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Social Entrepreneurship: whose responsibility is it anyway?

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The false premises of Social Entrepreneurship

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“Everyone has the right to work, to free choice of employment, to just and favorable conditions of work and to protection against unemployment.” The United Nations Declaration of Human Rights, September 24 1948.

“The political revival of free-market ideology in the 1980s is, I presume, based on the market’s remarkable ability to root out inefficiency. But not all inefficiencies are created equal. In particular, high unemployment represents a waste of resources so colossal that no one truly interested in efficiency can be complacent about it. It is both ironic and tragic that, in searching out ways to improve economic efficiency, we seem to have ignored the biggest inefficiency of them all.” Alan Blinder (1987: 33)

1. Introduction

Unemployment rates in almost all OECD economies have risen and persisted at higher levels since the first OPEC shocks in the 1970s. Since the end of World War II, most OECD economies have gone from a situation where the respective governments ensured there were enough jobs to maintain full employment to a state where the same governments use unemployment to control inflation. Full employment has been abandoned by governments in these economies. In the midst of the on-going debates about labour market deregulation, privatisation and welfare reform, the most salient, empirically robust fact that has pervaded the last two decades is that the actual GDP growth rate has rarely reached the rate required to achieve full employment (Mitchell, 2001a, 2001c). The pro-market policy agenda has failed to restore full employment.

Over the last 25 years, the political system, abetted by business and academic economists (for example, Layard, Nickell and Jackman, 1991; OECD, 1994), has relinquished responsibility for reducing unemployment and has, instead, shifted the blame to other groups in the economy. The supply side shift initially targeted the trade unions as the scapegoats after the wages breakouts of the mid 1970s and early 1980s. As evidence accumulated to show labour costs were not influential, the emphasis shifted to explaining unemployment in terms of the shortcomings of the unemployed themselves. The unemployed allegedly lack competitive skills or exhibit attitudinal deficiencies. Alleged external constraints imposed by the global currency markets are also invoked to explain why governments can afford only minimal financial outlays on labour market policies and general welfare provision (see Burgess and Watts, 2001; Mitchell, 2001a). However,
despite a raft of supply-side policies aimed at redressing these “causes”, unemployment persists at high levels (Mitchell, 2001b).

Watts and Mitchell (2000) show that the costs of unemployment are substantial and dwarf the costs of the so-called microeconomic inefficiencies, which are used to justify the supply-side policy agenda. The high unemployment arising from the restrictive fiscal and monetary policy stance has also placed stress on the welfare system to the point that an underclass has emerged in Australia (Johnson and Taylor, 2000). The same pattern is found in most OECD countries. Driven by a perceived breakdown of the welfare system, the Social Entrepreneurship movement (hereafter SEM) has grown as an “innovative approach for dealing with complex social needs” (Johnson, 2001: 1), and reflects the rising, but misplaced faith that private market-based resource allocations can deliver efficient outcomes.

In this paper we outline what we term as the false premises of the SEM. Initially, we focus on unemployment and argue that the advocates of SEM appear to conform to this neo-liberal supply-side orthodoxy. Authors like Botsman and Latham (2001) and Pearson (2001), who attempt to develop an intellectual underpinning to buttress the pragmatic, on-the-ground activities characterised by the SEM, fail to understand the causes of mass unemployment and uncritically accept the structural explanation. Once we understand how full employment can be achieved a substantial number of the problems taken as given in the SEM agenda disappear.

We also analyse the acceptance in the SEM literature of the alleged constraints on government spending. Latham (2001: 40), for example, declares “whether we like it or not, the days of tax-and-spend policies have ended.” By adopting this position, the SEM again conforms to the neo-liberal paradigm. We argue there is no financial constraint on government spending. The only constraint is real (that is, government spending is limited only by what real goods and services the private sector can sell in return for government money). That understanding opens up an entirely different set of options, which are closed to proponents of SEM. These options undermine a significant part of the SEM agenda.
Beyond these macroeconomic issues, the paper argues that it is inappropriate to apply models of risk and entrepreneurship to the provision of welfare services. Fundamental issues of consumer sovereignty, the role of the market, the identification of stakeholders, and the existence of externalities cannot be solved and the SEM claims for efficiency cannot be made. Moreover, the SEM proposals endanger the long-standing status of universal rights, which is at the heart of a socially cohesive society.

2. The abandonment of full employment and the Welfare State

Figures 1(a) and 1(b) provide an historical view of the major labour force aggregates (labour force, total employment and the unemployment rate). Prior to the Great Depression, the role of government in stabilising economic fluctuations was non-existent. The market system was highly unstable with the unemployment rate rarely below 5 per cent. Despite the severe recession in the 1890s, economists of the day believed that mass unemployment was impossible because the market would always adjust prices to ensure full employment. The Great Depression taught us that free market policies, like cutting wage rates, did not solve mass unemployment and that the capitalist system was prone to lengthy periods of high unemployment if left unassisted by injections of net government spending. From the end of the War until the mid-1970s, governments assumed the responsibility for maintaining full employment and they used monetary and fiscal policy to maintain levels of demand sufficient to ensure enough jobs were created to meet the demands of the labour force, given labour productivity growth. Unemployment rates were usually below 2 per cent throughout this period (see shaded area of Figure 1(a)).

Governments also developed the Welfare State in this period recognising that the state had an obligation to provide security to citizens. The welfare state “conveyed a notion of society's collective responsibility for the wellbeing of its citizens” (Jamrozik, 2001: 15). It was a definitive break with the poor law tradition, dispensing with the 'deserving' and 'undeserving' poor dichotomy, and replacing it with the provision of benefits as a right of citizenship (Timmins, 1995: 21; Marshall, 1973, 72-74). Transfer payments were provided to attenuate market outcomes that disadvantaged some individuals and groups. Services were provided by a professional public sector, and were standardised to provide, as far as possible, an equivalent level of service to all citizens. Rules and regulations
governed all aspects of service provision, including the right to benefits, the level of service provided, equality of opportunity provisions, and appeal procedures. In addition, privacy provisions ensured the security of personal information. The lessons of the Great Depression were thus clearly absorbed and the Welfare State embodied the emergence of social justice as a legitimate government responsibility alongside the maintenance of full employment (Timmins, 1995: 48).

