Economic Prosperity, Public Sector Restraint

Unpacking South Australia's Economic and Fiscal Advantages in the Shadow of Public Sector Pay Erosion

By Jack Thrower
Centre for Future Work at the Australia Institute

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BRIEFING PAPER

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Introduction and summary

By many measures, South Australia has enjoyed the strongest economy of any state in Australia. Its economic growth has been faster in recent years than any state – and in per capita terms, its prosperity has improved twice as fast as the national average. It enjoys a stable, diversified economic base: reflecting a virtuous combination of strong business investment, exports, household consumption, and government spending (both on current services and on capital investment). The state's labour market has been operating at or near record-low levels of unemployment and under-utilisation. The state government is even poised to return its budget to surplus after the COVID pandemic faster than almost any other state.

One might assume that this consistent record of prosperity would be reflected in improvements in state-funded public services, and in fair treatment for the public sector workers who deliver those services. However, compared to the vibrant growth of the state economy, the state's public sector is a poor cousin. The proportionate contribution of state and local government to overall economic activity is lower in South Australia than any other state. State spending on both current services and capital infrastructure has grown more slowly than Commonwealth spending in South Australia, and slower than most other components of gross state product. Painfully, compensation for the state's public sector workforce has gone backward, not forward, despite the state's macroeconomic success. The real purchasing power of public sector compensation in the state has declined by as much as 10% (depending on the measure) since before the pandemic. The combination of harsh wage restraint by the state government, with the acceleration of inflation after the pandemic, has produced a historic fall in the real compensation of public sector staff.

Indeed, the fall in real wages for public sector workers in South Australia ranks as the worst of any sector, in any state (tied with Western Australia, where public sector workers have also seen massive real wage cuts). And compared to wages in the private sector in South Australia (which also declined in real terms in recent years, but not as dramatically), relative wages for public sector workers have lost substantial ground. Falling real wages, and the failure to match broader compensation trends in the private sector, are creating a crisis in recruitment and retention in state public services.

The state government cannot cry poverty as an excuse for this painful suppression of public sector compensation. The state's consistent economic growth automatically generates strong revenue growth – and several indicators suggest the government has untapped fiscal resources available to support even stronger revenues. The state's quick return to budgetary surplus after the pandemic, and the fact that core expenses are growing consistently slower than revenues, confirms that the state government's fiscal position will only get stronger.

As a matter of fairness to the public sector workers who helped South Australia traverse the pandemic years, setting the stage for the strong economic rebound which has been enjoyed since, the erosion of real compensation for those employees must be quickly reversed. The state government has both the fiscal capacity, and the moral responsibility, to correct this glaring imbalance. The result will be a stronger public service, a stronger economy, and a better state.

Macroeconomic performance

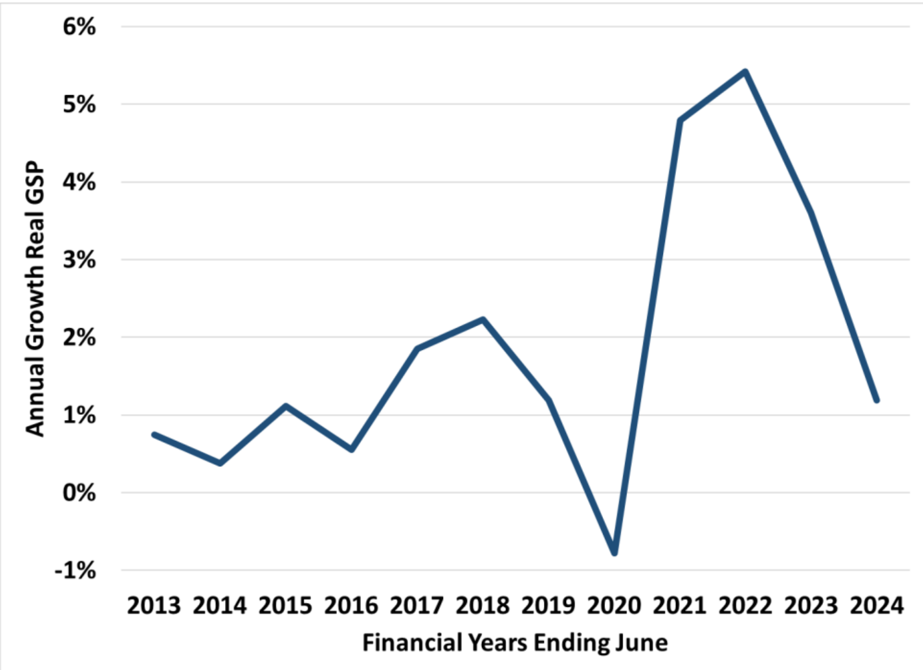
OVERVIEW

South Australia's economy has enjoyed consistent prosperity, rebounding strongly from the pandemic with vibrant economic growth and the most robust labour market in decades. Despite this overall prosperity, however, workers' real wages have declined as inflation has outpaced wage increases. Public sector workers have been particularly hard hit: real wages for South Australia's public sector workers have declined dramatically since the pandemic. The effects of this public sector wage suppression have not been equally borne. Most public sector workers have seen their real wages go backwards, but some of the lowest-paid public sector workers experienced the biggest real wage losses, worsening inequality.

ECONOMIC PROSPERITY

Economic growth

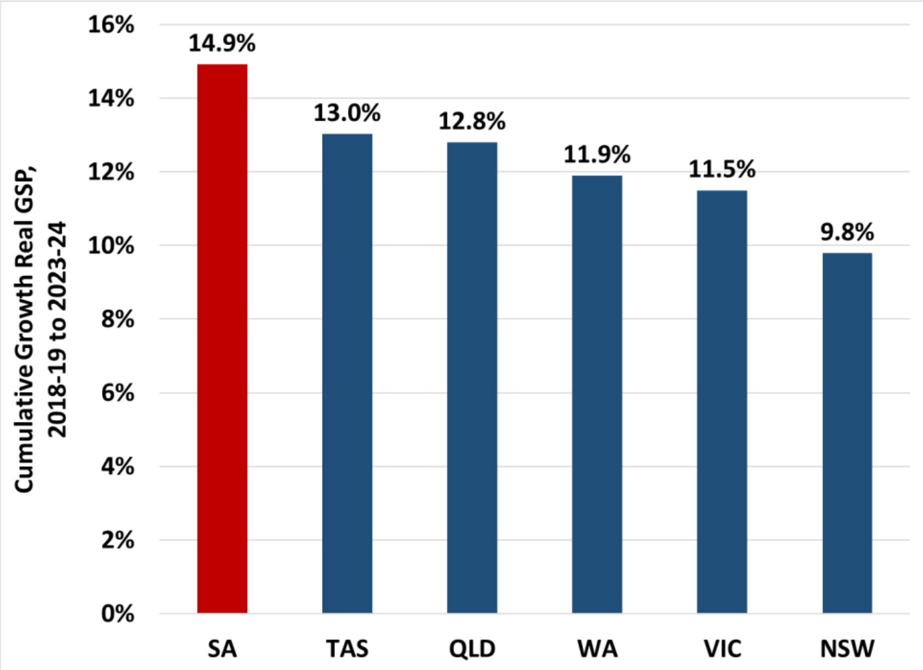
Figure 1: Real Gross State Product Growth, South Australia, 2013-2023



Source: ABS Australian National Accounts: State Accounts

South Australia energetically bounced back from a brief recession during the COVID-19 pandemic (see Figure 1). Even including the effects of this recession, real growth over the past five years has been historically strong, averaging 2.8% per year from 2018-19 through 2022-23, twice the average growth rate (of as against 1.4% per year for the five previous years, 2013-14 to 2018-19). Economic growth slowed in South Australia, as in the rest of the country, in 2023 following rapid increases in interest rates by the Reserve Bank of Australia – but despite that, the state's momentum remains positive.

Figure 2: Cumulative Real GSP Growth by State, 2018-2019 to 2023-24

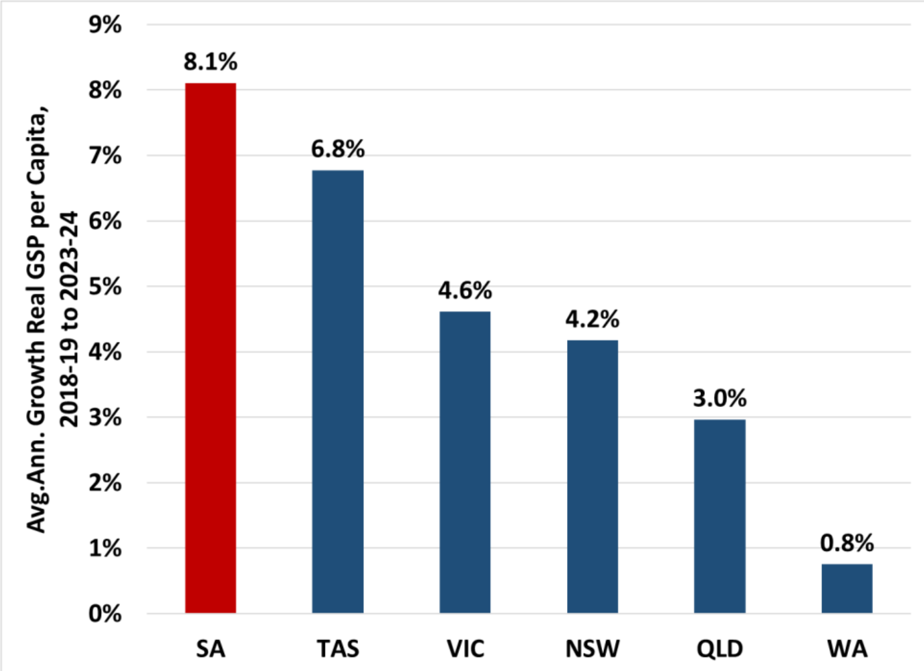


Source: ABS Australian National Accounts: State Accounts

This post-pandemic growth has led Australia's economic recovery. As shown in Figure 2, from 2018-19 to 2023-24 the South Australian economy grew by a cumulative total of almost 15% (or 2.8% per year on average), faster than any other state.

