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# The Third Way and the third sector: New Labour's economic policy and the social economy

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This paper reviews the relationship between Labour's economic policy and the third sector. Since 1997, the third sector has received significant government support and has gradually moved from the economic periphery towards the centre such that it is now instrumental in the delivery of a range of government policies. It operates alongside both the private and public sectors in delivering employment, education, health and social care, housing and environmental policies. The impact of this has been seen in measures of social exclusion, poverty, the environment, social capital, as well as GDP and employment. Future policies should strive to maintain and develop the distinctive capabilities of third sector organisations and the balance between economic, social and environmental objectives.

*Key words*: Third sector, Social enterprise, New Labour
*JEL classifications*: L30, L31, L39, I38

## 1. Introduction

The election of the Labour government in May 1997 brought the promise of a new era in economic policy in the UK. In common with many industrialised countries in the last quarter of the twentieth century, the promotion of the values of self-interest, self-reliance and individual opportunity by the Conservative rule of the preceding 18 years had been at the expense of community and the promotion of public services (Inglehart, 1997). This shift in policy was aptly captured by Thatcher's observation that 'there is no such thing as society' (1987, pp. 8–10). Whilst it had brought gains for those able to capitalise on these values, many fell by the wayside. This in turn led to rising economic inequality, social exclusion and increased polarisation of society between the haves and the have-nots. The incoming Labour government promised to address these issues and committed itself to meeting the needs of wider society, implementing a raft of policies to tackle economic inequality and social exclusion. As part of this agenda, the government has embraced the third sector—this paper critically reviews this relationship and considers its prospects for the future.

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The first part of the paper defines the nature, characteristics, size and scale of activity of the third sector. This is followed by an analysis of factors related to the growth of the sector. An account of Labour policies directed at strengthening the role of organisations in the third sector, and an analysis of their social and economic impacts then follows. The final section concludes, identifying key challenges for future government policy and relations with the third sector.

## 2. The nature and characteristics of the third sector

An important strand in the policy approach of New Labour was to review the institutionalised assumption of a two-sector economy based on either private or public ownership and control of production of goods and services. The private sector, comprising corporations, firms and entrepreneurs, is assumed to be motivated by self-interest and seeks to maximise profit or shareholder value.[1] A market with profit potential encourages entrants eager to exploit opportunities, whereas where returns are unattractive, the private sector would be noticeable only by its absence. Operating alongside the private sector, the public sector provided goods and services for consumption by society (public goods), to those likely to be underprovided for (merit goods), and to those unable to access private sector suppliers. Thus, the traditional view of the economy, both in terms of theory and policy, was institutionalised into a two-sector framework.

It is well known, however, that a host of organisations that aim to deliver social and environmental benefits, and that are neither profit making nor statutory, exist and operate outside (or between) both the market and the state. These organisations have together been referred to at policy level as either the voluntary and community sector or, more generally, the social economy. Including non-profit organisations, charities, community groups and voluntary associations, a new collective noun for this group emerged in the UK in 1995 (Rifkin, 1995)-the third sector. The concept of the third sector had already appeared in the USA (Levitt, 1973) and in EEC/EC official documents of the mid 1980s (Kendall and Anheier, 1999), however its appearance in the UK at that moment may perhaps be explained by its verbal echo of *The Third Way* philosophical stance of New Labour. Irrespective of the terminology used to refer to those organisations falling between the market and the state, the sector is characterised by a huge diversity of goals, structures and motivations, and has been described as a loose and baggy monster (Kendall and Knapp, 1995) with a complex structure and fuzzy boundaries (Brandsen *et al.*, 2005).

To help reduce such fuzzyness the relationship between the third sector and the social economy can be clarified reflecting the distinction between *social objectives* and *social activities*. The latter comprise social and environmental activities which may be undertaken by actors in the third sector but may also be undertaken by other organisations in the economy such as those in the private sector (for example firms may implement corporate social responsibility policies and corporate strategies to improve the environment or build social capital). What is important, however, is that although many organisations in the private sector may undertake some social activities their primary objective is to generate profit and increase shareholder value. This contrasts with ventures in the third sector where the defining characteristics of such organisations are their pursuit of social and environmental objectives; as well as independence from state structures, and non-profit

[1] Of course, under managerial capitalism where shareholders divest control to managers the usual agency problem arise, which often leads to non profit maximising objectives (see Berle and Means, 1932).

distributing status. They are independent organisations, many have complex governance structures, and they are prevented by law from distributing profits to those with a controlling interest in them. It should be noted, however, that in some cases organisations in the third sector may undertake *non-social activities* which are similar to private enterprises such as the trading activities undertaken by many social enterprises (see below). An analysis of the social economy can either use objectives or activities as the unit of analysis - in this paper we are primarily concerned with organisations in the third sector who pursue social objectives.