Figure 1 An historical view of labour market performance in Australia

![Unemployment rate, 1861-2000](image1)

![Labour force and employment, 1944-2000](image2)


This welfare consensus in Australia started to unwind in the early 1970s. The major shock came in 1974, when the first OPEC oil price rise led to wage-price pressures and accelerating inflation in most OECD countries. The inappropriate restrictive policy stances that followed created the previously unseen juxtaposition of high inflation and high unemployment – or stagflation. The economic dislocation provided the conditions for a paradigm shift in macroeconomics. This was driven by the resurgence of pre-Keynesian antagonism to government intervention in markets that had been simmering in academic departments and in corporate boards. The shift in sentiment had nothing to do with what we now call globalisation. The rejection of the Keynesian orthodoxy was not empirically based. It “was, instead, a triumph of a priori theorising over empiricism, of intellectual aesthetics over observation and … of conservative ideology over liberalism.” (Blinder, 1988: 278). There are two major dimensions to this paradigm shift, both of
which are relevant to the critique of the SEM proposals: (a) the natural rate of unemployment hypothesis, (b) the alleged government budget constraint.

The Keynesian notion of full employment, defined by Vickrey (1993) as “a situation where there are at least as many job openings as there are persons seeking employment” was largely abandoned with development of the natural rate of unemployment (NRU) hypothesis (Friedman, 1968; Phelps, 1967). The NRU concept is more commonly represented by the term Non-Accelerating Inflation Rate of Unemployment, or NAIRU (Modigliani and Papademos, 1975) although there are theoretical differences between the two, which are unimportant here. The NRU hypothesis posits that policy attempts to maintain low unemployment would ultimately only generate ever-accelerating inflation and was the lynchpin of the Monetarist attack on Keynesian demand management. Full employment was redefined in terms of a unique unemployment rate where inflation was stable - the NRU. The NRU was allegedly determined by supply variables and was invariant to demand management tools. A free market would always generate this unemployment rate and, by definition full employment. The only legitimate role remaining for government was to facilitate free market operations by dismantling regulation (like minimum wages, social security payments) and reducing trade union power. The NRU as a model of full employment bears no relation to the Keynesian notion where there are as many jobs as those who want them. Mitchell (1987) noted that some Australian economists claimed that the full employment unemployment rate was around 8 per cent during the 1980s.

The Monetarists seized the political initiative after the 1974 oil shock by falsely linking the supply-side inflation (driven by oil prices) with the Post-War Keynesian full employment policies. The NRU hypothesis simply rehashed the pre-Keynesian theory that had been discredited during the Great Depression. However, like in any paradigm change, the zealots ensured that any Keynesian remedies proposed to reduce unemployment were met with derision from the bulk of the economics profession who had embraced the NRU concept and its policy implications. As a result, policy makers were convinced that only microeconomic changes could reduce the NRU, should it be at levels considered unacceptable, and the policy debate became increasingly concentrated
on deregulation and privatisation (Thurow, 1983). Unemployment persisted at unacceptably high levels.

The resurgence of this pre-Keynesian theory in Australia was first noticed in the 1974 Federal Government Budget where there was a sharp rejection of the use of budget deficits to solve the rising unemployment problem. Essentially, monetarist-inspired policy advisors failed to understand the causes of the inflation and chose to ignore the fiscal role the Government (as the currency issuer) has to play for full employment to be sustained. Monetary policy developments also reflected this paradigm shift. The Reserve Bank of Australia (RBA) has been significantly influenced by the NAIRU concept (Mitchell, 2001c, 2001a). The RBA uses interest rate increases to dampen demand and control inflation even though this worsens unemployment. Public statements by the RBA confirm that they believe in the long-run that output and employment growth are only determined by “the economy's innate productive capacity, … [which] … cannot be permanently stimulated by an expansionary monetary policy stance … [and] … [the RBA therefore] … does not seek to engineer growth in the longer run by artificially stimulating demand.” (Edey, 1999) The NAIRU approach has led to the chronic unemployment. A substantial body of literature shows that the NAIRU concept is fatally flawed and does not provide a suitable framework for policy analysis (for more evidence and analysis see Mitchell and Carlson, 2001). Figure 1(b) shows that since 1975 total employment has never been sufficient relative to the available labour force. In Section 4.1 we expand on the fiscal policies that are required to ensure that full employment is sustained.

Accompanying the monetarist attacks on macroeconomic policy were concerted attacks on the supplementary institutions – the industrial relations system and the Welfare State. The attacks were a mixture of misplaced perceptions of fiscal necessity and ideological zealotry. The Workplace Relations Act (1996) pushed the industrial relations system further into the common law domain, reflecting the view that labour hiring is a simple commodity exchange and therefore suitable for contractual specification. Importantly, the contractual responsibilities of individuals and the rights to redress against individuals have become a central part of the new industrial system with trade union influence being severely constrained (see Carlson, Mitchell and Watts, 2001). In terms of welfare provision, the new market-based approach construes individuals as being accountable for
their own economic outcomes and rejects the possibility of systemic failure. The neo-liberal welfare rhetoric now claims that individuals have to accept responsibility, be self-reliant, fulfill their obligations to society, etc. (Latham, 2001c). Rees (1994: 184) commenting on the debate in Australia during the 1980s and 1990s said

Down the ladders of social strata were some obvious deviants, the convicted offenders, the long-term unemployed, those groups who were marginal because they were not economically productive … In an almost explicit reassertion of the old Poor Law principles, certain groups could be labeled morally unworthy and made to pass a variety of tests if they were ever to be redefined as socially acceptable.

Government welfare policy changes have reflected this rhetoric and have introduced alleged responsibilities to counter-balance existing rights while promoting the movement from passive to active welfare (Burgess and Watts, 2001). It is worth noting that benefits were not unconditional under the Welfare State. There have always been responsibilities attached to the receipt of welfare benefits. For example, the unemployed always had a responsibility to seek employment. Under the new regime, these responsibilities have been accelerated and now the rights of citizens has been replaced by compulsory contractual relationships with the government outlining behavioural criteria as a condition of the receipt of welfare benefits – citizens have become customers.