South Australia's superior performance is even more outstanding when measured in per capita terms – after considering changes in population. South Australia's population growth has been somewhat slower than other states, and this makes its strong GSP growth all the more impressive. During the last five years, South Australia's real GSP per person grew by over 8%, double the national average (Figure 3).

Figure 3: Real GSP per Capita Growth by State, 2018-19 to 2023-24



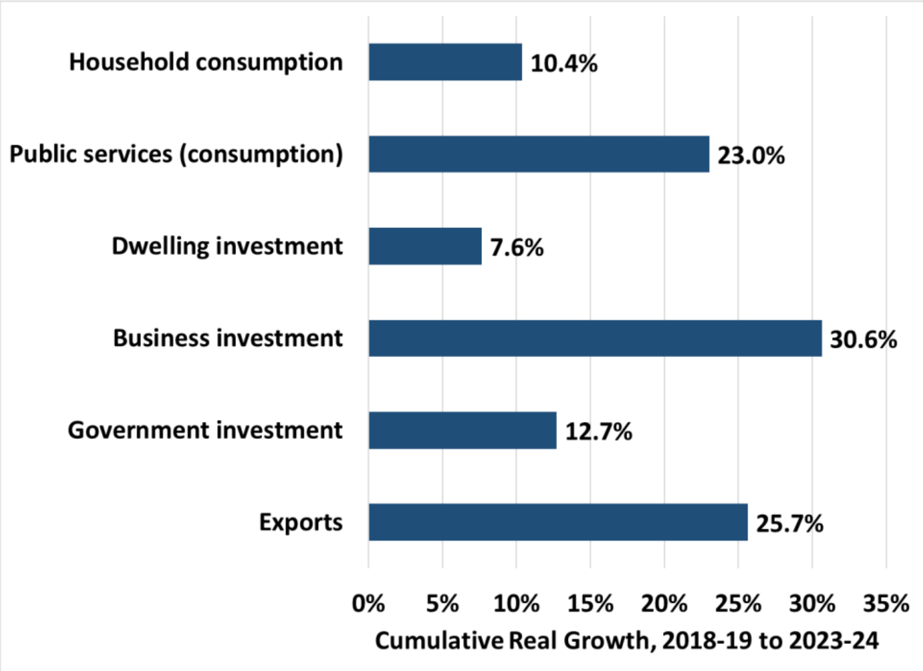
Source: ABS Australian National Accounts: State Accounts

South Australia's economic growth has been powered by an impressive and diversified combination of drivers: including public services, household consumption and private business investment (see Figure 4). Household consumption, which accounts for about half of all economic activity, remains the biggest single driver of growth, although its rate of expansion has recently been held back by high interest rates. Dwelling investment has also been restrained by the effects of the pandemic and subsequent high interest rates.

Government consumption spending (on current public services) has been stronger than household consumption, although government investment (in infrastructure and other public assets) has been less vibrant.

What is especially noteworthy about the composition of South Australia's economic growth has been the strong performance of the state's private sector. Capital spending by private businesses grew by over 30% in the last five years. International exports of goods and services from South Australia grew by over 25%. In both cases, South Australia's performance was stronger than the average for the rest of the country.

Figure 4: Real GSP Growth by Major Component, SA, 2018-19 to 2023-24



Source: ABS Australian National Accounts: State Accounts

The strength of private business investment in South Australia is particularly noteworthy. Firms clearly agree that the South Australian economy offers significant investment advantages. This increased business investment is setting the stage for future employment, state tax revenues, and enhanced fiscal capacity. The state's international exports have also grown very strongly in real terms, further reinforcing this diversified foundation for future growth.

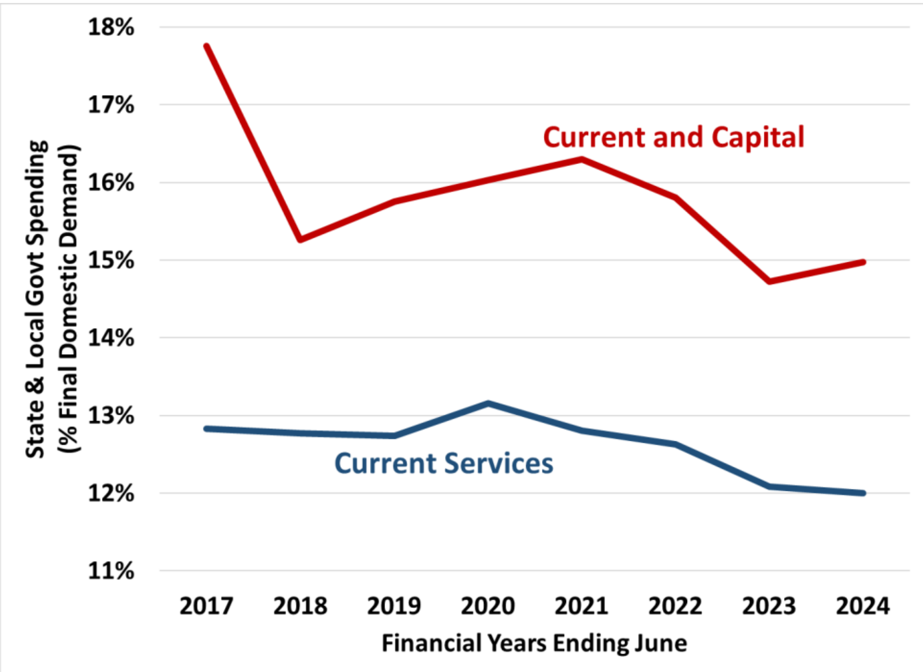
In sum, it is not just the pace of economic growth in South Australia which has been so impressive in recent years – faster than any other state. The composition of that growth is diversified and hence stable. A combination of business, household, and public sector expansion has powered South Australia's economy to the strongest record in the country. Other observers have confirmed the state's leading performance – with South Australia being recognised by bodies such as CommSec, the Business Council of Australia, the Housing Institute of Australia and others for its country-leading performance.[1]

[1] For example, see Jacob Shteyman and Abe Maddison, "The surprise state topping Australia's economic ladder," *Sydney Morning Herald*, 29 July 2024; Duncan Evans, "Business Council of Australia declares South Australia the winner for 2024," *News.com*, 2 December, 2024.

South Australia's modest state-level spending

Government spending has played a relatively modest role in contributing to this strong record of economic growth – especially spending by the state government. In fact, spending by state and local governments, including both current services and capital investment (such as infrastructure spending), has shrunk as a proportion of the economy since before the pandemic. As illustrated in Figure 5, state and local government-funded current services accounted for just 12% of South Australia's total final domestic demand[2] in 2023-24. That continues a decline that has lasted through most of the past decade, interrupted only temporarily by pandemic-related spending in 2020. Including state public investment spending (which has fluctuated over the years),[3] total state and local public spending (on both current services and capital) has fallen even more markedly, accounting for 15% of final domestic demand in South Australia in 2023-24 (down from 18% in 2016-17). The strong economic growth enjoyed by the state has not translated proportionately into improved spending on public services and assets.

Figure 5: State-Level Public Spending as % State Final Demand, 2012-13 to 2023-24



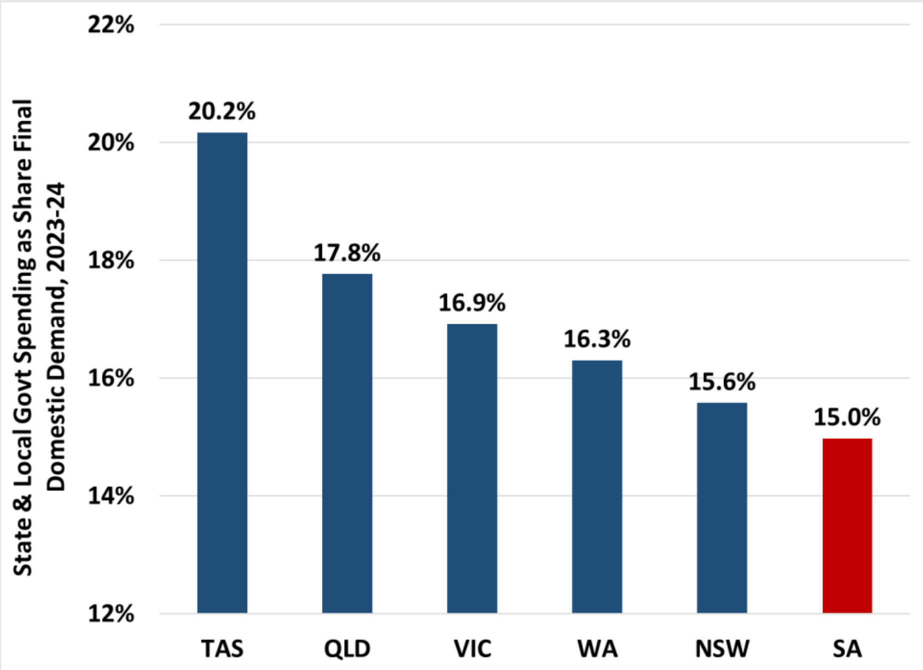
Source: ABS National Accounts: State Accounts

[2] Final domestic demand (FDD) is a measure of total expenditure in the economy excluding foreign trade flows. FDD shares are computed in current dollar terms.

[3] Including capital spending by state-level public corporations.

Indeed, state-level public spending now accounts for a smaller share of economic activity in South Australia compared to any other state. South Australia is an outlier, compared to other states, in the unusually small budgetary allocations provided to state-funded activity.

