Quality of Public Expenditure Index

For Prelims: **Reserve Bank of India**, Quality of Public Expenditure Index, **Global Financial Crisis**, **Fiscal Responsibility and Budget Management (FRBM) Act, 2003**, **Goods and Services Tax (GST)**, **Zero-Based Budgeting**.

For Mains: Public Expenditure, Quality of Public Expenditure, Fiscal Discipline.

Source: IE

Why in News?

The **Reserve Bank of India (RBI)** has developed the **Quality of Public Expenditure (QPE) Index** to assess how efficiently the **Centre and state governments** allocate public funds.

What is the Quality of Public Expenditure Index?

- **About:** QPE Index is a framework that assesses the **efficiency of government spending.**
  - Rather than focusing **solely on the total expenditure**, the index analyzes the composition of spending and its impact on **long-term economic growth and development.**
- **Key Components:** The index is based on five major indicators:

Indicator	What It Measures	Significance
Capital Outlay to GDP Ratio	Share of **Gross Domestic Product (GDP)** allocated to infrastructure (roads, railways, power, etc.).	**A higher ratio** indicates better expenditure quality.
Revenue Expenditure to Capital Outlay Ratio	Comparison of spending on salaries, pensions, and subsidies vs. infrastructure and asset creation.	**A lower ratio** indicates more funds allocated to productive investments.
Development Expenditure to GDP Ratio	Spending on education, healthcare, R&D, and public infrastructure.	**A higher ratio** indicates improved economic productivity.
Development Expenditure as Share of Total Government Expenditure	Proportion of the total budget dedicated to development sectors.	**Higher share** indicates higher spending quality.
Interest Payments to Total Expenditure Ratio	The financial burden of past borrowings.	**A lower ratio** indicates better fiscal health and more funds for development.

- **Key Findings:** The RBI's QPE Index has categorised India's public expenditure trajectory since **1991 into six distinct phases.**

- **1991–1997:** Early **liberalization** saw slight improvement in Centre's expenditure quality, but states struggled amid fiscal pressures and declining public investment.
- **1997–2003:** Expenditure quality declined due to salary hikes (**Fifth Pay Commission**), rising interest payments, and revenue-heavy spending.
- **2003–2008: Fiscal Responsibility and Budget Management (FRBM) Act, 2003 enforced in 2004**, improved fiscal discipline.
  - States benefited from **higher tax devolution**, but the **2008 Global Financial Crisis (GFC)** halted progress.
- **2008–2013:** The Centre's stimulus spending initially improved quality but later caused fiscal imbalances.
- **2013–2019:** States improved with **higher development spending** and **14th Finance Commission funds,** while the **Centre faced challenges** as **Goods and Services Tax (GST) revenue sharing** initially benefited states more.
- **2019–2025: Fiscal stimulus measures** during **Covid-19** led to a temporary decline in expenditure quality.
  - **Post-pandemic recovery**, driven by **higher capital expenditure**, helped improve spending efficiency.
  - In 2024-25, India's **QPE is at its highest level** since the 1991 economic liberalization, reflecting improved fiscal management and spending efficiency.

What is Public Expenditure?

- **About:** Public expenditure (PE) refers to the **spending by the government** to fulfill collective needs such as **education, healthcare, infrastructure, and welfare**.
- **Objective:** PE ensures **efficient resource allocation**, promotes **income redistribution**, and maintains **economic stability** by managing inflation and employment.
  - It also drives **development** through investments in infrastructure, technology, and welfare, fostering inclusive growth.
- **Classification:**
  - **Revenue Expenditure:** Routine expenses like salaries, pensions, and interest payments.
  - **Capital Expenditure:** Investments in long-term assets. A higher share of capital expenditure (Capex) improves the quality of public spending, leading to long-term economic growth.
- **Recent PE Trends:** According to the **Economic Survey 2024-25,** government **Capex** increased **8.2% YoY**, while state revenue expenditure grew **12% Year-over-year (YoY)**.
  - The **Union Budget 2025-26** has allocated **Rs 11.21 lakh crore** for **capital expenditure (3.1% of GDP) in FY 2025-26**.
- **Challenges:** Excessive spending on **salaries, pensions**, and **subsidies** (revenue expenditure) and welfare (like free electricity) can reduce financial sustainability.
  - Excessive PE leads to **fiscal deficits and debt burdens**, reducing funds for development.
  - Higher **budget deficits strain public finances,** limiting the government's ability to invest in development.
  - High Revenue Expenditure can weaken investor confidence, affecting overall economic stability.

Way Forward

- Prioritizing **Zero-Based Budgeting (ZBB)** and **Performance-Based Budgeting** ensures efficient and accountable fund allocation.
  - Focus on high-impact sectors like health, education, and infrastructure that can drive economic growth and improve social well-being.
  - Increase **devolution of funds to states and local governments** for need-based allocation, while ensuring **fiscal prudence**.
- To reduce **deficit financing**, promoting **self-sustaining projects** and attracting **domestic and foreign investment** is essential for long-term fiscal stability.
- Expand **Direct Benefit Transfers (DBTs)** through financial inclusion via the **Jan Dhan-Aadhar-Mobile (JAM) Trinity** to reduce leakages and corruption in revenue expenditure.

Drishti Mains Question:

Discuss the significance of the Quality of Public Expenditure Index in assessing fiscal efficiency. How can it help improve government spending in India?

UPSC Civil Services Examination, Previous Year Question (PYQ)

Prelims

Q. Which of the following is/are included in the capital budget of the Government of India? (2016)

1. Expenditure on acquisition of assets like roads, buildings, machinery, etc.
2. Loans received from foreign governments
3. Loans and advances granted to the States and Union Territories

Select the correct answer using the code given below:

(a) 1 only
(b) 2 and 3 only
(c) 1 and 3 only
(d) 1, 2 and 3

Ans: (d)

Q. There has been a persistent deficit budget year after year. Which action/actions of the following can be taken by the Government to reduce the deficit? (2016)

1. Reducing revenue expenditure
2. Introducing new welfare schemes
3. Rationalizing subsidies
4. Reducing import duty

Select the correct answer using the code given below:

(a) 1 only
(b) 2 and 3 only
(c) 1 and 3 only
(d) 1, 2, 3 and 4

Ans: (c)

Mains:

Q1. Distinguish between Capital Budget and Revenue Budget. Explain the components of both these Budgets. (2021)

Q2. The public expenditure management is a challenge to the Government of India in the context of budget-making during the post-liberalization period. (2019)