What is striking is that as a policy agenda, monetarism and its subsequent neo-liberal manifestations (sometimes called economic rationalism) has been a stark failure. Figures 1(a) and 1(b) show that most basic requirement that policy maintains output growth sufficient to fully employ the available workforce, has not been met since 1975. On average there have been 11.1 unemployed persons per unfilled vacancy since June 1974. Mitchell (2001a) suggests that “the unemployed cannot search for jobs that are not there!” Income inequality and poverty rates have also worsened (Watts, 2001).3 Notably, Modigliani (2000: 3), the father of the NAIRU concept, now says

Unemployment is primarily due to lack of aggregate demand. This is mainly the outcome of erroneous macroeconomic policies… [the decisions of Central Banks] … inspired by an obsessive fear of inflation, … coupled with a benign neglect for unemployment … have resulted in systematically over tight monetary policy decisions, apparently based on an objectionable use of the so-called NAIRU approach. The contractive effects of these policies have been reinforced by common, very tight fiscal policies (emphasis in original)
Not all countries fell into this neo-liberal mediocrity. Several countries did not abandon Keynesian policies and maintained their Welfare State provisions. Ormerod (1994: 203) writes:

… the countries which have continued to maintain low unemployment have maintained a sector of the economy which effectively functions as an employer of last resort, which absorbs the shocks which occur from time to time, and more generally makes employment available to the less skilled, the less qualified. There is, of course, a cost associated with this concept, but it is a cost which societies with a high degree of social cohesion have been willing to pay.

Elsewhere, there have been several reactions to the growing incomes disparities and persistence of unemployment since the 1970s. In terms of this paper, the Third Way movement emerged against the background of growing resistance to this neo-liberal agenda, complete with a new critique of the Welfare State. It characterised the Welfare State as being undemocratic, bureaucratic, with alienating and inefficient institutions and “perverse consequences that undermine what they were designed to achieve” (Giddens, 1998: 112-113). Reconstruction of welfare is to be achieved through social entrepreneurship; social partnerships between the public, social and business sectors, harnessing the “dynamism of markets but with the public interest in mind” (Giddens, 1998: 100; Latham, 2001c: 21).

We now turn to an examination of this viewpoint as a basis for arguing in the later sections that, like the neo-liberal paradigm, the SEM is based on false premises with respect to the fiscal role of government and full employment.

3. Social Entrepreneurship and the Third Way

3.1 Overview of Social Entrepreneurship

What is social entrepreneurship? While it is hard to define precisely, it is best understood within the context of a broader politico-economic movement known as the Third Way (Giddens, 1998; Botsman and Latham, 2001). According to the Third Way logic, the Keynesian Welfare State is unsustainable in the increasingly globalised world economy. Latham (1998) claims that globalisation has led to entrenched unemployment and growing economic insecurity, which in turn has promoted a rising demand for welfare services. Globalisation has also undermined the capacity of government to tax and hence
fund the welfare state. There is a sense that the government is now helpless. Section 4 will show that this view is erroneous.

Despite the burgeoning literature on the topic, definitions of social entrepreneurship differ (see Johnson, 2001 for a comprehensive survey). The Canadian Centre for Social Entrepreneurship (CCSE) defines social entrepreneurship as “a variety of initiatives which fall into two broad categories. First, in the for-profit sector, social entrepreneurship encompasses activities emphasizing the importance of a socially engaged private sector, and the benefits that accrue to those who “do well by doing good”. Second, it refers to activities encouraging more entrepreneurial approaches in the not-for-profit sector in order to increase organizational effectiveness and foster long-term sustainability.” Fowler (2000) extends this by identifying three layers of social entrepreneurship: (a) integrated social entrepreneurship where profit making corporate activity also produces social benefits, (b) reinterpretation involving cost-cutting or revenue diversification of the non-profit organisation, and (c) complementary social entrepreneurship where non-profit organisations undertake profit-seeking activities to cross subsidise their social mission.

In this paper we ignore the for-profit sector activities, commonly aggregated as corporate social responsibility. There are many contentious issues associated with this aspect of social entrepreneurship including the shifting global distribution of production, the dichotomous behaviour by large global companies in production and marketing, the role of consumer sovereignty, and, ultimately, whether corporate responsibility can be consistent with the logic of capitalist accumulation. These are left for another paper.

In terms of the non-profit sector, there are some common threads in the SEM literature including the structuralist interpretation of unemployment, the acceptance of constraints on fiscal activism, the central role accorded to risk-taking entrepreneurial behaviour, the emphasis on individual independence, and the importance of community development. We briefly examine each in turn.

3.2 Unemployment

In section 2, we outlined the decline of Keynesian policy and abandonment of full employment. The neo-liberal orthodoxy claimed that unemployment was not due to demand-deficiency but rather supply-side failures. Abbot (2000), for example, says “The
role of the welfare system in creating and sustaining unemployment has been one of the
great unmentionables of Australian public policy debate.” Noted SEM advocates also use
these neo-liberal constructs when referring to unemployment. For example, Pearson
(2001: 137-38) says “It goes without saying that structural unemployment has challenged
one of the central assumptions of a welfare system devised in the old economy. Rather
than unemployment being a temporary condition, where the state guaranteed income
maintenance for people moving between jobs, it has become a permanent condition for
increasing numbers of Australian breadwinners and their families.” Latham (2001c: 115)
says “The old world of full employment, steady career paths and predictable family life
came to an end. Globalisation and the Information Revolution have produced a new
society – full of possibilities, but also full of threats. The welfare state is yet to adjust to
these changes. It continues to be based more on the old world than the new. This is why
its original goals are no longer being met.”

There is no recognition that unemployment is a systemic failure. Taken together with the
related arguments by the SEM on individual independence, it hard to differentiate the
SEM characterisation of unemployment, albeit somewhat blurred, from that of the
prevailing supply-side orthodoxy. An impression is conveyed that government fiscal and
monetary policy is impotent. This is also the key conclusion of the natural rate of
unemployment hypothesis. We return to this in Section 4.1.