Figure 6: State and Local Public Spending as Share Final Demand, 2023-24



Source: ABS National Accounts: State Accounts

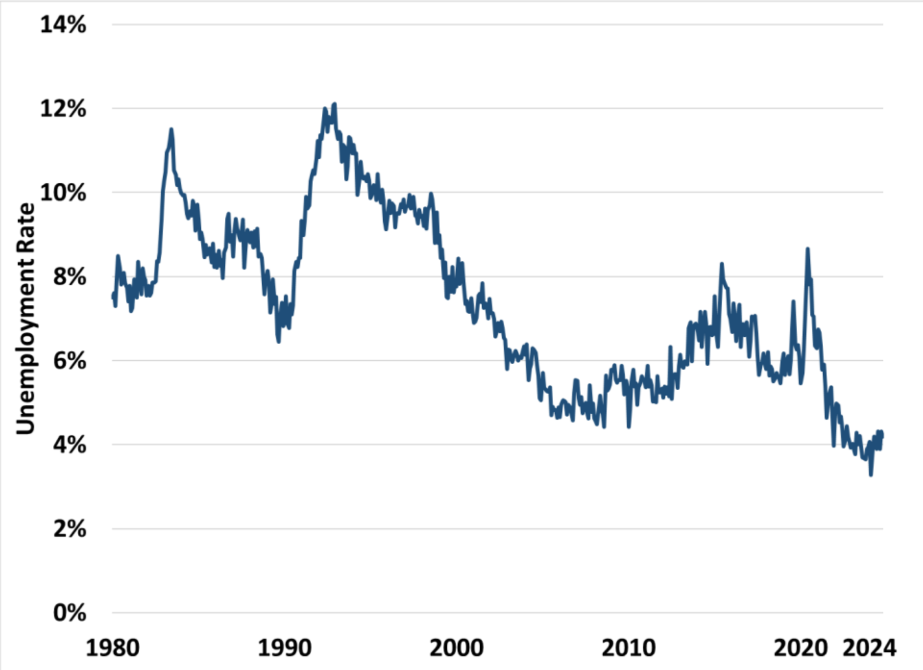
In contrast to the unusually small and declining role of state-level spending, federal government spending in South Australia has been more robust. Federal spending on current services and capital (including capital spending by Commonwealth public enterprises) contributed another 12.5% to state final domestic demand – more than any other state except Tasmania. As a result, the share of *total* government spending (both state/local and federal) in South Australia's overall economy is roughly average compared to other states. In effect, stronger commitments by the Commonwealth to current and capital spending in South Australia, is offsetting the disproportionate weakness of spending by the state government. But this imbalance in the governments' respective spending commitments to South Australia is not economically or politically sustainable.

EMPLOYMENT AND LABOUR MARKET TRENDS

Along with overall economic activity in recent years, South Australia's labour market is also impressively strong. South Australia's unemployment rate has averaged just 4%

over the past two years; in February 2024 it fell to 3.3%, its lowest point in the history of ABS state-level unemployment data (which dates back to the 1970s). Despite the economic slowdown from high interest rates since 2022, the state's unemployment rate remains historically low (see Figure 7).

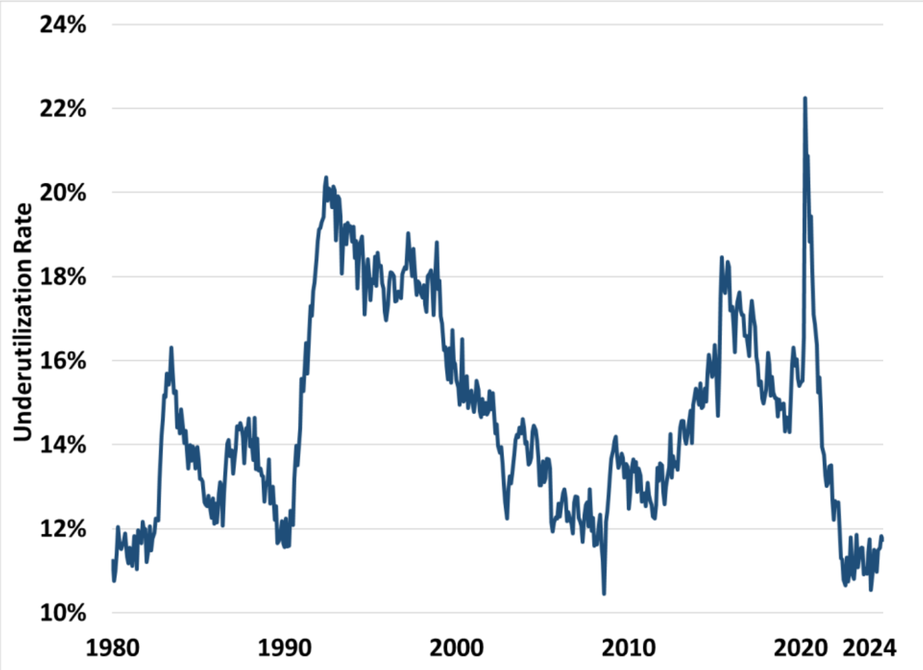
Figure 7: Unemployment Rate, South Australia, 1980 to 2024



Source: ABS Labour Force, Table 4

This strong labour market performance is also reflected in several broader measures of labour market performance. One such measure is the under-utilisation rate, which includes both the number of unemployed and underemployed (those working but seeking more hours of work). South Australia's under-utilisation rate has declined markedly since the pandemic, and is currently close to its all-time low rate since the ABS started publishing this data in the 1970s (see Figure 8).

Figure 8: Under-utilisation Rate, South Australia, 1980 to 2024



Source: ABS Labour Force, Table 23

Such a strong labour market has obvious implications for public sector staffing strategies. With low unemployment and abundant opportunities in other industries, to effectively compete with the private sector for staff the government must offer more competitive wages and more attractive working conditions.

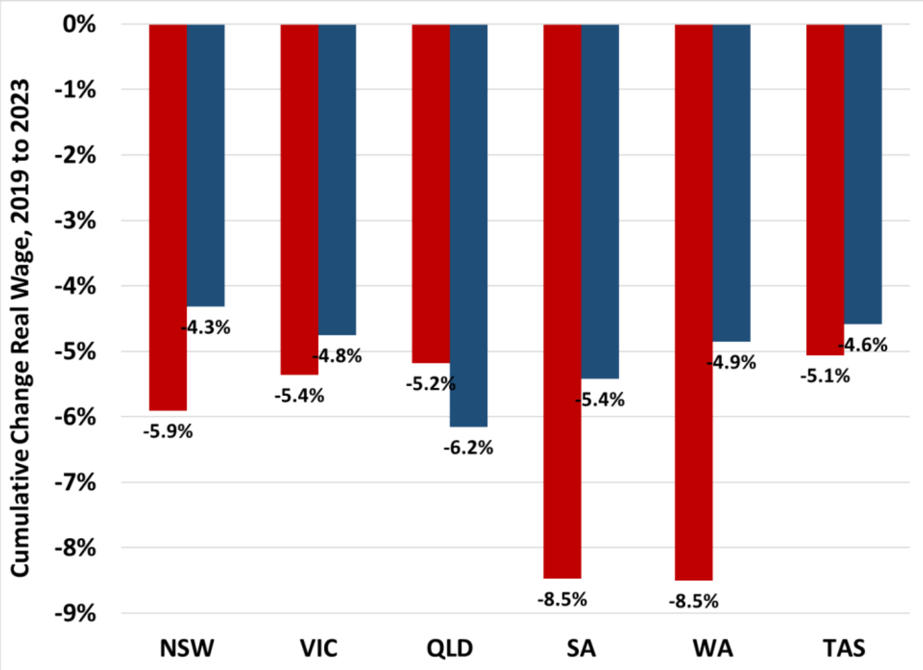
WAGES

Despite South Australia's superior economic growth and robust labour market, inflation has considerably outpaced wage increases in the state over recent years. The Australian Bureau of Statistics measures labour compensation in various ways, each providing insight into a different aspect of the labour market. However, these varied metrics tell a consistent story: South Australian wages have gone backwards in real terms, with public sector workers experiencing particularly severe setbacks.

Eroded real wages

The Wage Price Index is one measure of labour compensation; it is constructed by the ABS to reflect 'pure' inflation in a fixed 'bundle' of jobs, thus controlling for changes in the composition of employment (such as inter-industry shifts, or shifts into and out of part-time work) that can affect average wages. Deflating changes in this index by inflation shows that real public sector wages in South Australia fell 8.5% between 2019 and 2023 (see Figure 9).[4] This ranks as the largest real wage decline of any state, for either public sector or private sector workers (tying with an equal 8.5% decline in real wages for public sector workers in Western Australia). In short, South Australian public sector workers are receiving substantially less real compensation for the same work done before the pandemic, and the extent of this decline is more severe than other states or sectors.

Figure 9: Change in Real Wage Price Index by State by Sector, 2019-2023



Source: ABS Wage Price Index, ABS Consumer Price Index, author's calculations

It is shocking that South Australia has boasted the strongest economic growth of any state – yet public sector workers lost such a substantial proportion of their real purchasing power in just four years.

