

The macroeconomic impact of the NSW public sector pay cut

Cutting public sector wages and spending the 'savings' on capital works will reduce employment by about 1,110 jobs and remove tens of millions of dollars from regional areas.

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NSW PUBLIC SECTOR WAGE CUT

On the 27th May 2020, the New South Wales Government announced its intention to 'save' an estimated \$3 billion over 4 years by cutting public sector pay by 2.5%.

In providing a rationale for the decision the NSW Treasurer Dominic Perotett said:

Pausing pay rises to save and create jobs is the right thing to do, and I think most people would agree on that.¹

And

Pausing pay rises will enable the Government to focus on preserving existing public sector jobs while also stimulating job-creation as NSW confronts the prospect of a deep recession and contraction of the economy.²

The NSW premier Gladys Berejiklian said:

We are not talking about saving the budget or saving the economy. We are literally talking about saving jobs.³

¹ NSW Government (2020) *NSW Government pauses pay rises to protect and create jobs*, <https://www.nsw.gov.au/media-releases/nsw-government-pauses-pay-rises-to-protect-and-create-jobs>

² NSW Government (2020) *NSW Government pauses pay rises to protect and create jobs*

³ Visentin V (2020) *NSW Premier freezes public sector pay for 12 months*, <https://www.smh.com.au/politics/nsw/nsw-premier-freezes-public-sector-pay-for-12-months-20200527-p54wtj.html>

CAN SPENDING LESS ON WAGES BOOST EMPLOYMENT?

The NSW Government has released no analysis to support the assertion that lowering the disposable income of over 400,000 public servants will lead to an increase in employment. Its rationale appears to be that if the money saved on public sector wages is instead spent on infrastructure, there will be a net increase in employment.

Leaving aside the fact that there is nothing to prevent the NSW Government from both honouring scheduled pay rises and increasing expenditure on capital works, the available data does not support the assertion that switching public spending away from public sector pay and towards capital expenditure would lead to an increase in employment in NSW.

While reducing the disposable income of NSW public servants will not result in a direct reduction in employment, it will likely have a significant impact on spending by NSW public sector employees and, in turn, on the level of demand and employment in the NSW economy.

The key empirical question is - Does the consumption spending of public servants create more or less jobs than expenditure on capital works?

EMPLOYMENT INTENSITIES

According to the Australian Bureau of Statistics (ABS) the construction industry generates 0.97 direct jobs for every \$1 million spent on construction. ABS data also shows that for every \$1 million spent by consumers in Australia 1.79 direct jobs are created.⁴⁵ In short, according to the ABS, every million dollars spent by NSW public servants creates nearly twice as many jobs as \$1 million spent on construction activity.

However, we need to account for the difference between the NSW Government's expenditure on public sector wages and the income of those public servants which arises due to the taxes paid by public sector workers. Accounting for taxes paid by public sector employees means that every \$1 million reduction in public sector wages results in disposable income falling by approximately \$750,000 which in turn generates a reduction of 1.34 direct jobs (rather than 1.79 jobs associated with a \$1 million

⁴ Authors' calculations based on ABS Cat no 6306.0 - *Employee Earnings and Hours, Australia, May 2018*, and Cat no 5209.0.55.001 - *Australian National Accounts: Input-Output Tables, 2016-17*.

⁵ Both construction spending and general consumer spending both create similar 'second round' employment effects so these have been excluded from this analysis.

reduction). However, even after accounting for taxes paid by employees, the impact of a reduction in public sector on employment is significantly larger than the 0.97 jobs created per million dollars spent on construction.

Put another way, according to the best available data, and in the absence of any analysis from the NSW Government to suggest otherwise, it is likely that any shift in spending away from public sector salaries and towards construction activity will lead to a reduction in employment in NSW.

The NSW Government has estimated that its proposed 2.5% public sector pay cut will result in a reduction in public sector wage costs of \$3 billion over 4 years. If that \$3 billion is spent on construction, it could be expected to generate 2,910 jobs. If on the other hand that \$3 billion was spent on public sector pay it could be expected to increase employment by 4,020 jobs. This means that a shift in government spending away from public sector salaries and towards construction activity would result in the loss of around 1,100 jobs.

REGIONAL IMPACTS

While specific construction projects might lead to an increase in construction employment in specific regions, because public sector workers are employed across NSW any reduction in the incomes of public sector workers will have economic consequences across the state.

The NSW public service commission provides information on the number of public service employees by region.⁶ From this we can estimate the total loss of income for public service employees by region. This information is presented in Table 1.

⁶ NSW Public Service Commission (2019) *Workforce Profile Report 2018, Chapter 11: Regional profile of the public sector*, NSW Government, available at <<https://www.psc.nsw.gov.au/reports---data/workforce-profile/workforce-profile-reports/workforce-profile-report-2018/chapter-eleven>>

Table 1 – Loss of public service income by region from a one-year wage freeze

NSW region	Loss of pre-tax income
Hunter Valley (excl. Newcastle)	\$81,000,000
Mid-North Coast	\$81,000,000
New England & North West	\$84,000,000
Far West & Orana	\$78,000,000
Coffs Harbour — Grafton	\$63,000,000
Richmond — Tweed	\$93,000,000
Capital Region	\$81,000,000
Riverina	\$72,000,000
Murray	\$42,000,000
Central West	\$108,000,000
Sydney East	\$1,017,000,000
Sydney West	\$741,000,000
Central Coast	\$120,000,000
Newcastle and Lake Macquarie	\$177,000,000
Illawarra	\$117,000,000
Southern Highlands and Shoalhaven	\$45,000,000

Estimates based on June 2019 public service head count with the 2018 regional distribution.

Estimate assumes average wages are equal across different regions. All figures are before tax.

The data presented in Table 1 represents the pre-tax losses in gross income for each region over four years which in turn translates into tens of millions of dollars less being spent in regional shops and businesses. Such cuts will inevitably have an impact on the ability of regional areas to recover from the current economic crisis.

CONCLUSION

An increase in state government construction activity that is offset with a reduction in the public sector wage bill will result in a reduction in employment across NSW of approximately 1,110 jobs. While the NSW Government is yet to announce where it might locate new construction projects, the amount of income and employment that will be lost as a result of the wage freeze is quite clear.

It is not just the size of public spending that determines employment effects, but its shape. If the NSW Government seeks to maximise employment growth in its state it should focus its expenditure on those items that are labour intensive and that lead to a large amount of indirect job creation. The data presented above makes clear that construction is not labour intensive.

The data presented above does not mean that investment in construction is a poor investment for the state, simply that if expenditure on construction is to lead to an increase in state wide employment the construction spending needs to be additional to, not a substitute for, other more labour intensive areas of expenditure.