3.3 Fiscal constraints
A common theme in the SEM is that Keynesian demand management policies are no
longer possible because as Latham (2001: 40) declares “whether we like it or not, the
days of tax-and-spend policies have ended.” Further, Latham (1998: 31) claims that
“Labor’s agenda is particularly disadvantaged by what has become known as the fiscal
crisis of the welfare state – that is, the gap between the revenue raising capacity of an
internationally competitive taxation regime and the public outlays required to fund social
democratic programs and the local costs of economic adjustment.”

This argument then logically motivates a model of alternative welfare provision. To get
more from less, the SEM argues you need to deliver services more efficiently. The term
is borrowed from orthodox microeconomics and refers to the highest output at the
minimum per unit cost. The costs and benefits are usually computed in private terms because they are the magnitudes arbitraged by the private market place. Hence they ignore the external or social externalities (positive and negative) that arise from market activities. The next logical step is to argue that privatised entrepreneurial activity is the best model of resource allocation because according to orthodox theory of the firm, it is the most efficient. In this way, with dwindling government funds, the welfare sector can achieve the best outcomes by pursuing market-based strategies. In Sections 4.2 and 4.3, respectively, we challenge the acceptance of fiscal constraints and the validity of using the orthodox resource allocation model in the welfare context.

3.4 Entrepreneurship

Within the literature on social entrepreneurship for non-profit organisations, there appears to be less emphasis on the social and more on the entrepreneurial activities and abilities of individuals (Dees, 1998; Henton et al, 1997). Dees (1998: 2) considers the social entrepreneur to be “one species of the genus entrepreneur.” The emphasis on the commercial model is also found in the Directional Statement of the Australian Social Entrepreneur Network (SEN, 2001), which says that “Social entrepreneurs are people who possess both an innovative idea for social change and the entrepreneurial drive to achieve its realisation” and “they use best practice commercial, management and risk taking skills to create solutions to social problems”

This raises the important question of whether the entrepreneurial characterisation used by the SEM can carry over from economics into a social or collective context. In the economics literature, models of entrepreneurship in the context of the theory of the firm and market structure are well developed. There are major problems, however, recognised to some extent by Dees (1998), in applying these to activities that pursue a social mission rather than wealth creation. For the management of a private firm adopting risk and return strategies to maximise the wealth for their owners, the market serves to discipline and assess their activities. According to orthodox theory, the market will continue to finance activities that add value. The failure of a firm reflects the market’s assessment that it has not been able to offer consumers a product at a price consistent with the customers’ valuations. While the literature is not without controversy, the concepts are
simple enough and rely on consumer sovereignty to give effect to the market discipline. In Section 4.3 it is argued that in the case of the social entrepreneur there is a major problem in identifying a relevant market and consumer sovereignty does not exist. Accordingly, the claims for efficiency cannot be made.

3.5 Individual independence

According to the advocates of social entrepreneurship, “passive welfare” produces “dependence” which “disempowers” and causes “social exclusion” (Pearson, 2001: 135). Thus the SEM argues that welfare reform must establish incentive structures to avoid individuals becoming welfare dependent. There is some confusion in this literature over the cause of the alleged dependency. Giddens (1998: 114) argues that the dependency problem arises because people act rationally to take advantage of the opportunities offered by the welfare state. However, Latham (2001b: 117) declares it is “anything but a rational state of mind. Logic and responsiveness to financial incentives are replaced by an irrational and negative way of life.” This in turn is not consistent with the insistence by Botsman (2001b: 93) that “progressive economists and thinkers must support rationing areas of social spending that promote dependency and social inequality.”

Importantly, specific SEM proposals represent a major break from the rights-based welfare provision of the Post-War Welfare State and a shifting of the responsibility from government to the individual. The necessity of reintegrating the allegedly, welfare dependent underclass into the community provides the justification for “mutual obligation” and the concept of “no rights without responsibilities” (Latham, 2001a: 258). Social entrepreneurship aims to dismantle the ‘lopsided patron/client approach’ of the Welfare State and “level out these relationships” (Latham, 2001b: 119). These new relationships would be achieved through case management. Specifically, welfare payments should become a weapon to force recipients to obey directives in regard to most aspects of their lives. Citing the importance of the home environment to educational outcomes, Latham (2001d: 49-50) proposes that parents accept responsibility to be “effective educators in the home”. This role would be mandatory for parents on income support and refusal to cooperate with parenting programs should result in a reduction of income support, plus reporting to the relevant child protection authorities. In other words,
rectifying deficiencies in the education system is perceived as an individual, rather than a social, responsibility.

Welfare payments also would become conditional on recipients agreeing to a raft of conditions including “improved personal health habits, the care and maintenance of public housing accommodation, and good parenting practices” (Latham, 1998: 219). None of these conditions would be imposed on other members of society. In addition to compliance with these types of conditions, Latham (1998: 227-231) proposes that welfare recipients repay the assistance they receive in similar fashion to student repayments associated with the Higher Education Contribution Scheme (HECS). Further, he suggests the introduction of Income Security Accounts (ISA) to enable individuals to protect themselves from future economic uncertainty. The money accumulated in these accounts could be used for education or retraining, child care costs and supplementary income support. In Section 4.4 the importance of systemic constraints and a reinterpretation of dependence, largely ignored by the SEM will be outlined.

3.6 Communities and resource pooling

The SEM also proposes that the delivery of welfare services be facilitated through local, community-designed and implemented solutions accompanied by a system of place management (see Botsman and Latham, 2001). The main role of government is to assist in the development of social entrepreneurs, encourage entrepreneurial projects and to “devolve its resources and service delivery to place management models” (Latham, 2001b: 130). The aim is to break the government-individual nexus and to provide taxpayer funds to subsidise private entrepreneurial concerns. As we will see this raises major questions about accountability and efficiency monitoring.

What are pooling arrangements? Pooling arrangements, wrongly described by Botsman and Latham (2001) as ‘place management’ involves the pooling of government allocations for health, education, housing, training and employment (Botsman, 2001a: 71). The community becomes the decision-making unit that allocates the funds. All social security payments, currently paid to individuals, would be pooled “to invest in community cooperatives that allocate a living wage for community employment”
(Botsman, 2001a: 71). Place management is more accurately used to describe ‘whole of government’ coordination of responses to particular social problems in specific locations.