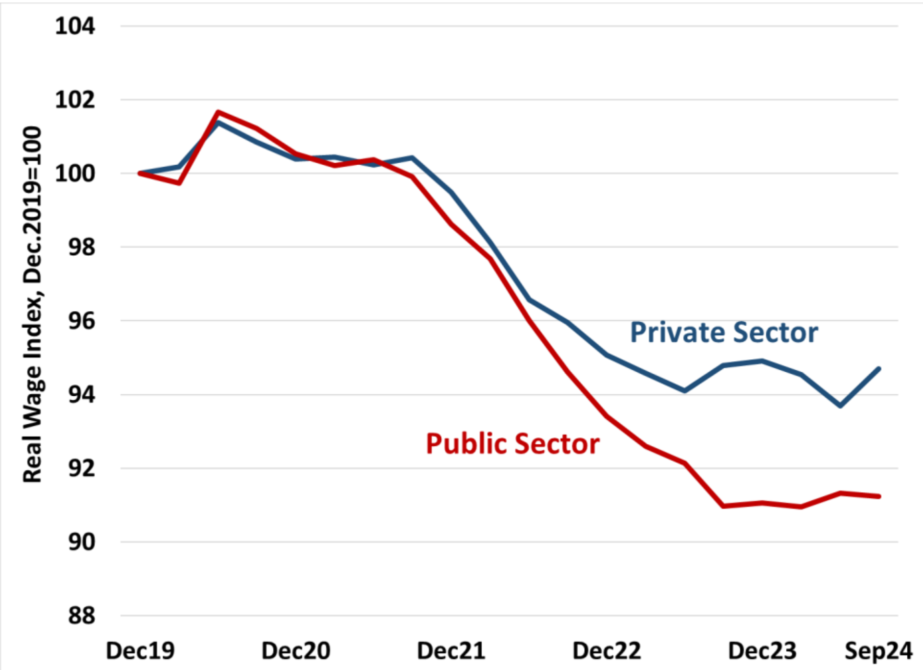
Divergence between public and private sector wages

Figure 10 demonstrates how this real wage decline for South Australian public sector workers unfolded over time. During the worst period of the pandemic, real wages slightly increased, primarily due to a short-term decline in prices (during initial

[4] Comparing change in the annual averages for 2019 and 2023, of the wage price index deflated by the consumer price index for each state.

lockdowns). Real wages then started to slowly decline as wage rises stalled and inflation gradually picked up speed, eroding the value of real wages. However, from late 2021 onwards, inflation accelerated markedly; as the global economy reopened, prices rose as a result of supply shortages, energy price shocks, and profit-taking by corporations (who took advantage of the disrupted economy to increase prices more than their own costs). However, wage increases remained subdued, especially in the public sector, accelerating the decline of real wages. Through most of this period, nominal wage increases were higher in the private sector than the public sector in South Australia. Hence real wages for public sector workers fell faster, and further, than for the private sector. This disparity has been particularly pronounced since 2023: private sector real wages have rebounded modestly in the last year, offsetting some of the effects of previous inflation, while public sector real wages remain stagnant at close to 9% below their December 2019 values. Since the pandemic, the relative real compensation of public sector workers in the state has deteriorated by about 4% compared to the private sector. This can only exacerbate the challenges of recruitment and retention facing so many public sector agencies in South Australia.

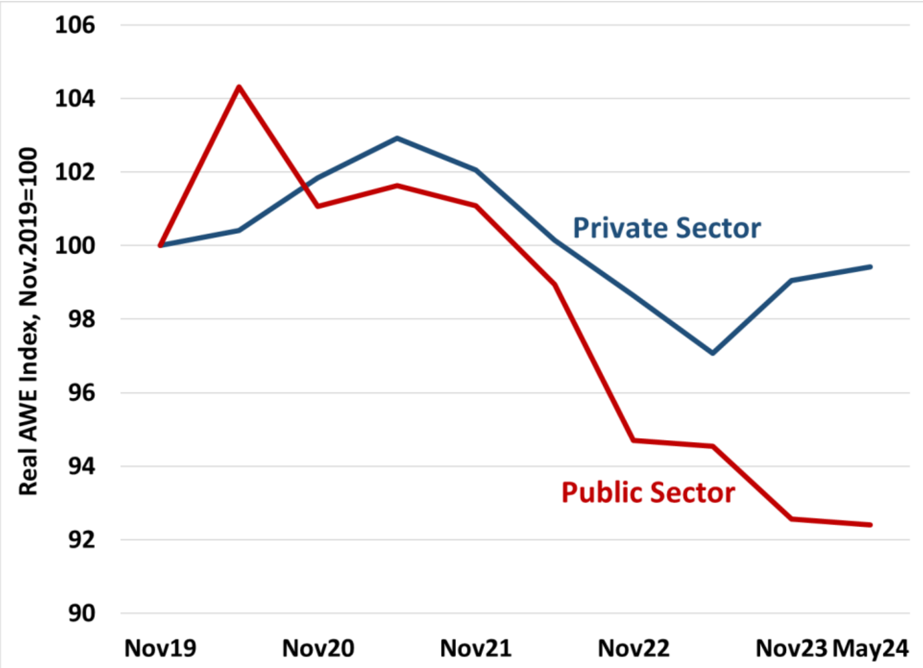
Figure 10: Real Wage Index, South Australia, 2019-2024



Source: ABS Wage Price Index, ABS Consumer Price Index, author's calculations

A similar but even more glaring disparity is evident in another measure of labour compensation published by the ABS, based on its biannual survey of average weekly earnings. Figure 11 illustrates the trend in ordinary time[5] weekly earnings for full-time employees, in both the public and private sectors of South Australia, since late 2019 (before the start of the pandemic). Again, nominal earnings are deflated by the growth of consumer prices. This measure also confirms that South Australian public sector workers have experienced unprecedented real wage losses since the pandemic: with average real full-time weekly earnings falling almost 8% compared to pre-pandemic compensation. The decline in real weekly earnings for private sector workers was not as dramatic, and those real earnings have recovered over the past year (nearly returning to pre-pandemic levels). However, in the public sector real weekly earnings have actually continued to decline. By this measure, the relative level of public sector wages has declined even further relative to private sector norms: a 7% divergence since the pandemic.

Figure 11: Real Weekly Earnings Index, South Australia, 2019-2024



Source: ABS Average Weekly Earnings, Consumer Price Index; author's calculations

Real wage cuts for state public servants

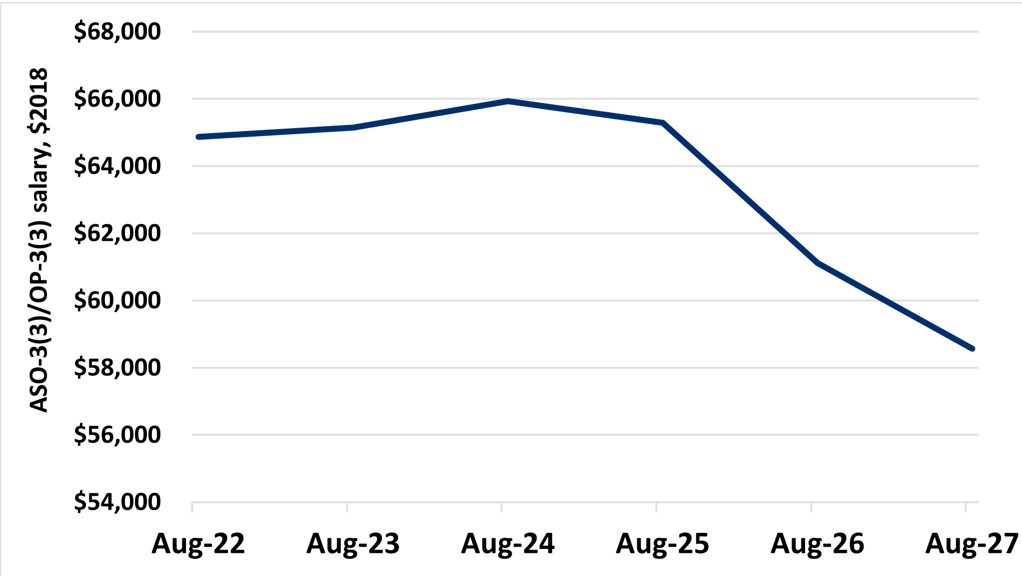
Further confirmation of the fall in real wages for public sector workers in South Australia is provided by specific analysis of public servant salaries, as described in enterprise agreements. ASO-3 (3) and OPS-3 (3) are two common classifications under which many public sector workers are employed, providing similar base salary rates.

[5] Excluding bonuses and overtime.

These classifications can be considered broadly representative of the overall trajectory of salary bands for state public sector employees in South Australia.

Since 2020, the real value of these salaries has fallen drastically. After small real wage increases in 2019 and 2020, real salaries for these classifications declined: slowly at first, and then rapidly after 2021. In real terms, a cumulative real wage decline of over 10% has been experienced in these positions between 2019 and 2023 (see Figure 12). Similar trends have been experienced by other classifications. That loss in real wages for state government employees is even larger than the overall real wage losses described above. Those measures applied to all public sector workers in the state, including public sector staff working for federal and local governments. Figure 12 confirms that the trend was even worse for state employees. This indicates that the state government's workforce has experienced even more severe real compensation reductions than other public sector workers in South Australia.

Figure 12: Real Salary Full-time ASO-3 (3) and OPS-3(3), 2018 to 2023



Source: South Australian public service enterprise agreements, ABS Consumer Price Index, author's calculations; date range chosen to include most recent pay rise

Modest nominal wage gains provided by previous enterprise agreements have lagged far behind the acceleration of inflation after the pandemic. The painful result is that South Australia's public servants – who provided such essential service during the challenges of the pandemic – have experienced a historic and painful decline in living standards. Repairing that decline in real wages will be a historic priority for future wage negotiations.

Summary: a historic retrenchment

The analysis above has presented data from several sources regarding the erosion of real purchasing power for public sector workers in South Australia. The apparent scale of the decline in real wages for public servants depends on the specific wage indicator considered. Table 1 summarises these contrasting sources. Across the variety of sources, the conclusion is clear and consistent. Real compensation for public sector workers in South Australia has been reduced by between 8 and 10 percent compared to pre-pandemic levels. Such a loss in real purchasing power constitutes a historic and painful retrenchment in living standards. It poses an enormous challenge to the financial stability and well-being of tens of thousands of public sector workers, their families, and their communities.

Table 1
Measures of Real Wage Loss, South Australia Public Service

Concept	Data Source	Workers Covered	Time Covered	Cumulative Decline
Real hourly earnings	ABS WPI	All public sector	Dec.2019 to Sep.2024	-8.8%
Real weekly earnings	ABS AWE	All public sector	Nov.2019 to May 2024	-7.6%
Real EA classification	Enterprise agreements	State govt ASO-3 (3) and OPS-3(3)	Aug.2019 to Aug.2023	-10.1%

Source: Author calculations from sources as described in text

OUTLOOK FOR SOUTH AUSTRALIA'S ECONOMY

In its 2024-25 budget, the South Australian Treasury noted that though the state economy has recently slowed (like other states, as a result of high interest rates and a national macroeconomic slowdown), the strength of the labour market has nevertheless exceeded expectations. Household consumption and private business investment have slowed as high inflation and interest rates reduced real disposable incomes. But current growth has been supported by public sector spending (once again, especially by the federal level) and exports.

