

# Policy and programme evaluation in a labour surplus economy

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EMPLOYMENT AND THE ECONOMICS OF JOB CREATION

# »»» Outline

- Employment as a policy objective
- Complementarity & trade-offs in policy implementation
- Surplus labour in economic thought
  - The dual economy model
  - “Price and value” in the labour surplus economy
  - Project appraisal: nominal vs accounting “shadow” prices
- Shadow wage estimation – WB methodology
- Distributional considerations
- Implications for evaluating policies and programmes
- Meeting the cost of the nominal wage premium



*“...This government is committed to the challenge of beating back unemployment...”*

Minister of Finance Enoch Godongwana  
Opening remarks, 6 Sept 2023



# Complementarities & trade-offs

- Growth – fiscal consolidation – public service delivery  
*Difficult trade-offs*
- Employment – poverty reduction – lower inequality  
*Complementary objectives*
- Present vs future consumption  
*Investment and saving*
- Technology as a social choice  
*Acemoglu & Johnson, Power and Progress*
- Implications for public policy – shifting the bias against the unemployed and the future

# »»» Unemployment & the shadow wage

*If workers are unemployed, the economy forgoes less than the nominal wage in giving the full-time employment. In the limiting case of total unemployment, the economy nothing by putting them to work. One therefore ought to use an accounting wage less than the nominal wage – zero in the limit – in evaluating the cost of unskilled workers in a surplus-labour economy...*

*(Stephen A Marglin, Value and Price in the Labour-Surplus Economy, 1976)*

*In the simplest case, the shadow wage rate aims at measuring nothing more than the opportunity cost of labor...In the case of severe unemployment that is expected to persist...the shadow wage would be zero and not whatever market wage is actually being paid...*

*(Squire & van der Tak, Economic Analysis of Projects, 1975)*

# »»» The shadow wage calculus

$$\left[ \begin{array}{c} \textit{Shadow} \\ \textit{wage} \\ \textit{rate} \end{array} \right] = \left[ \begin{array}{c} \textit{Labour's forgone} \\ \textit{marginal product} \\ \textit{at accounting prices} \end{array} \right] + \left[ \begin{array}{c} \textit{Net social cost} \\ \textit{of increased} \\ \textit{consumption} \end{array} \right] + \left[ \begin{array}{c} \textit{Social cost} \\ \textit{of reduced} \\ \textit{leisure} \end{array} \right]$$

$$SWR = m\alpha + (w - m) \left( \beta - \frac{d}{v} \right) + (w - m)\phi e \frac{d}{v}$$

- $m\alpha$  is forgone output at border prices
- $(w - m)$  is increase in consumption (net wage increase)
- $\beta$  is forex cost of increased consumption
- $\frac{d}{v}$  is a social value-adjusted distributional weight
- $\phi e$  is a socially adjusted reduced leisure factor

Source: Squire & van der Tak, *Economic Analysis of Projects*



# Distributional considerations



- Different shadow wage adjustments apply to different skills levels, regions, sectors...
  - If skilled labour is scarce, its marginal social cost might exceed the nominal wage
- Poverty & inequality reduction are complementary benefits of rising employment
- Wage protection & basic labour standards might raise the nominal wage above marginal productivity...
  - ...but over time productivity rises through learning by doing





# Implications for evaluation



- “Project appraisal” as an *ex ante* evaluation of the cost-benefit feasibility of infrastructure or development programmes:
  - Unskilled/semi-skilled labour should be “costed” at below-wage prices
- Programme evaluation *post facto* should similarly consider employment costs (or benefits) at shadow prices
  - But over-complex techniques that obfuscate results should be avoided
  - Treasuries are generally unsympathetic to shadow pricing
- Skilled or scarce expertise in public programmes is probably *more expensive* to the economy than its nominal cost
- The *general* case for a below-wage shadow price in the surplus labour economy is an argument for a *general subsidy for low-wage employment*, or a negative income tax





# »»» What about the cost?

- "Shadow pricing" does not in itself determine how actual costs should be met...
- Project appraisal is about the *choice between projects or programmes*,
  - *Not about how they are accommodated within budgets or how costs are recovered from users*
  - *Or how costs are shared between the state and market*
- It is about "technology choice" (*Acemoglu & Johnson*) –
- So there are implications for sectoral policy priorities and design of incentives, and for procurement policies and evaluation criteria
  - *Preferential procurement as currently practiced leaves little room for prioritizing unskilled and semi-skilled employment*
- Redistribution within the tax-spending system can shift the bias towards employment
  - Through public employment programmes
  - More broadly across the income-generating economy through social security and a basic wage subsidy



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