The community-based approach is extended into other areas like education. Botsman and Latham (2001) advocate the establishment of community schools, with independent boards. They also argue for five types of universities, ranging from free universities for the poor, to institutions charging fees. This arrangement strongly suggests an aspect of “less eligibility” which is likely to accelerate the move to a two-tier education system (Jamrozik, 2001: 59). Latham (2001d) also proposes the establishment of Lifelong Learning Accounts (LLA) by individuals and families to pay for education and training.

In conclusion, there are marked similarities between the conceptions of the individual and her/his interaction with the economic system and the state held by the SEM and those which pervade the orthodox economic theory characterised by the natural rate hypothesis. We now analyse the false premises in the SEM that arise from this association.

4. A critique of Social Entrepreneurship

4.1 The causes of unemployment – the first false premise

The characterisation of the unemployment problem as a problem of the individual rather than systemic failure represents the first false premise of the SEM. Beveridge (1909: 3) long ago said “the enquiry must be one into unemployment rather than into the unemployed.” Noted SEM authors mistakenly assume that unemployment reflects problems of structure (regional dislocation or new technology), individual attitudes (people choosing welfare rather than work) or a state induced by global finance and trade. Clearly, under full employment the task of providing welfare services is significantly smaller and more manageable compared to that which is confronted in a chronically unemployed and underemployed economy.

So how does mass unemployment arise? In first-year macroeconomics, one learns about the relationships between stocks and flows and national accounting relationships. The most basic explanation of the operations of the macroeconomy begins with the fact that unless the flow of spending equals the value of goods and services supplied in expectation of that demand, then stocks will change. For example, spending shortfalls
manifest as unplanned inventory accumulation by firms. In the labour market, spending deficiencies cause the stock of unemployed and underemployed (part-time workers who desire more hours of work) to rise as firms reduce demand for labour hours. If non-government (including the foreign sector) spending is insufficient to purchase all the available supply, then the gap must be filled by net government spending if stocks are to remain unchanged. In this way, mass unemployment reflects a choice being made by governments to provide lower flows (net government spending) and accept higher stocks (unemployment). Latham (2001: 28) seems to think that the attainment of full employment is an artifact of the past, when “in the old economy, left-of-centre parties pulled levers of economic aggregates: through government regulation and demand management.” The specific goods and services purchased by government may reflect the prevailing ideology. But ideology has nothing to do with the national income relations outlined above. One is not being “Keynesian”, in the ideological sense of that word, to say that to maintain full employment the budget deficit must be sufficient to fill the gap between available supply and non-government spending. Rather, it is merely an understanding of the national income accounting of stocks and flows and leaks and injections (see Wray, 1998; Mitchell and Mosler, 2001, for more technical discussion).

Section 2 showed that these first lessons have been ignored by the overwhelming majority of economists and the captive policy makers. The major political parties still preach the virtue of Federal budget surpluses and deny any causal link between this strategy and the persistent unemployment. First-year macroeconomics also tells us that budget surpluses squeeze the private sector by draining wealth. If tax receipts are higher than government spending, the private sector must sell its holding of public debt back to the government to get currency to fulfill its taxation obligations and maintain its desired flow of spending and saving. By generating surpluses, the government boasts that it is running down debt, but in substance it is destroying private wealth by taking resources from the private sector. The manifestation is unemployment. Low unemployment was once a target of policy but now governments use unemployment to achieve low inflation by suppressing demand and activity through high interest rates and budget surpluses. The Australian Government has abandoned full employment and the security that goes with it (Mitchell, 2001a; Mitchell and Mosler, 2001).
In conclusion, the failure of the SEM to understand the true causes of the high unemployment and associated costs makes it susceptible to supply-side, individualistic neo-liberal constructs. This is evident in the concession that “in the new economy … [government] … need to shift to supply-side interventions” (Latham, 2001: 28). The argument above should provide a basis for all parties concerned with welfare outcomes to question the current lack of any job creation policy to reduce unemployment. We now turn to the second dimension of the attack on Keynesian demand management – the so-called government budget constraint.

4.2 The government budget constraint – the second false premise

Essentially, there are no financial constraints on government spending. This is a myth of the neo-liberals. Like most policy makers and orthodox economists, the SEM has adopted it without question. This position reflects a failure to understand how the financial system actually operates. The myth is derived from the false analogy between the household budget and the government budget (see Mitchell, 1998; Wray, 1998; Mitchell and Mosler, 2001). The development of the government budget constraint framework (GBC) formalises this analogy (Ott and Ott, 1965). The analogy is flawed at the most basic level. A household, the user of the currency, must finance its spending, *ex ante*, whereas the government, the issuer of the currency, spends first and never has to worry about financing. The government is the source of the funds the private sector requires to pay its taxes and to net save (including the need to maintain transaction balances).

The GBC literature suggests that the government can “finance” its spending in three ways: (1) by raising taxes; (2) by selling interest-bearing government debt to the private sector (bonds); and (3) by issuing non-interest bearing high powered money (printing money). A deficit is thus “financed” by a combination of (2) and (3). Various scenarios are constructed to show that either deficits are inflationary, if financed by printing money (debt monetisation), or squeeze private sector spending, if financed by debt issue. It should be noted that the GBC is just an *ex post* accounting identity, whereas orthodox economics claim it to be an *ex ante* financial constraint on government spending.

There are many flaws in this argument. For our purposes we note three. First, as issuer of the currency, spending is inherently constrained only by the real goods and services that
are offered for sale, not available funds. Second, bonds issues are best thought of as following spending (not preceding it), as they function to support interest rates rather than to provide funding. Third, there is no inevitable link between monetary growth and inflation. Mitchell and Mosler (2001) present a full technical exposition of these claims. We summarise their argument while relating it to the SEM literature.

The Federal Governments is the monopoly provider of fiat currency or money. The unit of account is the unit in which prices and money contracts are denominated. In Australia, this is the dollar and fiat money is issued by the Federal Government in these units. The first step in understanding the argument is to appreciate that tax liabilities are always expressed in the unit of account and can only be discharged in the same units. Typically, a money economy will require a federal budget deficit for smooth functioning and full employment. When the Governments buys real goods and services from the private sector it provides the private citizens with the unit of account, which they use to pay their taxes and fulfill their desires to net save. In a temporal sense, government spending has to precede tax payments and logically the latter cannot be seen as financing the former. Further, if there is a desire by the private sector to net save in the unit of account then government spending must exceed the taxation liabilities in aggregate. A budget deficit provides for these desires. A budget surplus in this context will squeeze the desires of the private sector to hold financial assets, net save and fulfill its taxation obligations. Ultimately, this becomes the root cause of unemployment. But the point is that the Government faces no financial constraints because it issues the currency. The only constraint on government spending is the quantity of real goods and services that the private sector is willing to sell.

