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Social Entrepreneurship – false premises and dangerous forebodings

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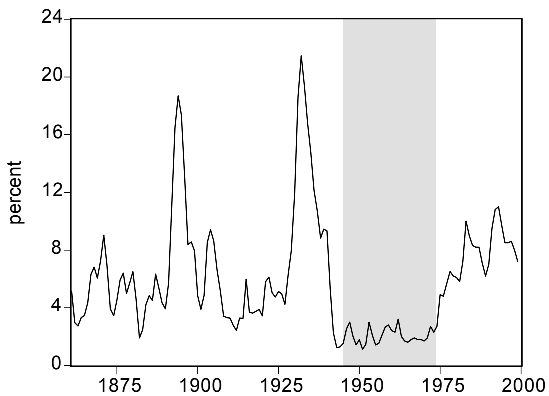
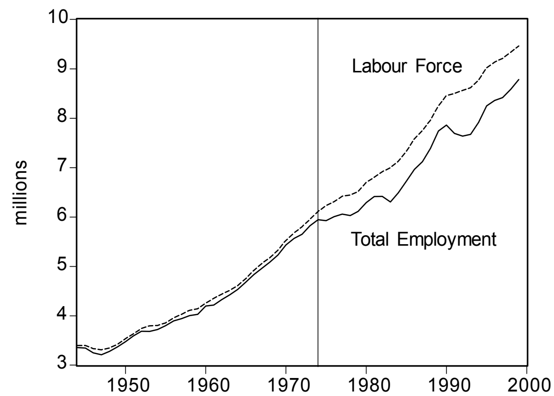
1. Introduction

Unemployment rates in most economies have risen and persisted at higher levels since 1975. In the midst of on-going debates about labour market deregulation, privatisation and welfare reform, the most salient, empirically robust fact over the twenty five years (shown in Figure 1) is that the Australian economy has not produced enough jobs to achieve full employment (Mitchell and Carlson, 2001). The shaded area in 1(a) shows the Keynesian period where government took responsibility to maintain full employment.

Figure 1 An historical view of labour market performance in Australia





(a) Unemployment rate, 1861-2000 (b) Labour force and employment, 1944-2000

Source: ABS, The Labour Force, 6203.0, and Withers *et al.* (1985).

Over the last 25 years, successive Federal governments have used restrictive fiscal and monetary policy to control inflation with high unemployment the consequence. Policy makers deny any link between their inflation-first strategy and the persistent unemployment, and see the latter in terms of the shortcomings of the unemployed themselves rather than any macroeconomic failure (Abbott, 2000). In this paper, we use the term neo-liberal to classify this shift to supply side policy and explanations.

Watts and Mitchell (2000) show that the costs of unemployment dwarf the costs of the so-called microeconomic inefficiencies that have been used to justify the neo-liberal agenda. High unemployment has also stressed on the welfare system to the point that an underclass has emerged in Australia (Johnson and Taylor, 2000). The Third Way movement emerged amidst growing resistance to neo-liberalism and a perceived welfare system breakdown (Johnson, 2001). However, the Third Way also eschews Keynesian remedies and casts the Welfare State as being undemocratic, bureaucratic, with alienating and inefficient institutions (Giddens, 1998). Social Entrepreneurship is the means that Third Way writers propose to reconstruct welfare and involves building social partnerships between the public, social and business sectors and harnessing the ‘dynamism of markets but with the public interest in mind’ (Giddens, 1998: 100).

In this paper we argue that the Social Entrepreneurship movement (SEM) is based on two major false premises and also has some alarming implications. Overall, we argue that the SEM has become indistinguishable from neo-liberalism, and, as such, does not represent a viable solution to unemployment and the welfare problems that accompany it. First, the SEM fails to understand the phenomenon of mass unemployment. Once this understanding is achieved a substantial number of the problems taken as given by the SEM disappear. Second, the SEM alleges that government financial constraints prevent welfare problems being solved using budget deficits. We argue there are no financial constraints on government and thus undermine a significant part of the SEM agenda. Third, we examine the implications of specific SEM proposals including the role of entrepreneurship in generating resources for welfare provision and models of community development. We argue that these proposals threaten the long-standing status of universal rights, which are at the heart of a socially cohesive society. Concluding remarks follow.