Treasury expects the economy to continue to grow, though at a slower pace, reinforced by the strength of the labour market, ongoing construction, and public sector services and investment. Treasury expects growth to return to normal levels as interest rates fall, real incomes begin rising again, and consumer spending (including housing construction) rebounds. However, the state government has a responsibility to do its share to support the recovery of real incomes and consumer spending, which it acknowledges will be essential to renewed growth in the state. The state government can do this by moving quickly to repair the historic damage to real earnings experienced by the state's own public servants.

In short, the state government has a responsibility to help ensure strong macroeconomic performance in the South Australian economy. Recent years have seen impressive economic growth in the state, driven especially by private business investment, exports, and federal government spending. However, this has coincided with significant declines in real wages by South Australian workers, particularly for public sector workers. Households reliant on these wages are now facing significant financial stress.

Given the recent slowdown in private business investment and household consumption (both responding to high interest rates), this is a crucial moment for the state government to step up its own support for the state's overall economic activity – which, proportionately, is the smallest of any state. The state government needs to do more to ensure continued growth, including by expanding public services, and paying public sector workers fairly. By doing so, the state government can directly contribute to the restoration of real incomes and spending power in tens of thousands of South Australian households. In turn, this will benefit the state's economy in a time of uncertainty, by accelerating the recovery in consumer spending and boosting aggregate demand.

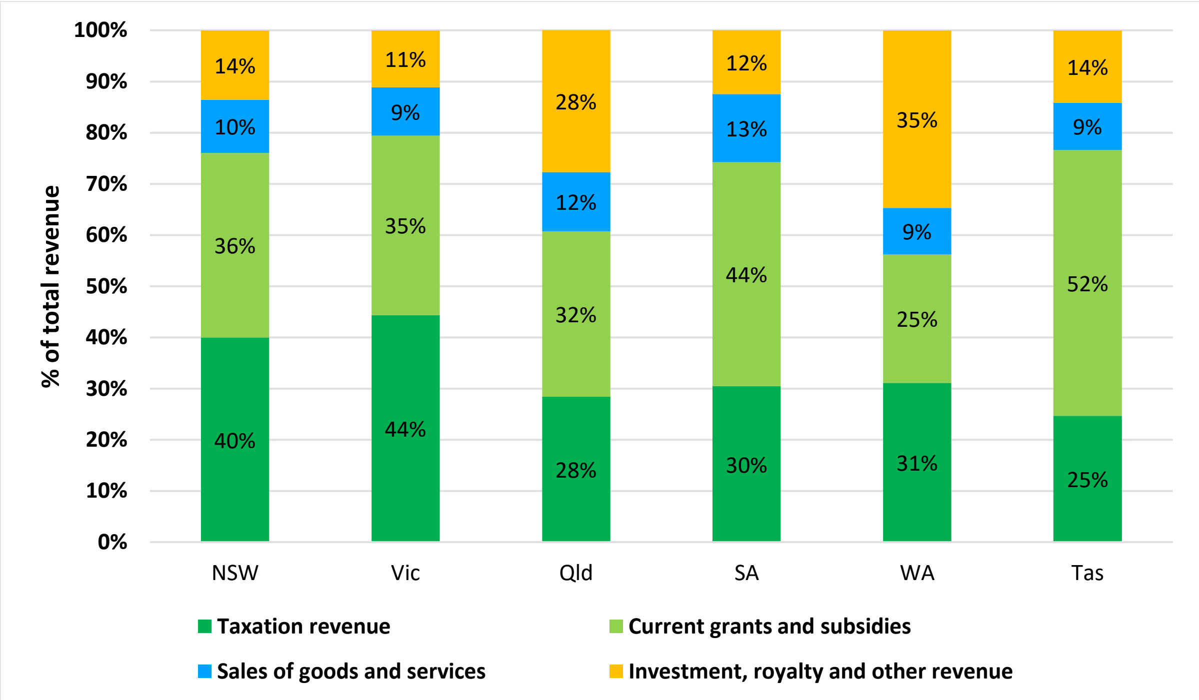
South Australia's fiscal position

STRUCTURE

Revenue

South Australia's revenue base is diverse and stable, with a composition of revenue sources similar to other states. The largest single revenue source (44%) consists of grants and subsidies from the federal government. This reliance on federal government funding is higher than some larger states, but lower than Tasmania and the territories (see Figure 13).

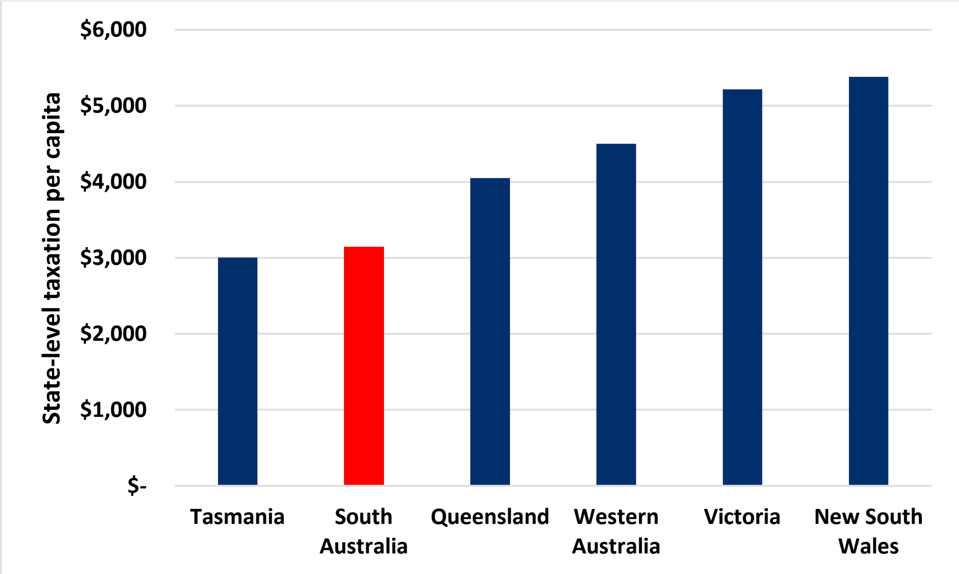
Figure 13: Composition of State Revenues, 2023



Source: ABS Government Financial Statistics, author's calculations

Various metrics reveal that South Australia's level of state taxation is modest, indicating potential for expanded revenue bases. According to the South Australian 2024-25 budget, "In terms of tax revenue per capita, South Australia is a relatively low-tax jurisdiction." As illustrated in Figure 14, South Australia collects less state-level taxation per person than any other state but Tasmania. This suggests considerable potential for the state government to increase its revenue base if needed to fund stronger public services – and fair compensation for those who provide them.

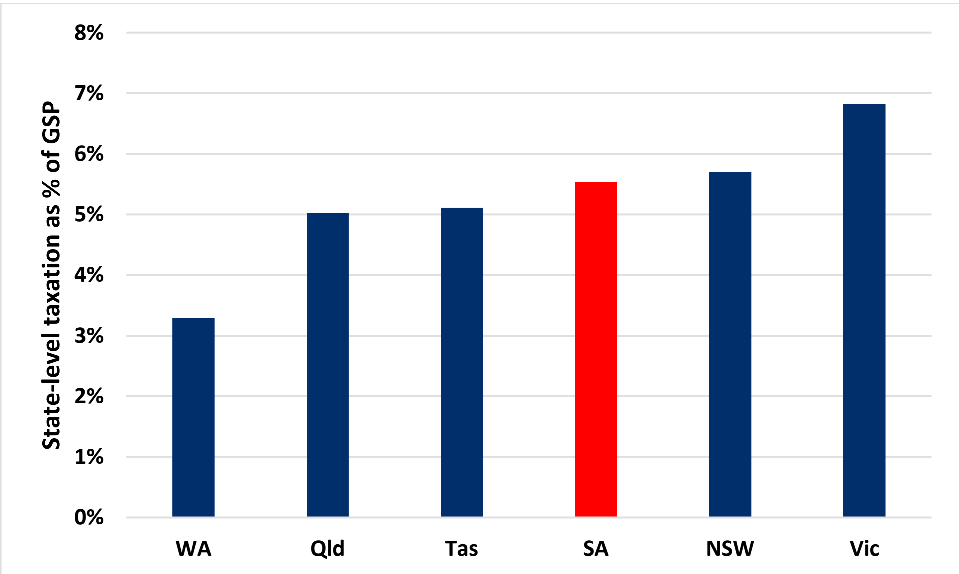
Figure 14: State-level Taxation per Capita, 2023-24



Source: South Australian Budget Papers

Another measure of the potential for expanding South Australia's tax base revenue is provided by comparing state-level taxation as a percentage of each state's economy. As shown in Figure 15, South Australia's overall state taxation (5.5% of GSP) ranks around the middle of all states, and is significantly lower than in Victoria (6.8%).

