gujarat	8.0	9.0	10.2	11.8	13.6	15.4
Jammu & Kashmir	7.0	8.1	9.5	11.2	13.2	15.5
Haryana	8.6	9.1	9.8	10.9	12.3	14.0
Delhi	6.9	8.0	9.3	10.8	12.5	14.2
Chhattisgarh	7.6	8.0	8.8	10.1	11.7	13.4
Rajasthan	7.1	7.8	8.6	9.8	11.2	12.8
Assam	6.4	7.1	8.2	9.8	11.6	13.7
Madhya Pradesh	7.5	7.8	8.5	9.6	11.1	12.8
Jharkhand	6.5	7.6	8.4	9.5	10.8	12.3
Uttar Pradesh	7.4	7.7	8.1	9.0	10.3	11.8
Bihar	6.3	7.1	7.7	8.5	9.5	10.9
India	**8.4**	**9.2**	**10.1**	**11.4**	**13.1**	**14.9**

Colour Code	Classification
	Ageing States
	Intermediate States
	Youthful States

Source: Staff estimates.

Policy Suggestions for Ageing States

Ageing States should prioritise healthcare financing reforms, preventive health systems, and public–private partnerships, while rationalising subsidies and non-merit spending to create fiscal space. Ensuring universal access to quality health services together with increasing life expectancy can result in second and third waves of demographic dividend like in the case of East Asian economies.

Second, due to rising old-age dependency, the ageing States would witness a gradual decline in labour supply resulting in lower productivity and economic growth.

Third, interstate migration could be another way to boost labour supply in the ageing States. Internal migration in India has been closely linked to regional disparities, with movement predominantly directed from less-developed to more-developed States. Out-migration is currently heavily concentrated in a few States like Uttar Pradesh, Bihar and Rajasthan. Migration might cushion the decline in working-age population due to ageing, and, if fully integrated into the labour market, help by generating fiscal income.

Fourth, India must address its longstanding gender gap in labour force participation. Though India has witnessed a rise in the female labour force participation rate (LFPR) from 37.0% in 2022-23 to 41.7% in 2023-24, it still lags far behind the male LFPR of 78.8% in 2023-2416.

Fifth, the demographic transition characterised by an increasing share of elderly population imposes unique fiscal challenges on States. For instance, the ageing States having higher percentage of elderly are financially more burdened compared to the youthful and intermediate States. Future Finance Commissions may explicitly incorporate population ageing as reflected in terms of higher share of elderly population or old-age dependency ratio into their devolution formula to ensure fiscal sustainability of the ageing States.

A one size fits all approach may not yield desired outcome in the case of India. A cluster-based approach involving States with similar demography may be more suitable. Several developed nations in the past resorted to a carefully designed migration policy during the phase of rising dependency. Somewhat similarly, within India, States which are at relatively advanced stages of the transition would depend on the late entrants for migrant workers. In these States, public policy should focus around creating diverse and multi-cultural workplaces, along with thrust on elderly care infrastructure.

The Author is a Finance Professional and has keen interest in current affairs and Indian culture.