2. The SEM and the causes of unemployment

The Great Depression taught us that capitalist economies are prone to lengthy periods of unemployment without government intervention. From 1945 until 1975, governments used fiscal and monetary policy to maintain levels of overall spending sufficient to generate employment growth in line with labour force growth. Throughout this Keynesian full employment period unemployment rates rarely rose above 2 per cent (see shaded area of Figure 1(a)).

However, following the first oil price rise in 1974, which led to accelerating inflation in most countries, there was a resurgence of pre-Keynesian thinking. Governments reacted with contractionary policies to quell inflation and unemployment rose. The economic dislocation that followed provoked a paradigm shift in macroeconomics (Thurow, 1983). 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 abandoned as policy makers adopted the natural rate of unemployment (NRU) approach (Friedman, 1968). The NRU approach redefines full employment in terms of a unique unemployment rate (the NRU) where inflation is stable, which is determined by supply forces and is invariant to Keynesian demand-side policies. It alleges that free markets will always guarantee full employment and Keynesian attempts to drive unemployment below the NRU will only generate inflation. The Keynesian notion that unemployment represents a macroeconomic failure that can be addressed by expansionary fiscal and/or monetary policy is rejected. Instead, unemployment reflects supply failures such as poor incentive structures facing individuals, skill mismatches between demand and supply, excessive government regulations (OECD, 1994). Consequently the role for government is confined to dismantling supply impediments (like minimum wages, social security payments). The NRU and Keynesian notions of full employment are thus diametrically opposed.

There is a growing literature outlining fatal flaws in the NRU approach, which render it unsuitable as a policy framework. After 25 years, neo-liberalism has been a stark failure given that the economy has not been able to generate sufficient employment to match the available workforce. On average there have been 11.1 unemployed persons per unfilled vacancy since June 1974 (Mitchell and Carlson, 2001).

Despite this evidence, the SEM adopt a characterisation of unemployment, albeit somewhat blurred, that is hard to distinguish from the NRU hypothesis. They suggest that government fiscal and monetary policy is impotent and that individuals have to be empowered with appropriate market-based incentives (Botsman and Latham, 2001; Pearson, 2001).

The failure to see mass unemployment in macroeconomic terms represents the first false premise of the SEM. Some SEM advocates point to local schemes that have created small numbers of jobs (for example, Henton *et al*, 1997), but fail to understand that in a constrained macroeconomy the scale of job creation required is beyond the capacity of local schemes. This specific-to-general logic pervades neo-liberal logic and formed the basis of the Keynesian attack on orthodoxy during the Great Depression.

Introductory macroeconomics teaches us that unless spending equals the value of goods and services supplied in expectation of that demand, unplanned inventory accumulation and increases in unemployment and/or underemployment will occur. To avoid this situation, net government spending (the budget deficit) must fill the spending gap. Thus, mass unemployment reflects a choice made by government to provide lower net government spending and accept higher unemployment (see Mitchell and Mosler, 2001, for a more technical discussion).

By failing to understand the true causes of mass unemployment, the SEM becomes indistinguishable from neo-liberal accounts of labour market dysfunction. For example, Latham, (2001a: 28) says 'in the new economy … [governments] … need to shift to supply-side interventions.' Anyone concerned with welfare problems arising from unemployment should initially start with an understanding of why unemployment arises. A fully-employed economy imposes significantly lower welfare burdens than one beset with chronic, government-induced unemployment.

3. SEN and the fiscal constraints on government

The corollary of the abandonment of macroeconomic demand management has been the obsession by government with budget surpluses and a denial that they promote persistent unemployment (Mitchell and Mosler, 2001). SEM advocates support this line, arguing that Keynesian demand management policies are no longer possible because of '… 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.' (Latham, 1998: 31)

The acceptance of federal fiscal constraints represents the second false premise of the SEM. In fact, there are no financial constraints on federal government spending. This is a myth peddled by neo-liberalism and contradicts the way the financial system operates. The myth starts with a false analogy between household and government budgets. The analogy misunderstands that 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.

