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FISCAL POLICY BULLETIN

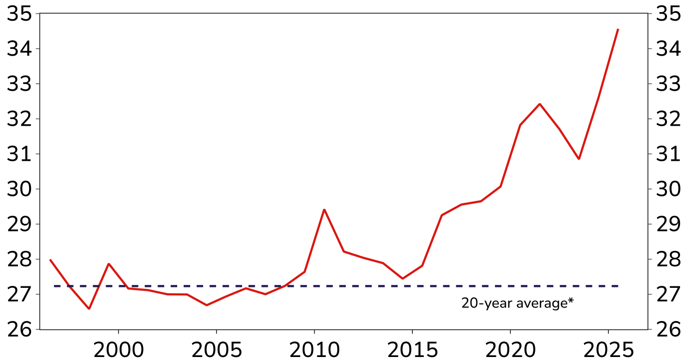
Public spending generates a record 35% of domestic output and 40% of total employment

Key points

- Australia is undergoing one of the largest structural changes in modern history, comparable in scale to the mining investment boom of the 2000s. Public spending now generates a record 35% of domestic output, around 7ppts higher than a decade ago, and is linked to nearly 40% of total employment, up around 9ppts over the same period. All else equal, the rising public share of activity accounts for around 1.3m additional jobs.
- The expansion in public spending has lifted output and employment across a broad swathe of the economy, not just the nonmarket sector. The median public share of output across market industries has risen from around 17% to 25% over the past decade, underscoring the scale of indirect spillovers. It is most pronounced in construction and some services sectors.
- This shift is not inherently negative. However, it carries important macro implications. Rising demand from the public sector has reduced the share of these industries' labour and capital available for private-sector purposes. At times, this has led to capacity pressures and higher inflation in those industries.
- The near-term evolution of the public sector's economic footprint will depend on the timing of construction project completions and the extent to which programs such as the NDIS continue to expand.

Output driven by public spending

% share of total nominal GVA



Source: ABS, Macrobond, Westpac Economics
*20-year average to the 2015FY

As Big as the Mining Boom: The Rise of the Public Economy

Pat Bustamante
Senior Economist, Westpac Group

Governments influence economic outcomes through a range of channels, including income support and transfers to specific groups, regulation and deregulation of markets, and the provision of free or highly subsidised services such as health, education and infrastructure.

We focus on the provision of public services and assess how the recent expansion in public spending is reshaping the broader Australian economy. Using structural relationships derived from input–output tables (see Appendix A for methodological details), we identify not only the sectors directly engaged in delivering public services, but also the industries that supply them with intermediate inputs. We adjust spending to account for imports, which were particularly significant during the mining investment boom but do not directly reflect domestic production. This framework allows us to capture both the direct and indirect economic effects of public spending.

For example, higher spending on public housing directly increases demand for construction services, while indirectly lifting activity in related industries such as professional services and the rental of construction-related equipment.

To the best of our knowledge, published Australian analysis has largely concentrated on the direct effects of increased public spending, with the indirect, often sizeable, impacts receiving much less attention. Taking this broader perspective provides a more complete picture of the government's economic footprint and its call on the economy's resources. Building on earlier work we show that the structural change associated with the recent expansion in public spending is comparable in scale to the mining investment boom of the 2000s, with important implications for forecasters and policymakers.

The Quiet Structural Shock Reshaping the Australian Economy

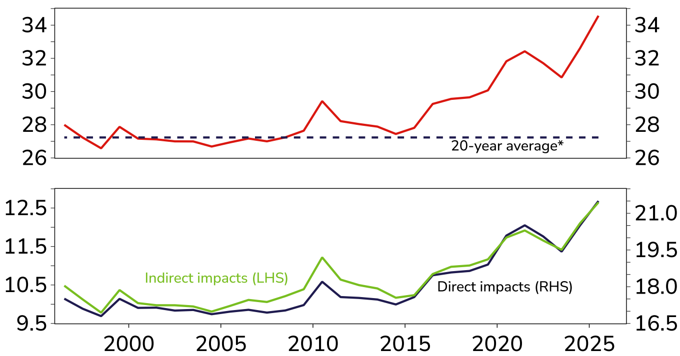
In modern market economies price signals largely determine what gets produced and how resources are allocated. But large demand and technology shocks can trigger persistent structural change, rapidly altering what is produced, which skills are in demand, and where capital and labour ultimately settle.

The mining investment boom is a clear example. In response to a sustained rise in global commodity prices and the structural rise of Chinese demand, the mining sector expanded its capital stock (machines, vehicles, roads, rail and port infrastructure) by roughly a factor of four, an unprecedented increase. Delivering this expansion required substantial inputs from other industries, particularly construction and professional services. While investment eventually unwound, the resulting capital deepening lifted mining output on an ongoing basis and left a lasting imprint on activity and employment across mining-related industries.

