Rethinking the Quality of Public Expenditure

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ABSTRACT

Public debate on budget in Bharat fixates on headline outlay, however the size of a budget says little about whether spending improves lives. This article argues that the more reliable test is the quality of expenditure and that quality can be assessed across three dimensions: Composition, Efficiency and Outcomes. It explains the Reserve Bank of India's Quality of Public Expenditure (QPE) index and its limitation. Using the Golden Quadrilateral as an empirical example, it shows how public investment can translate into measurable economic outcomes. This article concludes that the Bharat has already taken steps to strengthen expenditure quality, including through initiatives such as gender budgeting and the Output-Outcome Monitoring Framework. Further, Bharat should strengthen expenditure evaluation by linking budget priorities with effective implementation and measurable results.

Keywords: Public Expenditure, Quality of Public Expenditure, Fiscal Policy, Public Investment, Budget, Government Spending, Outcomes

The day after a budget is presented, newspaper headlines usually focus on the total budget outlay and how it compares with the previous year. In 2026-27, Union came with Rs 53.47 lakh crore and Maharashtra with 7.6 lakh crore. However, these headline figures do not reflect the quality of expenditure.

Imagine two finance ministers of two respective states. First develop an irrigation network, pays on time salaries to teachers and nurses and finishes the half built highway. Second settles the interest payments on borrowing, funds stalled projects that stays stalled and announces a scheme with no machinery to deliver it. Both spend the same amount. However, the outcome is different. The distance between them is what economists call the quality of expenditure and it is a far more reliable guide to a budget's success than its size.

Quality of expenditure asks one simple question i.e. what happens to a rupee after it leaves the treasury? Does it increase productivity, leave behind a long term asset, deepen human capability, widen the circle of people who benefit and produce an outcome someone can measure? Such spending that does these things repays itself several times over through the multiplier i.e. an extra income generated in the economy by each rupee government spends. Spending that does none of them is simply consumption financed by tomorrow's taxpayers. The idea of the "Quality of Public Finances" was given its modern framing in 'Public Finances in EMU' report of the European Commission[1].

Further, this term is part of RBI's research. Citizens have a direct stake because budgets are zero-sum in the short run: a rupee servicing yesterday's debt cannot build tomorrow's school. In the 2026-27 Union Budget, interest payments alone absorb roughly 26% of total expenditure and 40% of revenue receipts[2]. That ratio is a large part of the consequences of borrowing decisions taken over the past few decades. This needs to be explained clearly. Interest payments are not a bad expenditure, they are legal and contractual obligation due to past borrowings and honouring them protects the sovereign's credibility and future access to finance. But high interest burden does limit the resources available for current service and productive spending.

Usually we consider two methods to analyse the quality of expenditure. The first is developmental versus non-developmental. Development expenditure covers social services like health, nutrition, water, housing, urban development, welfare of weaker sections and economic services such as agriculture, irrigation, energy, industry, transport and science. Non-development expenditure covers interest payments, pensions and general administration. The second is revenue versus capital, capital spending creates an asset that outlives the year it was funded, revenue spending keeps the machinery of Government running.

These categories are a good way to see towards the budget, but not the perfect way. We should not consider them as a scorecard of the budget. Quality of expenditure has three different dimensions. Composition tells what the government chooses to spend on. Efficiency tells how well the allocated money is converted into outputs. Outcomes tell whether these outputs actually led to measurable improvements in people's lives or economic movement. These dimensions are connected but not the same, a government may choose a good priority but implement it poorly or complete a project successfully without achieving the intended outcome. Public investment does have the stronger claim, Indian research generally finds the fiscal multiplier on capital outlay tends to exceed that on revenue spending and to persist longer. For example, Bose and Bhanumurty (2015), estimates a capital-expenditure multiplier of about 2.45, against 0.98 to 0.99 for transfer payment and other revenue expenditure. However, these multiplier effects cannot always be the same. Multiplier depends on the state of the economy, public debt, monetary policy stance and openness of economy. The estimates vary across studies and methods. They should not be treated as a universal law.