The diversity of organisational 'visions, ideologies, theories and philosophies' (Moulaert and Ailenei, 2005, p. 2039) is reflected in the institutional heterogeneity of the third sector. Organisations range in size from very small, informal community groups and associations, to large, legally constituted non-governmental associations, cooperatives and charities. There are many ways of categorising the sector and a useful starting point is to highlight its three main groups. First, there is the voluntary sector, which includes many charities, housing associations, community associations and national campaigning organisations. Second, there is the community sector, which is usually constituted of small and locally organised groups, and includes civic societies, support groups and community and neighbourhood associations. And third, there is the social enterprise sector, which includes organisations that are businesses with social objectives, such as credit unions and community interest companies.

Since 1997, the third sector in the UK has received significant government support (Kendall and Almond, 1999), enabling it to move from the economic margin towards the mainstream (Kendall, 2000; Osbourne and McLaughlin, 2004A; Cairns *et al.*, 2005); it now plays an increasing role in economic, political and social life. Although there are a small number of large organisations with incomes of several million pounds (e.g., Oxfam, Royal National Institute for the Blind, Barnardos) the majority are small in size and turnover (Osborne and Hems, 1995; Salamon *et al.*, 2003). A further characteristic of voluntary and community organisations in the third sector is their traditional reliance for income on philanthropy and donations.

### *2.1 The growth of social enterprises*

A new characteristic of the third sector under New Labour has been the increase in the number of social enterprises. These share the characteristics of other non-profit organisations in that they pursue aims that benefit individuals and society, they earn income from grants and donations as well as trading and they adopt common legal structures, such as a charity, mutual association or the status of an industrial and provident society. However, they are distinctive in the rejection of grant dependency (or at least full dependency) in favour of pursuing financial independence through trading, for example through the delivery of services, particularly social welfare services, under contract to the public sector. The government definition of a social enterprise is:

> a business with primarily social objectives whose surpluses are principally reinvested for that purpose in the business or community (Office of the Third Sector, 2006A, p. 10).

A similar, but more detailed, definition is provided by the Organisation for Economic Cooperation and Development (OECD):

> any private activity conducted in the public interest, organised with an entrepreneurial strategy but whose main purpose is not the maximisation of profit but the attainment of certain economic and social goals, and which has a capacity of bringing innovative solutions to the problems of social exclusion and unemployment (OECD, 1999, p. 10).

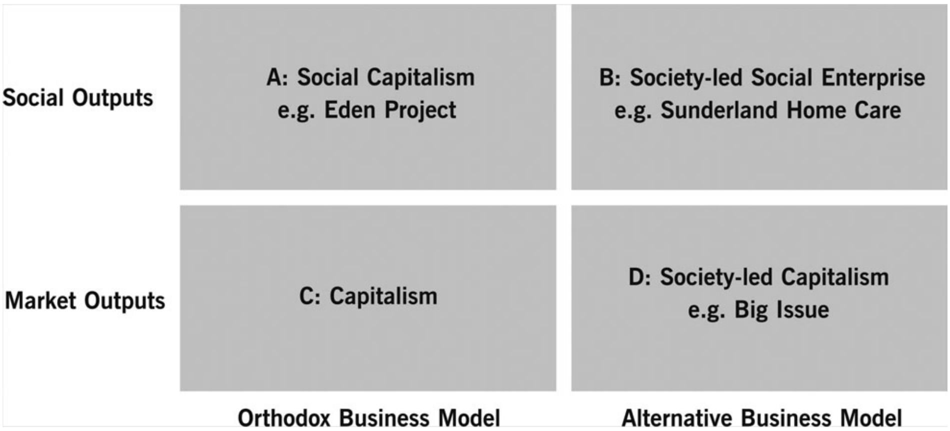



**Fig. 1.** *The social enterprise domain*

The social enterprise sector is diverse and encompasses a wide range of activities and business forms. To illustrate the types of activities and business forms, Figure 1 provides a stylised view of how social enterprises compare to orthodox capitalist businesses in terms of either the business models that they use or the output that they produce (or both). Most businesses in the private sector operate in the capitalist (C) quadrant where they adopt orthodox business models to produce marketable output in order to maximise profit and shareholder value. Social enterprises, however, occupy other business and social spaces. Some, in the D quadrant, produce marketable output but using alternative business models that have a social, ethical or environmental dimension. An example of society-led capitalism is the *Big Issue*, established in 1991, which competes in the magazine industry but its distinctive business model is to employ the homeless as vendors. In the A quadrant are social capitalist enterprises that adopt orthodox business models but in the pursuit of social or environmental objectives. The Eden Project is concerned with environmental sustainability and education and although it is owned by a charitable trust, it has an orthodox organisational structure. In quadrant B can be found enterprises that adopt alternative business models to achieve social or environmental outcomes. An example of society-led social enterprises is Sunderland Home Care, which provides personal care and domestic services for the sick and elderly, employing those who found it difficult to find employment in the depressed North East. The majority of the carers are women, although many men are also employed, mainly men from former mining communities who lost their jobs following the pit closures of the past 20 years.