The GBC approach then argues that if net government spending (spending minus taxation) is positive then debt has to be issued, which places upward pressure on interest rates, as it increases demand for private funds. However, this fundamentally ignores the way the banking system operates. All transactions between private entities, like commercial banks, net to zero. For every asset created, a matching liability exists. Thus no net money can be created by transactions between private entities. The money creating role of banks specified in economics textbooks is misleading for this reason. The only source of net money creation is via exchanges between the government (including
the RBA) and the non-government sector. This can take the form of net government spending, open-market purchases of government bonds, and RBA trades in the foreign exchange markets.

Modern monetary policy, practiced by the RBA, consists of setting and maintaining a target cash interest rate (via open market sales and purchases of bonds), which then condition the interest rate structure. For example, if there is upwards pressure on the cash rate due to heavy demands for funds in the commercial banking system, the RBA will buy some government bonds from the private sector and thus inject cash. The cash rate is exogenously set by the RBA and the resulting volume of cash demanded depends on the preferences of the private sector.

A budget deficit amounts to a net injection of cash into the system. This will reveal itself as a system-wide excess in the reserve accounts that the commercial banks hold with the RBA (the so-called exchange settlement accounts). These accounts are the centre of the settlements system where the multitude of transactions between individuals and banks are resolved. Banks do not like to hold excess reserves in their ESA because in Australia they only earn a support rate of 25 basis points below the current cash rate. System-wide cash surpluses place downward pressure on the cash rate as banks try to lend out the excess reserves. Of-course, in net terms these transactions cannot clear an overall cash surplus. If the RBA is intent on holding its monetary policy target in the face of excess cash reserves in the banking system, then it must drain these reserves. This is the key to understanding why government debt is issued. It serves as a cash or liquidity drain to allow the interest rate targets of monetary policy to be sustained. The private sector purchases the debt to maintain a positive yield on their reserve holdings. So far from pushing interest rates up, debt issues maintain existing rates. If there was no debt issued, the cash rate would eventually fall to the support rate. However, this would not constrain government spending but merely alter the asset returns available to the private sector.

Mitchell and Mosler (2001) examine the portfolio adjustments that may occur if debt was not issued. Essentially, the private sector may choose to increase their consumption if they cannot find suitable interest-bearing assets to absorb the cash surplus. This would necessitate a decline in net government spending to avoid an overheated economy. This
also relates to the orthodox claim, based on the discredited Quantity Theory of Money, that money creation always creates inflation. The relationship between monetary growth (nominal demand) and the price level is complex and depends on the state of aggregate supply. In times of deficient-demand, business firms have excess capacity and will respond to increased demand for their products by increasing production and employment rather than increasing prices.

The essential point is that the monopoly issuer of a currency, the government, is not financially constrained and has an obligation to ensure that its net spending is sufficient to maintain full employment.

4.3 The entrepreneurial model of welfare provision

In addition to the macroeconomic concerns, there are serious microeconomic shortcomings of the SEM market-based conception of resource allocation. As outlined in Section 3, the SEM proposes a radical new way of allocating resources to welfare provision. However, there is a tension between the economic and social conception of entrepreneurial behaviour. The proposal that risk-taking social entrepreneurs deliver welfare services is predicated on the assumption that emulating entrepreneurial behavior in a private market environment will improve efficiency of resource allocation. It should be stressed that within the theoretical market model, efficiency gains are tantamount to improvements in individual welfare. There are two concerns. First, the theoretical conditions that are required to generate the optimal results of the model are rarely found in practice. Second, this failing aside, the question is whether the private market context represents an appropriate model for the allocation of welfare resources. As noted in Section 3, the entrepreneurial model in economics bases much of its authority on the existence of a market with the demand for and supply of services being strictly independent. The sovereignty of consumer demand then interacts with the resource costs embodied in supply to deliver a socially optimal price and quantity configuration. If this independence is absent then the market fails and there can be no claim of efficiency. In the case of the welfare service provision there is a major problem in identifying a relevant market and further consumer sovereignty is impossible.
The basis of risk seeking entrepreneurial behaviour is grounded in the theory of the firm in basic microeconomics. The argument is developed using the competitive model or the contestable markets framework. In terms of a perfectly competitive market, the primary objective of individual firms is to maximise profits. Each firm is considered unable to influence the market price and produces up to the point where the price (the reflection of the consumer valuation of the benefits of the good or service) equals marginal cost (the cost of resources used to produce the last good or service). A firm that produces beyond this point would be wasting resources because marginal costs are assumed to rise. This outcome is deemed socially optimal because just enough resources are being devoted to the product as society demands.

The achievement of efficiency is dependent on the fulfillment of a number of basic assumptions. First, entry and exit of firms chasing profits is costless and when there are economic losses encountered due to flawed entrepreneurial decisions or unforeseen product demand changes, unprofitable firms are forced out of the industry. Second, products must be homogeneous or perfect substitutes. Third, producers and consumers must have perfect information about market conditions such as the level of demand, the price and quality of goods. Fourth, there must be an absence of externalities meaning that all costs and benefits associated with the activity are reflected in the price.

Most of these assumptions are difficult to sustain in practice. In particular, markets for public goods fail to operate because non-excludability produces a free-rider problem; once goods are provided additional users cannot be prevented from utilising them. In relation to welfare, positive externalities, or the benefits to society in general, need to be considered or the services provided will fall short of the optimum level.

In the absence of the optimal competitive conditions, it is often thought that policy changes that move the economy/industry towards the competitive ideal are still likely to improve efficiency. However, the Theory of Second Best (Lipsey and Lancaster, 1956) established that if it was not possible to achieve all the conditions necessary to attain optimality, then the second-best solution was not necessarily one where some of these conditions held. It is easy to show situations where attempts to improve efficiency in this
way have the opposite effect. Thus strategies that only partially deregulate markets are unlikely to improve efficiency.