Neo-liberalism uses the government budget constraint (GBC) framework to formalise their claim that the GBC represents an *ex ante* financial constraint on government spending, whereas in fact it is only an *ex post* accounting identity. The GBC literature outlines three sources of government "finance": (1) taxation; (2) selling interest-bearing government bonds to the private sector; and (3) printing money. A deficit (spending above taxes) is thus "financed" by a combination of (2) and (3). Various scenarios are constructed to show that deficits are either inflationary, if financed by printing money, or crowd-out private sector spending by pushing up interest rates, if financed by debt.

A summary of the many flaws in this argument is presented here (see Mitchell and Mosler, 2001 for more detail). The Federal Government is the sole provider of *fiat currency* or money. A monetary economy (like Australia) typically requires a federal budget deficit for smooth functioning and full employment. To understand this argument we note that tax liabilities must be discharged using this currency. Federal Government spending provides the private sector with the currency they need to pay their taxes and to net save. As government spending precedes tax payments it logically cannot be financed by taxes. Further, if private sector desires to net save are to be fulfilled then aggregate government spending must exceed taxation (a budget deficit). Budget surpluses squeeze the desires of the private sector to hold financial assets, net save and pay taxes and ultimately lead to mass unemployment.

The GBC approach then argues that budget deficits have to be finances with debt issues, which place upward pressure on interest rates by increasing demand for private funds. However, this fundamentally misconstrues the way the banking system operates. All transactions between private entities, like commercial banks, net to zero because 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 thus misleading. The only source of net money creation is via exchanges between government (including the Reserve Bank of Australia (RBA)) and the private sector (net government spending; government bond trading and foreign exchange trading by the RBA).

The RBA conducts monetary policy by setting and maintaining a target cash (short-term) interest rate, which then influences the overall structure of interest rates. 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 government bonds from the private sector and thus inject cash.

A budget deficit amounts to a *net* injection of cash into the system and creates a *system-wide* excess in the reserve accounts that commercial banks hold with the RBA (exchange settlement accounts). These accounts are central to the settlements system where the multitude of transactions between individuals and banks are resolved. Banks do not like to hold excess reserves in these accounts because in Australia they earn 25 basis points below the cash rate. Thus, 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 interest rate target then it must drain these excess reserves from the system. This is why government debt is issued. It serves as a liquidity drain to allow the RBA interest rate target to be sustained. The private sector purchases the debt to earn a market yield on their reserve holdings. So, far from pushing interest rates up, debt issues maintain existing rates, which would otherwise fall. If there no debt were issued, then the cash rate would fall. However, this would not constrain government spending but merely alter the asset returns available to the private sector.

The private sector may increase their consumption if they cannot find suitable interest-bearing assets to absorb their cash surplus. This would necessitate a decline in net government spending to avoid an overheated economy. This also relates to the neo-liberal claim 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.

In summary, the government, as the issuer of money, cannot be financially constrained and has an obligation to ensure that its net spending is sufficient to maintain full employment. By failing to understand that budget deficits are required if there is mass unemployment, the SEM constitutes a false agenda, which would disappear once governments restored full employment. Given that, we now turn to some of the specific implications of the SEM policy agenda.

4. Entrepreneurship and welfare provision

It is hard to precisely define what constitutes social entrepreneurship (Johnson, 2001 provides a good survey). The Canadian Centre for Social Entrepreneurship (CCSE, 2001) defines it 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.

For space reasons, we ignore the for-profit sector activities. Within the SEM literature on non-profit organisations, there is 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 social entrepreneurs to be 'one species of the genus entrepreneur.' The Australian Social Entrepreneur Network (SEN, 2001) also push a commercial emphasis, '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.'