A similar process has been unfolding through the expansion of public spending, which started a decade ago and accelerated sharply during the pandemic. Persistently elevated public spending on expanded government programs since then has pushed the public footprint even higher (see chart below). Higher government outlays have directly increased domestic output (ex-imports) in the 'government dominated' sectors (health, education and public administration) as well as in construction. They have also generated increases in employment and output in a surprisingly large range of complementary market industries, such as medical manufacturing, utilities and information technology.

Output driven by public spending

% share of total nominal GVA



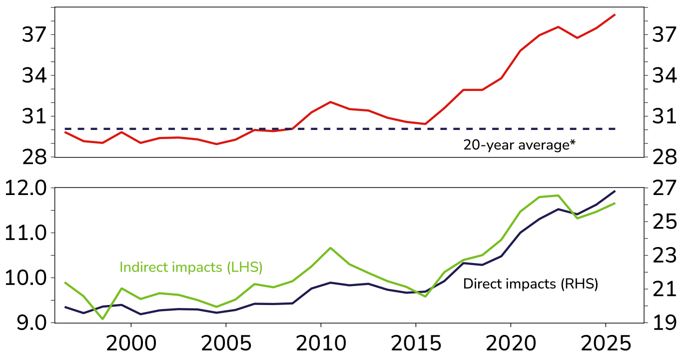
Source: ABS, Macrobond, Westpac Economics
*20-year average to the 2015FY

Public spending now accounts for a record 35% of total domestic output (or gross value added), around 7ppts higher than a decade ago and well above its average over the two decades to FY2015. This increase in the public footprint is comparable in scale to the mining investment boom, when mining's share of output rose by a similar magnitude over the decade to FY2012 (see RBA, 2013).

Using structural relationships from input–output tables, we can also estimate the labour market impacts of the growing public footprint. We find that close to 40% of total employment is now linked to public spending, almost 9ppts higher than a decade ago. This shift is unprecedented and represents a substantially larger labour market reallocation than occurred during the mining investment boom, owing to the far greater labour intensity of public services relative to mining.

Employment driven by public spending

% share of total employment



Source: ABS, Macrobond, Westpac Economics
*20-year average to the 2015FY

How Government Now Drives Large and Growing Parts of the Economy

Public spending reaches far beyond the non-market sector. While most services are delivered through health, education and public administration, government demand also drives substantial activity in construction, professional services, manufacturing, transport, utilities and ICT.
Over the past decade, the public footprint across industries has expanded. The median public share of output across market industries rose from around 17% to around 25%. The most striking change has occurred in construction. Close to 40% of total construction output and employment is now publicly generated (public share 38%, +12ppts). Budget documents indicate that the infrastructure construction pipeline is expected to plateau at an elevated level. This could see the public share of construction output gradually decline over time and help alleviate some of those capacity constraints that have plagued the sector.

Significant increases in the public share of output are also evident in manufacturing (37%, +12ppts) and ICT (28%, +11ppts). In several market industries, including construction, manufacturing, administrative services and arts & recreation, public spending now accounts for a record 35–40% of total domestic output. Surprisingly, in the health sector the public share of output has declined by around 1ppt, potentially reflecting policy shifts related to private health insurance.

Reflecting this expansion, public spending has generated an estimated 2.3 million additional jobs over the past decade, around 40% of which are in market sectors. Around 1.3 million of these jobs are attributable to the increased public share of economic activity, with the remainder driven by population growth. The breadth of these effects highlights that public spending influences labour market outcomes well beyond the nonmarket sector, with important implications for capacity, skills demand and wage dynamics.

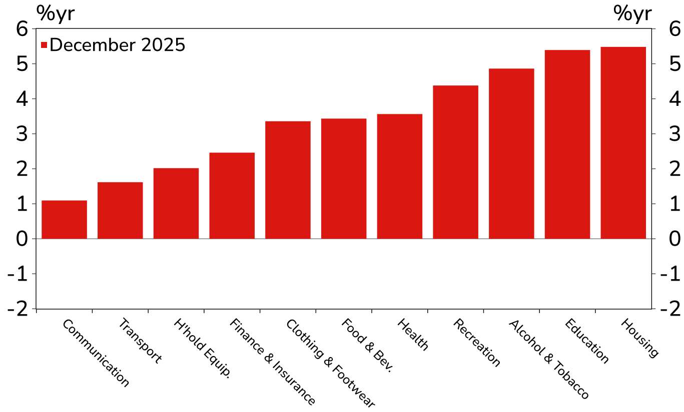
A Structural Shift with Macro Consequences

The expansion of the public sector is not inherently negative; rather, it reflects a greater share of the economy's resources being directed toward the provision of public services. These are generally services society values but which the market does not supply enough of on its own. The undersupply arises because there are benefits and other spillovers to these services that cannot easily be recouped through prices, and this provides the rationale for government provision. Childcare is a case in point. Subsidised childcare increases flexibility and enables higher labour supply. This has coincided with the substantial gains in participation observed over recent decades, especially for women, though it is unlikely to be the full explanation for that trend.