What specific issues arise in this regard in relation to the provision of welfare services? First, there can be no consumer sovereignty. For a market to work, individuals must be able to express their “market votes” via effective demands (demands for products backed by cash). The very nature of welfare provision means that this “valuation” mechanism is missing from transactions. One can invoke market imagery by calling the welfare recipients clients and customers, but it doesn’t alter the non-existence of consumer sovereignty. Further, the community pooling proposals seem to imply a compulsion on individuals to participate. Consumer sovereignty also breaks down in the case of health services where the consumers are generally ill equipped to decipher highly technical medical information, information on price is scarce and individuals are unable to predict how much treatment they will need. There can be no efficient market outcomes in these cases. Appealing to the authority of market efficiency is a fundamental flaw in the SEM approach.

The entrepreneurial model is calibrated by assuming that the index of performance is the maximisation of profit via efficient production methods. However, in the case of welfare provision, efficient delivery has to contain a social element – that is, it is wider than the maximisation of profits. For example, an efficient welfare system has to include social justice considerations, which a private market cannot value. These objectives include the provision of a minimum standard of living or equality of opportunity to be delivered through transfer payments, universal education and health services. Without a correct valuation then an efficient price cannot be established. Once again the market fails.

In the case of community-based entrepreneurship there are several problems not addressed by the SEM. How will resource allocation decisions be made to conform to the requirements of the efficiency model? What market signals will be received to guide the marginal decision making? What price information will dictate production and input decisions? How will the resource allocation decisions be assessed? The SEM model of welfare provision fails to enunciate how it would overcome market failure in a situation
where we know in advance that all the basic assumptions are likely to be violated. Dees (1998: 2) admits that:

Markets do not work as well for social entrepreneurs. In particular, markets do not do a good job of valuing social improvements, public goods and harms, and benefits for people who cannot afford to pay. These elements are often essential to social entrepreneurs. That is what makes social entrepreneurship. As a result, it is much harder to determine whether a social entrepreneur is creating sufficient social value to justify the resources used in creating that value. The survival or growth of a social enterprise is not proof of its efficiency or effectiveness in improving social conditions. It is only a weak indicator, at best.

In short, there can be no case made that a shift to social entrepreneurship is efficient. There is no market discipline that can guide resource allocation and correctly value the contributions and costs of the social entrepreneurial activity. The market fails outright and is thus not a legitimate benchmark to justify the changes from rights-based welfare.

There are other issues related to the entrepreneurial focus of the SEM that are worthy of mention. First, in the economic context, risk-taking behaviour carries with it the probability of failure. Under the Botsman and Latham (2001) enabling state model, the government becomes a venture capital provider and underwriter of small-scale capitalist production. The statistics on small business failure from the ABS (Small Business in Australia, 1995, 1321.0) indicate that around 7 per cent of small business exit within one year. Customers suffer when business fail. It would appear undesirable to promote a system of welfare where the fortunes of the disadvantaged receiving assistance are dependent on the vagaries of the entrepreneurial process. In this context, the Enabling State becomes susceptible to moral hazard where the funding-source has a moral obligation to prevent a provider failing. As a result, the entrepreneur faces distorted risk and return choices because they can effectively ignore the downside risks of any particular development plan. Market failure in this environment would be endemic. In the government provided welfare model, there is no moral hazard. The allocation decisions are based on a system of political accountability.

Second, one of the strands of the SEM involves a strengthening of ties between non-profit organisations and business for mutual benefit. This is presented as an unmitigated good whether it consists of donations for social programs or enterprise partnerships.
d'Indy (2000: 12) enthuses:

The significance of corporations investing directly in the community is that they, the holders of private wealth, are determining for themselves where social spending should occur. At the same time, these allocations are tailored for the long term benefit of companies.

This perspective provides a stark contrast with the social justice orientation of the Post-War Welfare State where resources were allocated on the basis of an ordering of societal needs, determined in the public domain, rather than by large corporations.

Third, the involvement of non-profit organisations in the administration of state welfare programs introduces the possibility of fundamentally changing the character of these organisations. In particular, carrying out the legal requirements of contracts entails the imposition of sanctions, depriving some of the most disadvantaged members of the community of their only income. Such actions may conflict with long-standing organisational goals and values (d’Indy, 2000: 15). Moreover, this situation may cause internal conflict between the ‘enterprise’ and ‘welfare’ divisions of such organisations, as clients sanctioned by one part of the organisation seek emergency assistance from another.

4.4 Welfare dependence – the untestable hypothesis

Historically, dependence could be defined as either economic or moral/psychological (Fraser, 1977: 124). Economic dependence applied to all who were employed by someone else, a normal social relation. Similarly, married women were often dependent on their husbands. While economic dependence was considered ‘normal’ and acceptable, dependence in the moral sense was attributed to undesirable character traits. This is important because it is precisely the interpretation of welfare dependency in the current debate, whereby working-age individuals relying on transfer payments are increasingly portrayed as socially dysfunctional. Abbot (2000) says that “In the absence of rigorous work tests, welfare benefits pitched close to the level of minimum wages eventually create a glass floor below which unemployment cannot fall. Why do some people not work? Because they don’t have to.” The SEM advances ideas that are consistent with this supply-side, individualistic view of the problem without focusing on the constraints faced
by the individuals in a demand-deficient economy. The alternative viewpoint is nicely expressed by Piore (1979: 10)

Presumably, there is an irreducible residual level of unemployment composed of people who don’t want to work, who are moving between jobs, or who are unqualified. If there is in fact some such residual level of unemployment, it is not one we have encountered in the United States. Never in the post war period has the government been unsuccessful when it has made a sustained effort to reduce unemployment. (emphasis in original)

The welfare dependency explanation for the persistent unemployment since 1975 fails when confronted with the evidence. With the Unemployment to Vacancy (UV) ratio averaging around 11 since that time, it is a fallacy of composition to consider that the difference between getting a job and being unemployed is a matter of individual endeavour. Adopting welfare dependency as a lifestyle is different to an individual, who is powerless in the face of systemic failure, seeking income support as a right of citizenry.