Crucially, Capex is not automatically high quality. A school building without teachers, a canal without desilting and a bus fleet without spares are all capital assets producing nothing. Productive revenue expenditure is often precisely what makes capital infrastructure work i.e. the salaries of doctors, nurses, teachers and agricultural extension officers, the running costs of immunisation and nutrition programmes, road maintenance, research institutions and digital public infrastructure are revenue expenditure in the ledger and investment in reality. The 15th Finance Commission also recognised this by recommending 27,539 crore in grants over 2021–26 for the maintenance of PMGSY roads. So the real question is not Capital or Revenue? But whether a given rupee generates efficient, productive and measurable public value.

RBI’s February 2025 bulletin gives the most systematic approach to evaluate this. Its QPE index combines five ratios[3] : I. Capital outlay to GDP; II. Revenue expenditure to Capital outlay; III. Developmental expenditure to GDP; IV. Developmental expenditure to total expenditure; V. Interest payments to total expenditure. Since lower revenue expenditure compared to Capex and lower interest payments indicate better quality of expenditure, these two indicators are reversed before being included in the index. All indicators are then converted to a common scale so that they can be compared fairly. Further, RBI used a statistical method called dynamic factor model to combine into a single QPE index, separately for Union and State Government.

However, the index's honest limitation is that it captures where money is allocated, not what it achieves. The index is based on the composition of the ratio. It primarily measures the structure of public expenditure, not implementation efficiency and final development outcomes. It cannot separate a well-built highway from a badly built one or a food subsidy that ends hunger from one that leaks. The Golden Quadrilateral (GQ) is a classic example of how public expenditure can translate into measurable economic outcomes. Under NHDP phase 1 in 2000, total Rs 30,300 Cr sanctioned for 7,498 km of highway, including 5,846 km of the GQ. The important point is the outcome went beyond the output i.e. construction of roads. Research by Ghani, Goswami and Kerr found that manufacturing output in non-nodal districts within 10 km of the GQ grew by about 49% over the decade after the construction began. The study also found greater firm entry and expansion of industrial activity along the network. Maharashtra’s Mukhyamantri Saur Krushi Vahini Yojana is another example of quality public expenditure.

International experience offers complementary tools for improving expenditure quality. The IMF focuses on the efficiency of public investment[4], while the OECD promotes performance and green budgeting. The World Bank and Asian Development Bank emphasise better project appraisal, procurement, financial management and implementation. Together, these approaches reinforce a simple principle: good budget priorities must be matched by effective implementation and measurable results.

The Output-Outcome Monitoring Framework, prepared by NITI Aayog's evaluation office alongside the Budget, maps scheme outlays to stated output and outcome targets[5]. Gender budgeting, presented as Statement 13 since 2005-06, had grown to about 8.8 % of the total Union budget by 2025-26. Municipalities deliver most of what citizens actually experience in clinics, classrooms, water hours, waste collection yet their outcome reporting remains thin. However, corporations like Brihanmumbai Municipal Corporation (BMC) already provide a climate budget and a performance budget. This should be scaled up in all corporations of Maharashtra and Bharat.

Currently the Govt. of India passes the composition test. The execution test is the one still open. The true success of a government budget is not determined by how much money it spends but by how effectively every rupee improves people's lives and strengthens the economy. Strengthening expenditure evaluation of government budgets including of Municipal budgets by linking budget priorities with effective implementation and measurable results, can help to improve the fiscal priorities to achieve the goal of Viksit Bharat and Viksit Maharashtra.

Notes

1. European Economy No 3/2002. Public finances in EMU 2002.

2. Union Budget 2026-27 Analysis

3. BULLETIN19022025111218566 72D4108BDFC7006125E1CDE.PDF

4. Making Public Investment More Efficient: IMF Policy Paper, June 11, 2015

5. Output Outcome Framework | DMEO | Development Monitoring and Evaluation Office | Attached office under NITI Aayog