That said, the scale and persistence of the public sector's expansion carry important macroeconomic implications that cannot be ignored.

Firstly, public spending is now accounting for a record share of activity and employment across multiple industries, contributing to capacity constraints in sectors such as construction, health, education, and rental and real estate services. With less spare capacity available, these sectors have a reduced ability to accommodate an upswing in private demand without generating upward pressure on prices and wages. This is consistent with the persistence of inflationary pressures in housing related costs, construction inputs, and health services.

CPI Inflation by Category



Source: ABS, Macrobond, Westpac Economics

Secondly, higher public demand can reallocate scarce resources across industries, even where public services are not directly involved. Firms providing goods and services into public projects may be required to bid labour and capital away from other sectors, raising input costs more broadly across the economy.

What does this imply for trend growth in Australia?

When the expansion in public spending eventually plateaus as a share of the economy, trend productivity growth is likely to be marginally lower than otherwise, all else equal. The transition to a larger public footprint—through an expansion in the nonmarket sector's share of the economy—has weighed on measured economywide labour productivity. This largely reflects lower measured productivity in the nonmarket sector, in part due to wellknown measurement challenges. As the expansion in public spending plateaus, this transitional drag should dissipate, with any lasting effect on productivity operating primarily through compositional changes.

On our estimates, this compositional effect is modest, reducing economywide trend productivity growth by around 0.1ppts per year, consistent with our earlier analysis. But this must be weighed against the benefits of the completed infrastructure projects, especially those in the transport sector.

The key uncertainty is the timing of this plateau. Our base case is that the expansion in public spending peaks in the current 2026FY. However, there are risks. Elevated demand for government driven programs—such as the NDIS, childcare subsidies, and clean energy support measures—combined with stronger than expected revenues on the back of elevated commodity prices (including gold), could see the expansion persist for longer than currently assumed.

What happens next?

Looking ahead, budget projections suggest governments intend to provide higher levels of services on an ongoing basis, absorbing a larger share of the economy's resources to deliver them. This implies a structural reallocation of labour and capital toward public and public-adjacent sectors.

In contrast, the infrastructure pipeline now appears to have peaked at a high level, which could see the public share of construction output gradually decline. As seen during the mining investment boom, the resulting capital deepening should support higher productivity levels.

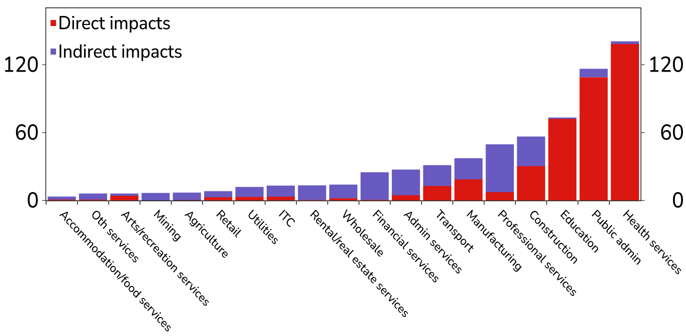
Taken together, the near-term evolution of the public sector's economic footprint will depend on the timing of project completions and the extent to which programs such as the NDIS continue to expand.

What's the bottom line?

Taken together, a larger and more persistent public footprint implies tighter near term capacity, a marginally negative, though uncertain in net terms, impact on trend productivity growth, and a significant reallocation of labour and capital across industries.