Figure 15: State-Level Taxation as Share of GSP, 2022-23

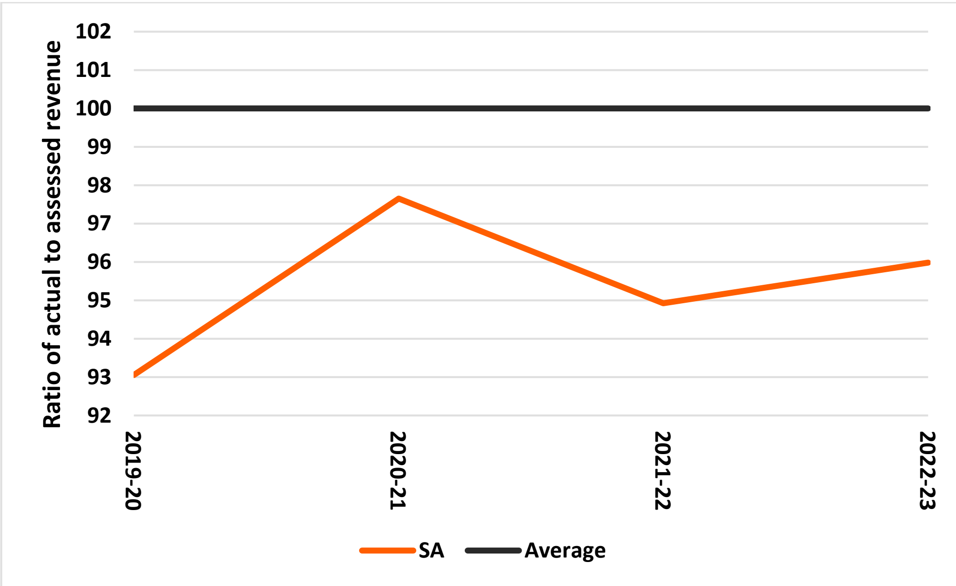


Source: ABS Government Financial Statistics; State Accounts; author's calculations

If South Australia implemented taxes to match Victoria's state-level tax share of the economy, it would generate over $2 billion in additional revenue per year. Western Australia appears unusually low on this chart for various reasons, including the state's reliance on resource royalties (which are not classified as taxation), and its favourable GST arrangement with the Commonwealth.

Lastly, analysis by the Commonwealth Grants Commission (published in the South Australian budget papers) shows that South Australia has consistently had a lower-than-average 'tax effort' over past years. This 'tax effort' is a measure of the comparative effort that each state and territory is making to tax its available tax bases, such as payrolls and land values. Essentially, it indicates how much tax could be raised in a state if the nation-wide average rates of taxes were applied to its own tax bases, against how much tax the state actually raised.

Figure 16: South Australia, Ratio of Actual to Assessed Revenue ('Tax Effort'), 2019-20 to 2022-23



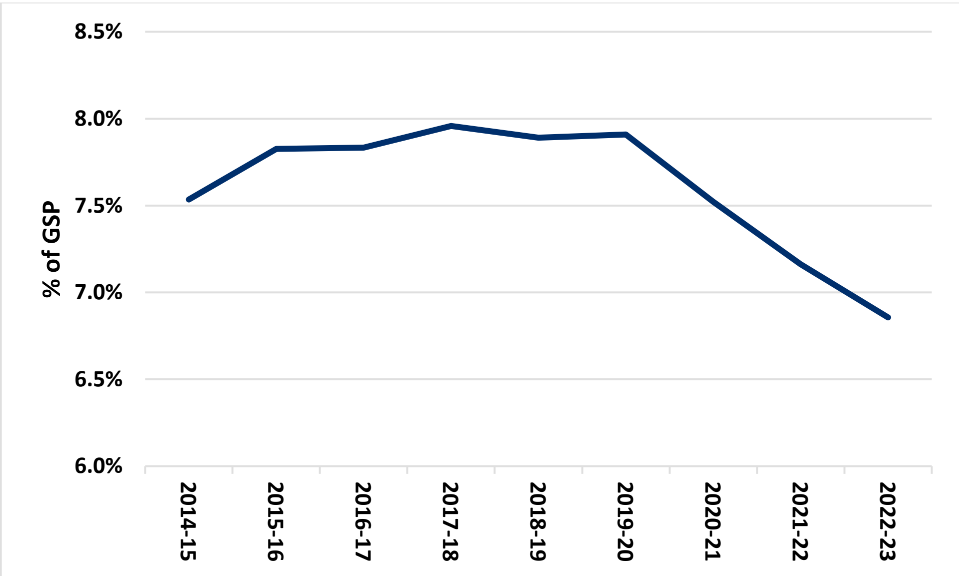
Source: Commonwealth Grants Commission – 2024 Update

As shown in Figure 16, the South Australian government is leaving about 4% of potential revenue on the table, by under-utilising the potential of its existing tax bases (compared to the practice of other states). This suggests there is considerable room for South Australia to enhance its tax effort (to at least match the practice of other states), and counters arguments South Australia is 'over-taxed.' To the contrary, the state has not leveraged the revenue potential of its strong state economy to the same degree as other states and territories. This suggests significant potential for revenue measures to fund state services if needed in the future. Additionally, South Australia's treatment of mining revenues, which include non-tax sources such as royalties, has also been lower than the national average – indicating another potential source of revenue.

Expenses

The composition of South Australia's state government expenses is similar to that of other states. In South Australia, employee expenses constitute approximately 45% of all expenses. The next largest components are non-employee operating expenses, which account for about 30%, and grants, subsidies, and other transfers (largely to local councils), which comprise about 12%. In recent years, due to the combination of a booming economy boomed alongside severe state public sector wage restraint, employee expenses dropped drastically as a percentage of the state's economic activity (see Figure 17).

Figure 17: State Government Employee Expenses as Share GSP

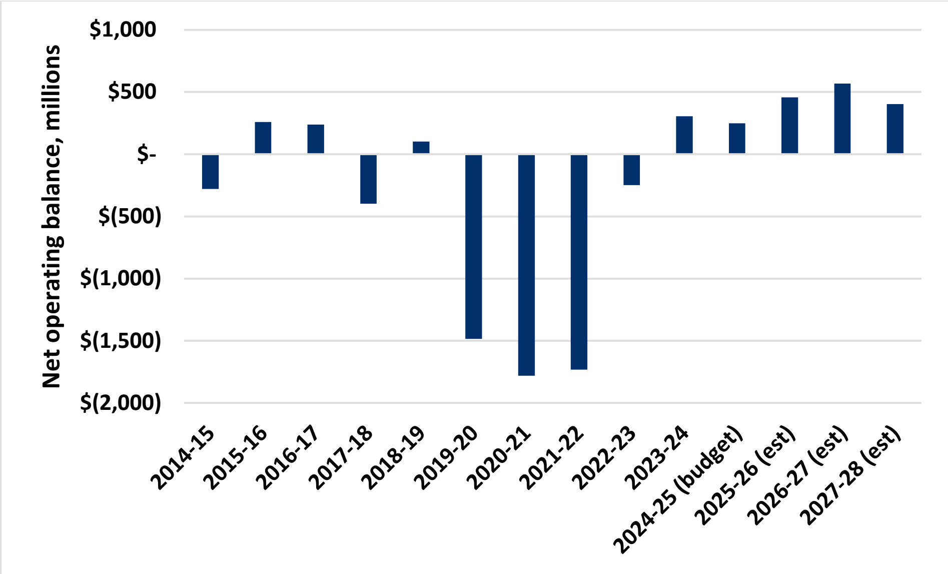


Source: ABS State Accounts; South Australian budget papers; author's calculations

Operating balance

Similar to other states, South Australia experienced significant deficits during the COVID-19 pandemic and shortly after. Those deficits were an expected and normal result of the extraordinary challenges faced at that time: including a drop-off in state revenue (due to reduced economic activity and employment), and extra costs for emergency health measures and other pandemic-related priorities. Despite these deficits, however, the state government expects to have returned to surplus in the last financial year (2023-24), faster than any state other than Western Australia (see Figure 18).[6]

Figure 18: Net Operating Balances, South Australia, 2014-15 to 2026-27



Source: SA Budget papers

The fact that the state government could return so quickly to surplus after the deficits of the pandemic years is not unrelated to the severe real wage suppression imposed on state government employees. As reviewed above, real compensation for state workers was reduced by as much as 10% since 2019. This produces hundreds of millions of dollars in cumulative savings for the state government (while imposing an equivalent scale of costs and hardship on public sector workers and their families). Carried forward, those savings are now reflected in the surpluses which the government now proclaims. In essence, those surpluses were created from the salary sacrifices of state public sector workers – and are now being 'banked' by the state government in the form of budgetary surpluses.

The state's temporary pandemic deficits are even less worrisome when considered in the context of the state's broader fiscal position. Figure 19 portrays the state government's 'comprehensive result'. This measure tracks overall changes in the net worth of the state government, including both cash flows and changes to the value of assets and liabilities held by the state government. By this measure, South Australia's net worth contracted only slightly and briefly in 2021-22 and 2022-23, and is projected to grow in future years.

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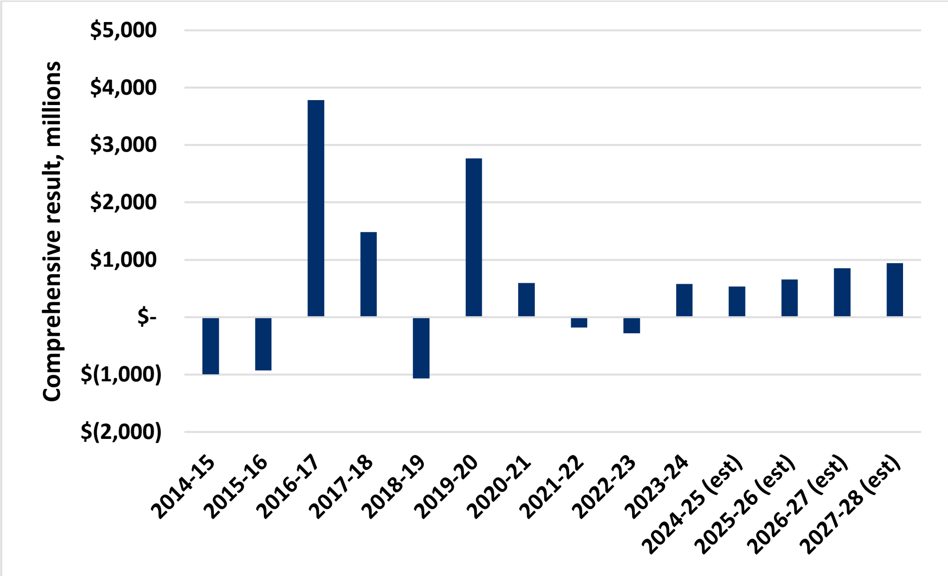
[6] Queensland experienced a surplus in 2021-22 but then returned to deficit.