The SEM argues that not only do welfare services need to be delivered more *efficiently* but entrepreneurial activities have to be adopted to create more funds (profits) to cross-subsidise welfare provision, given that it, wrongly, assumes that government is financially constrained. Welfare groups have always participated in small-scale capitalism (like opportunity shops), but the SEM envisages full-scale business models are needed to generate extra resources. Efficiency is a term borrowed from microeconomic text-books and means the highest output at the lowest cost. The text-book model claims that private markets allocate resources to the most efficient uses but also recognises that any social costs arising from private market transactions (like pollution) are not accounted for. Where social costs (or benefits) are present and not valued in the market, the private entrepreneurial model is not efficient. Pursuing *social justice* aims, which cannot be valued in the market, using a private entrepreneurial model, is likely to violate the conditions required for efficiency. It is unclear how a social entrepreneur balances resource allocations between profit-making and welfare-providing activities. Certainly there can be no authority gained from economics to guide them. Yet the SEM uses text-book terminology to claim legitimacy for its agenda. 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 … 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, no economics case in terms of efficiency can be made to support the shift to social entrepreneurship. No market discipline can guide resource allocation and correctly value the contributions and costs of social entrepreneurial activity. Accordingly, the market is not a legitimate benchmark to justify the changes from rights-based welfare.

5. Entrepreneurship, communities and welfare provision

The SEM advocates focus on local, community-designed and implemented solutions (Botsman and Latham, 2001). The main welfare-role for government should be to assist the development of local social entrepreneurs, encourage entrepreneurial projects and to 'devolve its resources and service delivery to place management models' (Latham, 2001c: 130). They aim to break the government-individual nexus and use taxpayer funds to subsidise private entrepreneurs. They also support strengthening the ties between non-profit organisations and business for mutual benefit. For example, d'Indy (2000: 12) argues '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.'

There are major concerns with these proposals. First, basing social spending according to corporate aims starkly contrasts with the social justice orientation of the Welfare State where resources were allocated according to an ordering of societal needs, determined in the public domain, rather than by corporations. Second, using non-profit organisations to administer state welfare programs for commercial gain may fundamentally change the character of these organisations. In particular, imposing sanctions (income-losses) on some of the most disadvantaged members of the community may conflict with long-standing organisational goals and values (d'Indy, 2000: 15). This 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.

Third, community pooling arrangements are proposed as a radical new form of welfare provision. Botsman and Latham (2001) suggest government allocations for health, education, housing, training and employment and all social security payments, currently paid to individuals be pooled 'to invest in community cooperatives that allocate a living wage for community employment' (Botsman, 2001a: 71). What are the problems with this model of community entrepreneurship? Clearly, the government would become a venture capital provider and underwriter of small-scale capitalist production. The ABS statistics on small business failure show around 7 per cent fail within one year (ABS, Cat. No.1321.0). It is undesirable to implement a welfare system where the fortunes of the disadvantaged receiving assistance are dependent on entrepreneurial vagaries. Further, community entrepreneurship is susceptible to a major source of market failure referred to by economists as *moral hazard*. The government would have a moral obligation to prevent an entrepreneur from failing. The entrepreneur thus faces distorted risk and return choices because they can effectively ignore downside risks of any particular development plan. Market failure would be endemic and wasteful investment schemes would proliferate. There is no moral hazard in a government provided welfare model where the allocations are based on a system of political accountability.

Fourth, the SEM claims that social cohesion is only developed at the community level (Latham, 2001d). However, social cohesion can take many forms. Some countries like Japan, Switzerland, and Norway maintained Keynesian policies and avoided the sustained unemployment that beset most economies after the mid-1970s. Ormerod (1994: 203) notes that each of these countries retained 'a sector of the economy which … functions as an employer of last resort … [and] … exhibited a high degree of shared social values … [or] … social cohesion, a characteristic of almost all societies in which unemployment has remained low for long periods of time.' Social cohesion, here, refers to the willingness of citizens to allow the state to use macroeconomic policies to maintain full employment.

SEN advocates want community to replace the state as the vehicle for social cohesion and argue that the community-focus would help to overcome the "one size fits all" aspect of bureaucratic Welfare States. However, a series of separate communities pursuing competitively driven aims do not necessarily develop shared values or social cohesion. They are indeed more likely to develop social antagonism toward each other. Further, transferring service delivery to communities 'relieves the government of the responsibility for social problems because it puts the onus for reform onto the community.' (Everingham, 2001: 110) Moreover, the substitution of community-developed, for bureaucratically determined, programs may introduce discord between sections of the community with divergent priorities, including intolerance of minorities.

