

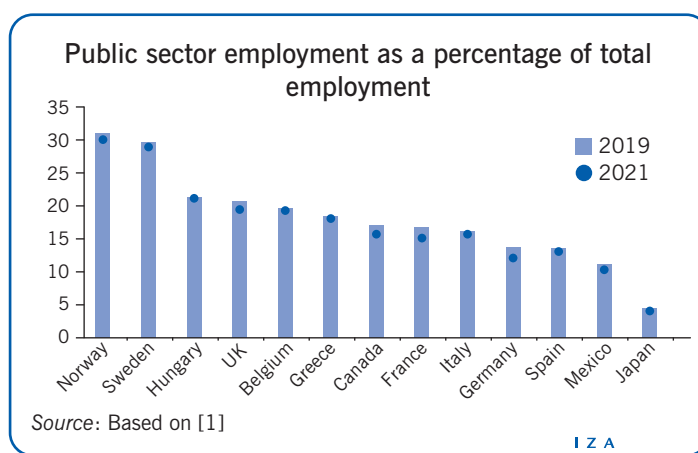
# The effects of public sector employment on the economy

## The size and wage level of the public sector affect overall employment volatility and the economy

Keywords: public sector employment, public sector wages, unemployment

### ELEVATOR PITCH

Public sector jobs are established by governments to directly provide goods and services. Governments may also choose to regulate the size of the public sector in order to stabilize targeted national employment levels. However, economic research suggests that these effects are uncertain and critically depend on how public wages are determined. Rigid public sector wages lead to perverse effects on private employment, while flexible public wages lead to a stabilizing effect. Public employment also has important productivity and redistributive effects.



### KEY FINDINGS

#### Pros

- ⊕ Expanding public sector employment can be an effective means of reducing unemployment in the short term, providing a stabilizing effect during recessions or in relatively disadvantaged regions.
- ⊕ Public sector employment can create demand in other sectors of the economy (e.g. private services).
- ⊕ Public sector employment supports equitable policies, such as encouraging employment and participation in the labor market of marginalized and/or disadvantaged groups.

#### Cons

- ⊖ Reducing short-term unemployment through expanding public sector employment can only occur when wages in the public sector are flexible according to productivity, rather than fixed.
- ⊖ Public-wage setting has aggregate implications; wages relatively unresponsive to productivity differences may lead to “crowding out” of private sector employment and increase unemployment, while wage compression may increase inequality.
- ⊖ High public sector employment may lower overall productivity in an economy that is reallocating resources from the private to the public sector, or from higher to lower productive sectors.

### AUTHOR’S MAIN MESSAGE

Flexible public sector wages that adjust to local productivity, or that are highly pro-cyclical, are crucial for public employment policy to generate positive effects on total employment. Geographically homogeneous or time-rigid (a-cyclical) wages instead exacerbate unemployment. Policymakers should thus promote flexible, pro-cyclical public sector wages. However, given the institutional structure of wage setting, it may be difficult to ensure flexible public sector wages, in which case policymakers should be aware that a policy that increases public sector jobs can generate higher total unemployment.