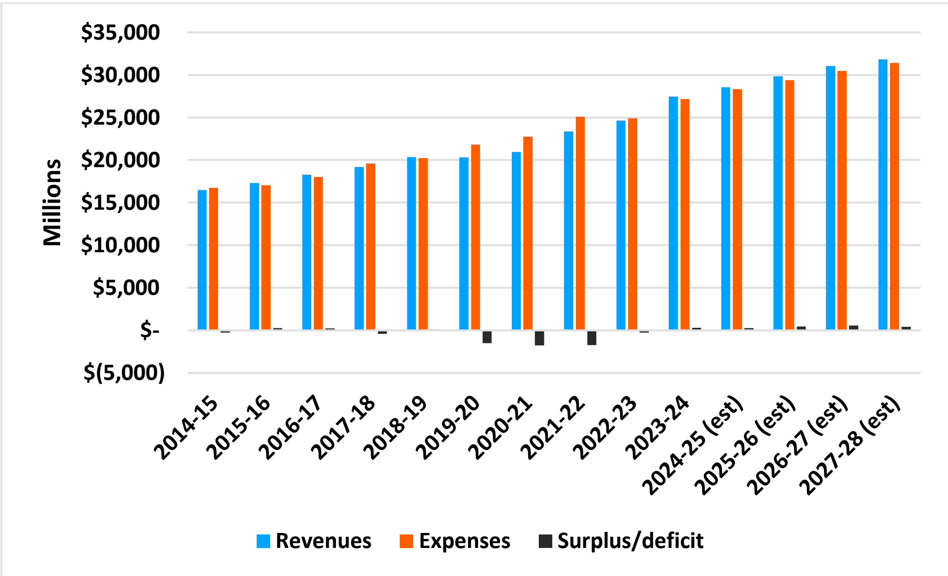
Figure 19: Comprehensive Result, South Australia, 2014-15 to 2026-27



Source: SA Budget papers

A closer look at changes in the operating balance over the pandemic period confirms that deficits in those years were principally the result of growing expenditures, rather than a drop in revenue. Higher spending was especially evident in the three years of major deficits: 2019-20, 2020-21 and 2022-23 (see Figure 20).

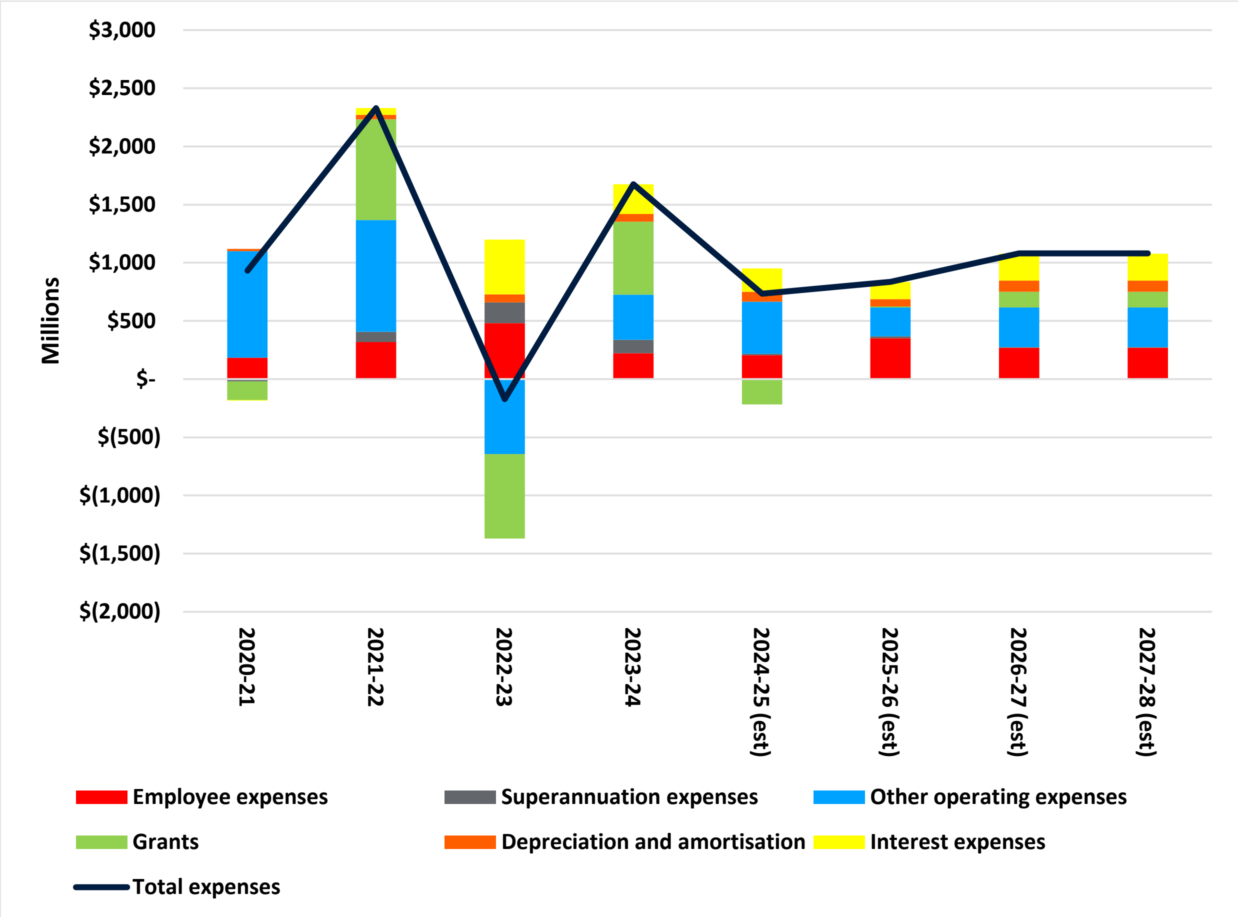
Figure 20: Revenues and Expenses, South Australia, 2014-15 to 2027-28



Source: SA Budget papers

Further disaggregation shows that growth in total expenditure during 2019-20, 2020-21 and 2022-23 was driven mostly by increases in ‘other operating expenses’ and ‘grants’, not by any significant increases to ‘employee expenses’ (see Figure 21). This is unsurprising given the costs of state government responses to the pandemic – including expenses such as emergency benefits and government health programs. Temporary pandemic spending was rolled back in 2022-23. Interest expenses have grown somewhat over this period due to higher interest rates (discussed further below).

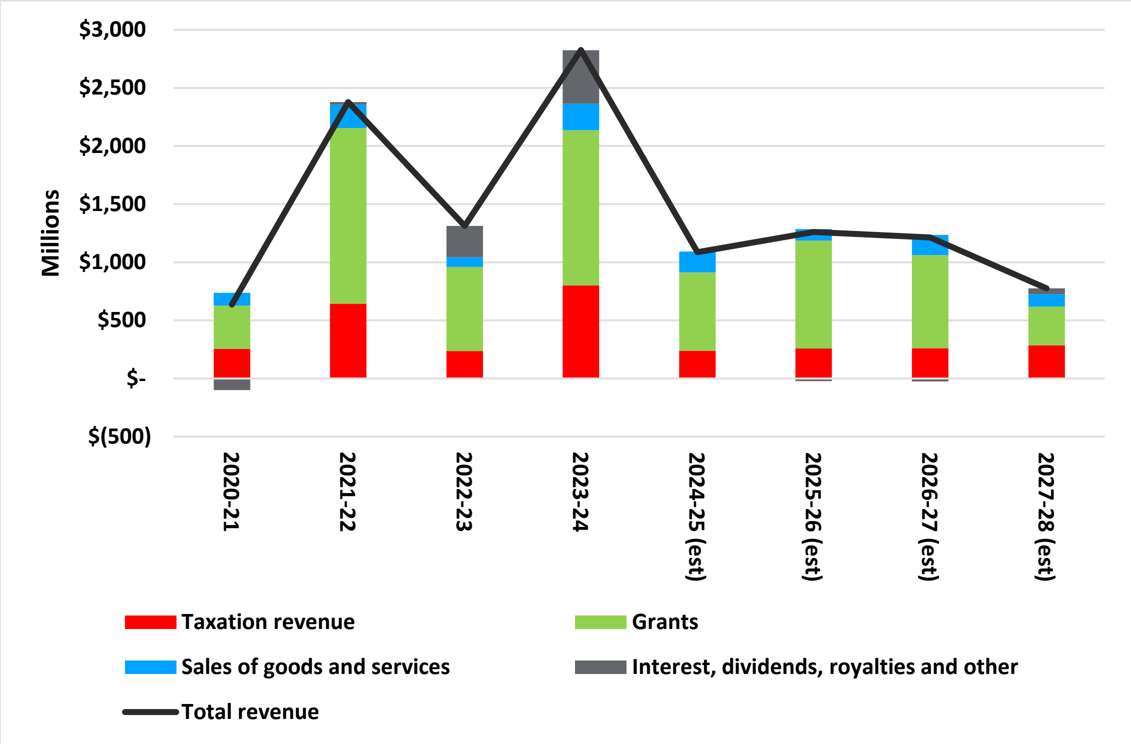
Figure 21: Changes in Expenditures by Component, 2020-21 to 2026-27



Source: SA Budget papers and author's calculations; 2019-20 compares budgeted figures with actuals due to change in methodology over this period

Figure 22 provides a disaggregation of the sources of revenue growth for the state government. During the period of the pandemic, grants revenue (from the federal government) grew substantially, though not sufficiently to finance all pandemic spending. Taxation revenue has continued to grow moderately but consistently over this period, thanks to the state's strong economic performance.