Unique programs in each community also imply the erosion of the individual right to a minimum service standard. Not only are rights exchanged for the concept of earning entitlements by proving deservingness, but, members of dynamic communities with greater entrepreneurial skills will be relatively disadvantaged.

The assumption that positive outcomes of a small number of organisations will automatically be transferable to every community is also problematic. Social entrepreneurs would compete with private companies and employment generated in these communities may be partially or totally offset losses in the private sector.

In short there are numerous dangers in pursuing the SEM model of community entrepreneurship. Communities working together with the fiscal power of the federal government to achieve national goals would best ensure the protection of citizens' rights originally secured by the introduction of the Welfare State, and, avert the possibility of divisiveness between and within communities.

6. The SEM and the rights of citizenship

The Welfare State evolved in parallel with the Keynesian full employment commitment and defined the state's obligation to provide security to all 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, replacing the deserving-undeserving poor dichotomy with the provision of benefits as a right of citizenship (Timmins, 1995: 21). Transfer payments were provided to disadvantaged individuals and groups and a professional public sector, provided standardised services at an equivalent level to all citizens.

Accompanying neo-liberal attacks on macroeconomic policy were concerted attacks on supplementary institutions such as the industrial relations system and the Welfare State.

The attacks were a mixture of misplaced perceptions of fiscal necessity and ideological zealotry (see Mitchell and Carlson, 2001). In terms of welfare provision, neo-liberalism sees individuals as being accountable for their own outcomes and rejects the importance of macroeconomic failure (Rees, 1994). Government welfare policy changes have introduced alleged responsibilities to counter-balance existing rights while promoting the movement from passive to active welfare (Burgess and Watts, 2001). Individuals now face broader obligations and their rights as citizens have been replaced by compulsory contractual relationships with behavioural criteria imposed as a condition of benefit receipt.

Notable SEM advocates support this policy shift and claim that individuals have to accept responsibility, be self-reliant, and fulfill their obligations to society (Latham, 2001c). Accordingly, 'passive welfare' produces 'dependence' which 'disempowers' and causes 'social exclusion' (Pearson, 2001: 135). They also argue that welfare reform must establish incentive structures to overcome welfare dependence. There is confusion in this literature over what causes dependency. Giddens (1998: 114) argues that it arises because people act rationally to take advantage of the opportunities offered by the Welfare State. However, Latham (2001c: 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.'

Specific proposals from the SEM are consistent with a desire to break from rights-based welfare provision, thus shifting 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, 2001d: 258). Mutual obligation is at the forefront of current Federal Government welfare policy and forces individuals to expend effort in return for their welfare payments. Unfortunately, a reciprocal obligation is not imposed on government to ensure that there are enough jobs. Some SEM advocates go further and suggest that 'improved personal health habits, the care and maintenance of public housing accommodation, and good parenting practices' among others, be conditions to be met before welfare benefits are paid (Latham, 1998: 219). None of these conditions would be imposed on other members of society.

Latham and others appear to ignore the role that macroeconomic constraints play in creating welfare dependence? Their preoccupation with instituting behavioural requirements and enforcing sanctions for welfare recipients suggest that they perceive dependence as an individual preference. However, with the unemployment to vacancy ratio averaging around 11 since 1974, 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 macroeconomic failure, seeking income support as a right of citizenry.

9. Conclusion

We have argued that the SEM literature is based on two false premises: (a) the failure to understand the true causes of mass unemployment, and (b) assuming that the federal government faces financial constraints and cannot afford to fund the welfare services that are required. The SEM policy agenda that follows contains a number of proposals that threaten the concept of citizenship. In many key respects, the SEM literature is indistinguishable from neo-liberalism.

We suggest that the SEM proposals to enhance community entrepreneurship would have two major consequences. First, the remnants of rights-based eligibility to universal welfare services would disappear due to the differentiation of service provision based on location. Welfare would revert to residual provision. Second, the objective of social control would replace social justice, and individuals would be pressured to conform to values determined by social entrepreneurs on behalf of the community.

Finally, like neo-liberalism, the SEM does not represent a solution to persistent unemployment. That requires active federal government intervention using expansionary fiscal and monetary policies, which neither understands.

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