In some respects, many businesses in the private sector have recently attempted to break out of the capitalist quadrant, either by adopting alternative business models or by suggesting that they are pursuing more socially orientated goals. Thus, we have seen the rush towards claims of corporate social responsibility, environmental sustainability and, in some cases, improved working conditions and employment practices. But there are significant limits to these changes. First, in the private sector, the profit motive and increased shareholder value remain the key drivers—although consumer and shareholder activism has encouraged new corporate practices, such practices do not emanate from an in-built concern for social or environmental objectives. Similarly, the potential loss of skilled labour and the associated search, recruitment and training costs is a generic driver of better employment policies. Second, the key push force is policy—such as that on the environment and via legislation controlling health, safety and employment conditions and practices. And the extent of this policy-push has been limited.

## 3. Size and scale of the third sector in the UK

Although it has an important role in policy delivery, the lack of a comprehensive database of organisations in the third sector has limited its visibility. Third sector organisations have either been deliberately ignored, or have been assumed to be too small to merit attention. Unlike the case of the USA, which requires non-profit organisations to file an IRS 990 using the 501c (3/4) code for charitable organisations each year, many UK third sector organisations are too small to appear on the Inland Revenue radar. Such data on the third sector as do exist are comparatively sparse, distributed across several databases and indexes (such as the Register of Charities, Guidestar and the Register of Industrial and Provident Societies), and suffer from lack of comparable definitional criteria. Thus, it is not possible to identify trends across the entire sector with complete confidence.

The data that do exist have been gathered by non-governmental organisations, of which three will be used here: the Charities Aid Foundation (CAF) (Saxon-Harrold and Kendall, 1995; Pharoah and Smerdon, 1998); the National Council for Voluntary Organisations (NCVO) (Hems and Passey, 1996, 1998; Wilding *et al.*, 2006); the Johns Hopkins University (Kendall and Almond, 1999). Each of these sources employs its own specific definitional criteria for inclusion in their database. CAF gathers data for an annual survey of voluntary income directly from major fundraising charities. The NCVO gathers data from a sample of the annual reports of 40,000 charities (provided by Guidestar, www.guidestar.org.uk) and employs a restricted definition of general charities that are registered with the Charity Commission in England and Wales, plus lists of charities from the Scottish Council for Voluntary Organisations and the Northern Ireland Council for Voluntary Organisations. Housing associations, independent schools, government controlled charities (e.g., NHS and non-departmental bodies) and organisations whose primary purpose is the promotion of religion are excluded from the NCVO data. At the Johns Hopkins University, Salamon and Anheier (1997) use a structural-operational definition of non-profit organisations from which they gather data via a survey. They define a non-profit organisation as formally constituted, private, non-profit distributing, independent of the state, and benefiting from voluntarism (donations or volunteering).

Data relating to social enterprises in particular have more recently become available. The Social Enterprise Unit (SEnU) commissioned a survey of social enterprise activity, which reported in 2005 (IFF, 2005). In addition, the Social Entrepreneurship Monitor has collected data about socially entrepreneurial behaviour from a random sample of approximately 27,000 individuals aged between 18 and 64, stratified by UK region (Harding and Cowling, 2004; Harding, 2006). These two sources of data will be used to give greater insight into the more enterprising aspects of the third sector.

Notwithstanding the definitional complexity of the third sector, the number of charities in the UK has grown from 98,000 in 1991 to 169,000 in 2004, of which 75% are located in England (see Table 1). The size of the sector is increasing in terms of the number of new organisations, and from the 'charitisation' of the public sector, such as through the creation of leisure trusts (Wilding *et al.*, 2006; Office of the Third Sector, 2006B).