Figure 22: Changes in Revenue by Component, 2020-21 to 2027-28

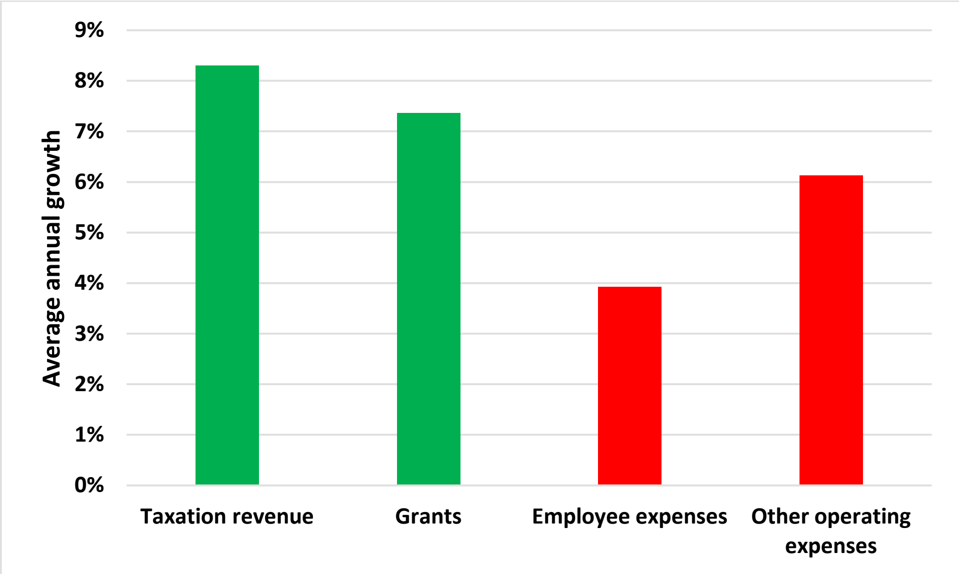


Source: SA Budget papers; author's calculations

Underlying fiscal trends

Despite the temporary operational deficits experienced over the pandemic period, the fiscal fundamentals of the South Australian budget remain very strong. Core revenue sources – grants and taxation – make up for about three-quarters of all revenue. Across the 2019-20 to 2027-28 period, grants are projected to grow at 7.4% per annum while taxation is expected to grow by 8.3% per annum. Meanwhile, the state government's core expenditures – employee expenses and other operating expenses – constitute over three quarters of total expenditures, and are projected to grow more slowly, by an average of 2.3% and 3.9% respectively over this same period.

Figure 23: Projected Growth of Core Revenues and Expenditures, 2019-20 to 2027-28



Source: SA Budget papers; author's calculations; date range chosen due to change of methodology in 2019-20

In short, the South Australian state government enjoys a diversified, stable, and strong fiscal situation. It eliminated pandemic deficits quickly. Major expenses are growing more slowly than revenues – and employee expenses have been strictly curtailed. Unfortunately, that has produced painful real wage losses for state public service workers of up to 10%. This historic loss of real compensation was imposed despite the extraordinary service these workers provided during the pandemic. The state government clearly has ample fiscal capacity to repair that damage to real incomes for its own workforce, without significantly altering its healthy fiscal trajectory. Additionally, as detailed above, there is evidence the South Australian government could feasibly gather additional taxation revenue if it chose to.

DEBT AND WORTH

Net debt

South Australia's state debt has grown in recent years, reflecting the deficits of the pandemic years, and investment in infrastructure and public assets. Public debt service payments have likewise increased over this period, reflecting the larger debt and higher interest rates. However, these trends do not constitute major challenges to South Australia's fiscal position.

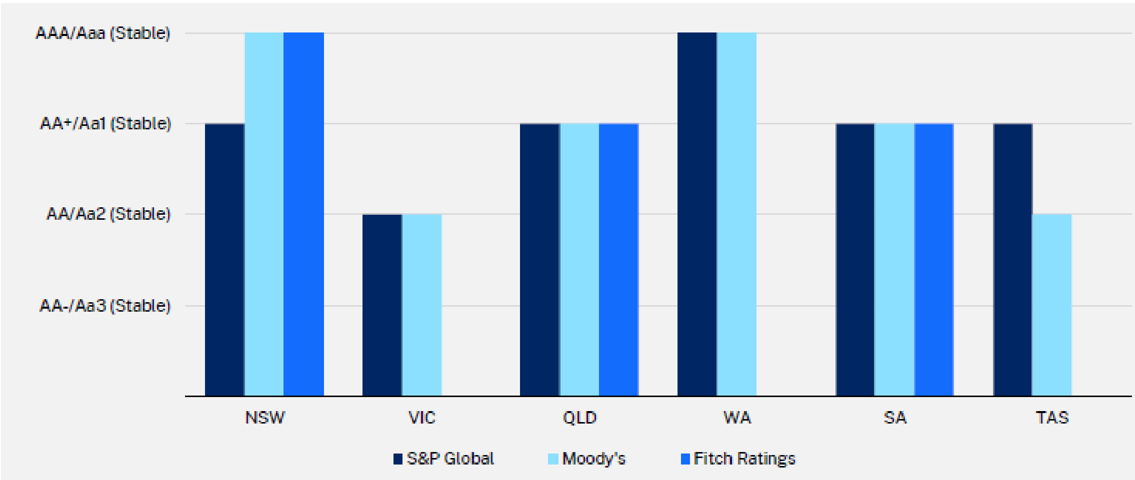
First, as outlined by the South Australian Treasury in the most recent budget:

The increase in borrowings is a result of the state's significant infrastructure program, including delivering the government's election commitments. The government is committed to maintaining a sustainable budget within the context of rising interest rates and its capacity to meet those payments through revenues.[7]

This underlines the government's own belief in the sustainability of debt levels, given that most public borrowing is to finance infrastructure programs that expand the productive capacity of the economy. Meanwhile, the fiscal fundamentals of the budget remain strong, including the fact South Australia is set to reach a surplus ahead of all states other than Western Australia.

Secondly, South Australia's credit ratings remain strong at AA+ (see Figure 24), in line with other states, and even ahead of some sovereign governments (such as the United Kingdom and France). Credit ratings are awarded based on international credit rating agencies' assessment of a government's credit worthiness, the strength and stability of its revenue base, and its ability to meet future debt repayments. These ratings demonstrate South Australia's fiscal sustainability, even in the eyes of cautious observers such as credit rating agencies.

Figure 24: Australian State Credit Ratings



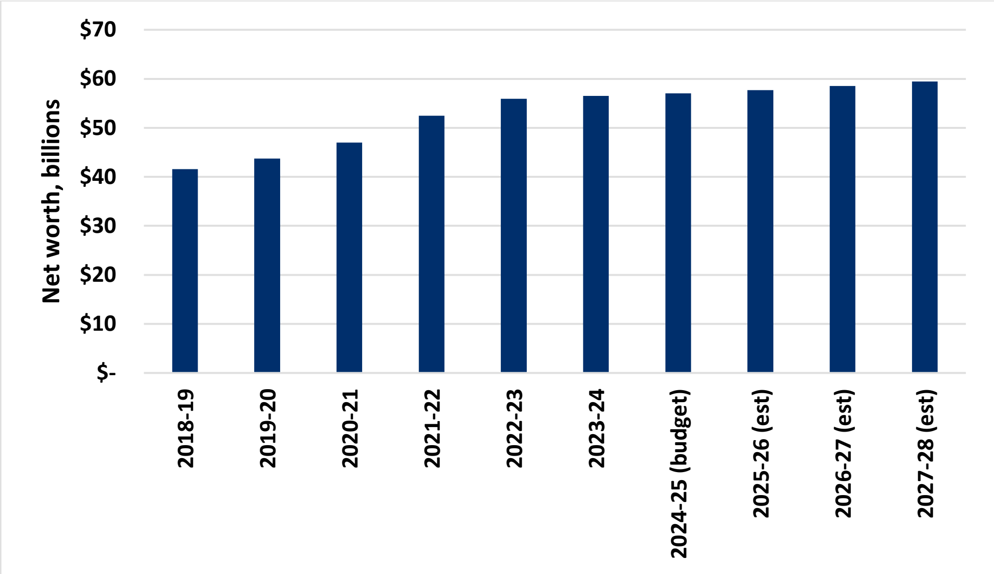
Source: NSW Budget papers

Lastly, a comprehensive understanding of the state government's financial circumstances should consider the government's full set of liabilities and assets, including non-financial assets and liabilities. According to this measure, the state

[7] South Australia State Budget 2024-25, Budget Paper #3, p.28.

government's overall net worth continued to grow throughout the pandemic period, and is projected to continue growth into the future (see Figure 25).

Figure 25: South Australia Government Net Worth, 2017 to 2027



Source: South Australian budget papers

Conclusion

Collectively, the economic and fiscal data reviewed in this report indicate that the South Australian economy has shown remarkable resilience in the face of domestic and global headwinds – including the pandemic, inflation, interest rate hikes, and geopolitical turmoil. South Australia has outperformed other states in economic growth, fiscal repair, and private sector investment and exports. As inflation and interest rates fall in the future, this strength will be consolidated. Ongoing macroeconomic improvement, in turn, will strengthen the state government's fiscal position through growing revenues.

South Australia's economic success, however, has not been reflected in the state government's economic footprint. State-level spending is disproportionately small: smaller than any other state. The state government underachieves in making the most of its potential tax base. Unfairly, the state government has dramatically reduced real compensation for its own staff – generating hundreds of millions of dollars in savings, that are now 'banked' by government in its much-proclaimed surpluses.

The state government has ample fiscal capacity to repair the historic damage that has been done to the real living standards of the state's public sector workforce. The sharp decline in real wages for state public sector workers stands in sharp contrast to South Australia's economic growth and labour market strength, and the rapid return to surplus of the state government. The wage suppression experienced by state public sector workers, the worst in Australia, is a moral and economic failure – all the more so given the exemplary service those state public servants provided during the pandemic. Restoring real purchasing power for these workers will reinforce continued economic growth in the state (by enhancing household financial stability and consumer spending), address challenges in recruitment and retention in state public services, and right a historic wrong that these workers and their families have experienced.