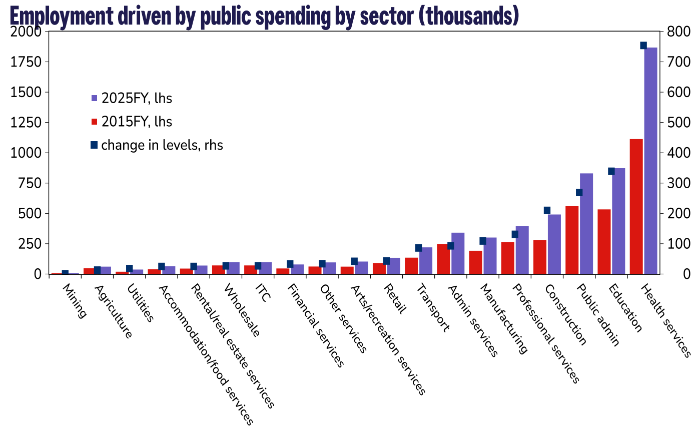
Output driven by public spending

Nominal GVA by sector, $billions, 2022-23 levels



Source: ABS, Macrobond, Westpac Economics

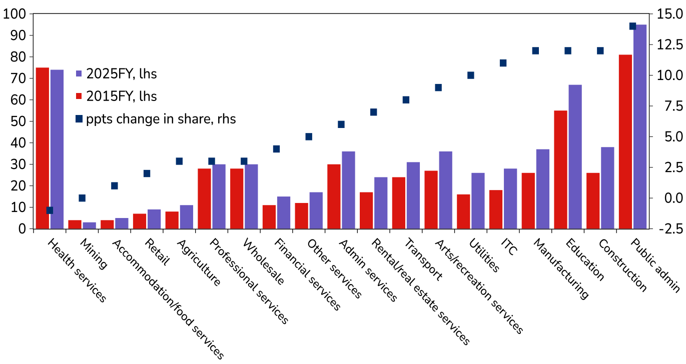
Employment driven by public spending by sector (thousands)



Source: ABS, Macrobond, Westpac Economics

Output driven by public spending by sector

% share of total sector GVA



Source: ABS, Macrobond, Westpac Economics

Appendix A: Methodology overview

We estimate the economic footprint of public spending using an input–output framework that traces how public demand flows through the economy.

Detailed ABS input–output tables show how industries produce goods and services and how these outputs are used by final demand, including government consumption and investment. We focus on government-related spending—such as government final consumption and public investment—and express this demand on a consistent, domestic, basic-price basis. This ensures the analysis captures domestic value added, rather than imported content, taxes, or margins. This distinction is particularly important during periods such as the mining investment boom, when investment was import-intensive and showed up in spending measures but not necessarily in domestic output.

Government spending is first allocated to the industries that directly produce the goods and services purchased by the public sector. This provides a measure of the direct impact, identifying where public demand is initially absorbed across the economy.

Industries supplying government demand also rely on inputs from other industries. To capture these supply-chain effects, we use the input–output relationships embedded in the tables to trace how government demand generates additional activity. This generates an estimate of the indirect impact, reflecting production in industries that supply inputs to those directly producing for government.

Combining these direct and indirect effects allows us to estimate the total contribution of government demand to domestic output and employment across industries.

Finally, extending the analysis over time using national accounts aggregates allows us to examine how sustained increases in public spending have altered the structure of the economy. This provides a basis for assessing how a larger and more persistent public footprint influences near-term capacity utilisation, inflation pressures, and the transmission of demand through the supply side of the economy.

Corporate Directory

Westpac Economics / Australia

Sydney
Level 19, 275 Kent Street
Sydney NSW 2000
Australia

E: economics@westpac.com.au

Luci Ellis
Chief Economist Westpac Group
E: luci.ellis@westpac.com.au

Matthew Hassan
Head of Australian Macro-Forecasting
E: mhassan@westpac.com.au

Elliot Clarke
Head of International Economics
E: eclarke@westpac.com.au

Sian Fenner
Head of Business and Industry Economics
E: sian.fenner@westpac.com.au

Justin Smirk
Senior Economist
E: jsmirk@westpac.com.au

Pat Bustamante
Senior Economist
E: pat.bustamante@westpac.com.au

Mantas Vanagas
Senior Economist
E: mantas.vanagas@westpac.com.au

Ryan Wells
Economist
E: ryan.wells@westpac.com.au

Illiana Jain
Economist
E: illiana.jain@westpac.com.au

Neha Sharma
Economist
E: neha.sharma1@westpac.com.au

Luka Belobrajdic
Economist
E: luka.belobrajdic@westpac.com.au

Westpac Economics / New Zealand

Auckland
Takutai on the Square
Level 8, 16 Takutai Square
Auckland, New Zealand

E: economics@westpac.co.nz

Kelly Eckhold
Chief Economist NZ
E: kelly.eckhold@westpac.co.nz

Michael Gordon
Senior Economist
E: michael.gordon@westpac.co.nz

Darren Gibbs
Senior Economist
E: darren.gibbs@westpac.co.nz

Satish Ranchhod
Senior Economist
E: satish.ranchhod@westpac.co.nz

Paul Clark
Industry Economist
E: paul.clarke@westpac.co.nz

Westpac Economics / Fiji

Suva
1 Thomson Street
Suva, Fiji

Shamal Chand
Senior Economist
E: shamal.chand@westpac.com.au

IQ
westpaciq.com.au

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