4.5 Pooling, communities, and the rights of individuals

A recurring theme in the SEM literature is the necessity of developing a national sense of social cohesion. It was noted in Section 2 that some countries avoided the sustained unemployment that beset most OECD economies after the mid-1970s by maintaining an employer of the last resort capacity. Why were countries like Japan, Austria, Norway, and Switzerland, among others, able to maintain this capacity? Ormerod (1994: 203) notes that each “has exhibited a high degree of shared social values, of what may be termed social cohesion, a characteristic of almost all societies in which unemployment has remained low for long periods of time.” There is a clear link between the low unemployment and the social cohesion.

The role of the community is central to the SEM aim of curing social and economic exclusion and restoring social cohesion. However, Everingham (2001) argues that this role has been redefined from a vehicle for social justice, to the imposition of social order. Further, the transferal of service delivery from government to the community “relieves the government of the responsibility for social problems because it puts the onus for reform onto ‘the community’ ” (Everingham, 2001: 110).
What are the implications of the primary role of communities in the SEM model? It could be argued that this approach provides the potential to overcome the “one size fits all” aspect of the bureaucratic Welfare State, to provide programs tailored to the specific needs of the community. Conversely, a series of separate communities pursuing competitively-driven aims do not necessarily develop shared values or social cohesion. Under such circumstances, they are indeed more likely to develop social antagonism toward each other.

First, the substitution of community-developed, for bureaucratically-determined, programs raises the possibility of introducing discord between sections of the community with divergent priorities, including intolerance of the rights and views of minorities. Community oversight of government spending effectively removes a degree of government responsibility for outcomes, and, simultaneously incorporates these groups as an arm of government. Second, unique programs in each community imply the erosion of the ‘right’ of individuals to a minimum standard of services. Not only are rights exchanged for the concept of earning entitlements by proving ‘deservingness’, but also, members of dynamic communities with greater managerial and entrepreneurial skills will be advantaged relative to other communities. Third, the assumption that the positive outcomes of a small number of organisations will automatically be transferable to every community is problematic. Leaving aside the issue of skills, there is the problem of fallacy of composition. Market activities of social entrepreneurs involve competition with private companies. We need to be cognisant of the probable outcomes of generalising such projects to all disadvantaged communities. There is a danger that whatever employment is generated in these communities would be partially or totally offset by the loss of jobs in the private sector. Fourth, service provision by community organisations, rather than the public sector, raises the issue of personalising relationships that were previously determined on an impartial basis. Devolving all control to the local level introduces the risk of discriminatory treatment of individuals relating to equitable access to services, employment and contracts.

In short there are numerous dangers in pursuing the SEM model of devolvement to the community level. Societies working together with the fiscal power of the federal government to achieve national goals would ensure the protection of the rights of
citizenship originally secured by the introduction of the welfare state and avert the possibility of divisiveness between and within communities.

5. Conclusion

In this paper, it has been have argued that the SEM literature contains a number of false premises. While the concept of social entrepreneurship is difficult to define exactly, the paper has identified some common features in the conceptual literature by SEM authors. These features appear to be consistent with the current economic orthodoxy (sometimes called economic rationalism), which places an emphasis on the individual and denies systemic failure. In this way, the SEM fails to understand the true causes of the high unemployment and it becomes susceptible to supply-side, individualistic neo-liberal constructs. It has been shown that persistently high unemployment over the last 25 years, which has reflected the ideological choice of government to abandon its role in maintaining full employment, is the major reason why the welfare system is under stress. Further, the SEM appears to accept the orthodox argument that government faces financial constraints and cannot afford to fund the welfare services that are required.

The microeconomics of the SEM proposal to adopt commercial methods to deliver welfare services has also been critically analysed. The conclusion is that the ‘market model’ cannot be applied in this context and claims to efficiency by the SEM are erroneous. There cannot be an efficient private market in welfare services. In that sense, moves to entrepreneurial and commercial welfare provision have to be justified in other ways. The literature fails to provide any other justifications and it is concluded that ultimately the SEM reflects ideological preference.

There would be two major consequences of the implementation of the social entrepreneurship program. First, the remnants of rights-based eligibility to universal welfare services would disappear due to the movement towards significant differentiation of service provision based on location. Welfare would revert to residual provision, complete with the 'deserving' and 'undeserving' connotations of the poor law of 1834. Secondly, the objective of social control would replace social justice, and individuals would be forced to conform to values determined by social entrepreneurs on behalf of the community.
References


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Notes

1 The authors are respectively, Research Associate, Centre of Full Employment and Equity; Senior Research Associate, Centre of Full Employment and Equity; and Professor of Economics and Director, Centre of Full Employment and Equity.

2 It should be noted that the exchange rate has reached its lowest levels against most currencies in the period that the Federal Government has been pursuing budget surpluses.

3 According to Australian Bureau of Statistics data, poverty in Australia increased from 10.2 per cent of income units in 1972-73 to 16.7 per cent in 1989-90 (ABS, 1996). Similarly income inequality rose despite a sustained period of economic growth. The top 10 per cent of the income distribution increased their share of income from 22.7 per cent in 1990 to 23.9 per cent in 1997-98 (Harding, 2001).

4 The stated purpose of the Third Way is to steer a course between “old-style social democracy and neoliberalism” (Giddens, 1998: 26), by combining right-wing economic policies and left-wing social policies (Latham, 2001c: 17).

5 Wray (1998: 12) defines fiat money “as state liabilities issued to purchase goods, services, or assets, or to discharge government liabilities, with no promise to convert. Most importantly, fiat money can be used to retire liabilities to the government – such as tax liabilities.” In an operational sense, fiat money exists in the form of notes and coins in circulation, bank reserves (notes and coins in vaults), and banks deposits at the RBA.

6 In the USA, the Federal Reserve, the equivalent of our RBA, pays a zero return to commercial banks with excess reserve balances in the accounts they hold with the Fed.

7 The theory of contestable markets attempts to sustain the desirable properties of the competitive model in situations where there are few firms. It is argued that as long as there is free entry and exit then the market still delivers efficient outcomes. It relies on the assumption of zero sunk costs and is clearly inapplicable in the case of welfare provision (see Martin, 1993).