In 2005, the first national survey of social enterprise in the UK employed the narrow definition of such enterprise (see above) and estimated that there were 15,000 social enterprises registered as either a company limited by guarantee, or as an industrial and

**Table 1.** *Number of general charities in UK, 1995–2004*

| | Under £100k | £110k–£1m | £1m–£10m | Over £10m | Total |
|---|---|---|---|---|---|
| 1995 | 109,384 | 10,164 | 1,331 | 121 | 121,000 |
| 2000 | 126,219 | 12,838 | 1,701 | 206 | 140,964 |
| 2004 | 146,963 | 19,064 | 2,930 | 290 | 169,249 |

*Source:* Wilding *et al.*, 2006, p. 4

provident society. Turnover for these organisations was approximately £18 billion and they accounted for 1.2% of all enterprises (IFF, 2005). In 2006, the figure was revised upwards by the Department of Trade and Industry to 55,000, thereby accounting for 5% of all businesses in the UK. The Social Entrepreneurship Monitor employs a broader definition of social entrepreneurial activity to include involvement (job-related or otherwise) in any kind of social, voluntary or community service, activity or initiative. This survey found that 1.2 million individuals, or 3.2% of the working age population, were involved in some type of social entrepreneurship. When compared to the general UK adult population, the attitudes of social entrepreneurs were more positive; they were, however, less positive than the attitudes of mainstream entrepreneurs (Harding, 2006).

### *3.1 Employment*

The most reliable employment data are provided in the Labour Force Survey which collects data for the private and public sectors, and in which non-profit institutions serving households (such as charities and universities) are included in private sector data. Employment in the private sector has risen consistently since records began; however, it is impossible to say with confidence that this is also the case for the third sector organisations that are in the private sector data. Employment in the public sector had fallen for 15 consecutive years up to 1998; however, since New Labour came to power, employment has risen, although there has been variation in different parts of the sector. The public sector is the dominant employer in health, education and public administration (Black *et al.*, 2004) and employment has increased in education and health, particularly following the increase in public spending during New Labour's second term. Since the early 1990s, however, there has been a decline in employment in local authority construction and social services; this has been primarily caused by changes in policy, which has shifted towards buying-in these services from the private sector [although there are exceptions, see the discussion of Sunderland Care Associates (above) and Section 7 (below)].

In 1995, prior to the election of the Labour government, organisations that would subesquently be included in the definition of the third sector employed just under 1.5 million full time equivalent paid workers, and accounted for just over 6% of activity in the economy (Kendall and Almond, 1999). Kendall and Almond (1999) found that the sector employed between 2% and 6% of the UK paid work force, and accounted for 3–9% of gross domestic product (GDP). The large range in these data is explained by the use of different definitions and the imputed value of volunteer contributions. As shown in Table 2, Wilding *et al.* (2006) found that charities in the UK employed a paid workforce of 608,000 in 2003/4; this accounts for 2% of the total workforce. In the social economy, the paid workforce is supplemented by volunteer labour; according to Home Office (2004A) estimates, 13.2 million people volunteered once a month, which is equivalent to an

**Table 2.** *UK employment by sector, 1995–2004 (figures in 000s)*

| | 1995 | 2000 | 2004 |
|---|---|---|---|
| Private sector | 19,095 | 20,711 | 20,270 |
| Public sector | 6,042 | 6,246 | 6,842 |
| Voluntary sector | 473 | 563 | 608 |
| Total | 25,616 | 27,520 | 27,720 |

*Source:* Wilding *et al.*, 2006, p. 9

additional 1.1 million full time employees. Furthermore, part-time work is a key feature of voluntary sector employment: in 2004, 38% of employees worked part time (377,00 full time and 231,000 part time) (Wilding *et al.*, 2006) and the average hours worked per week have risen from 16.5 in 1998 to 20 in 2004.

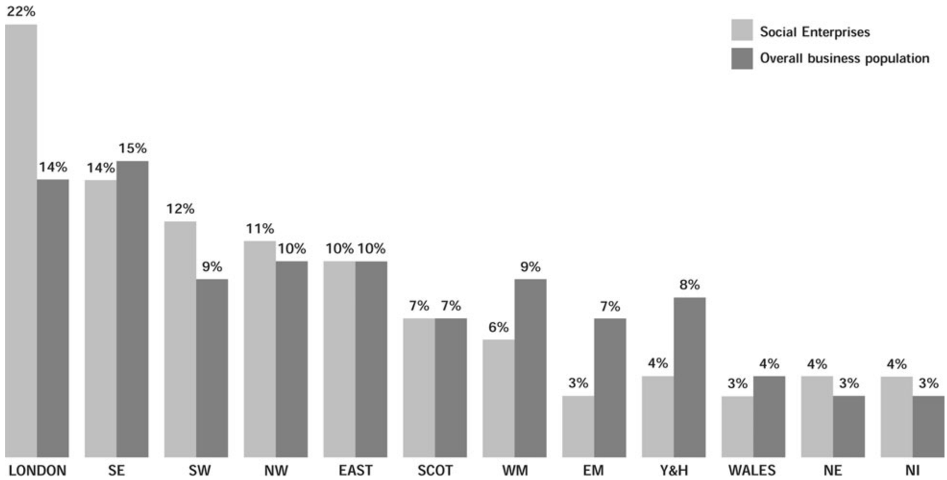
The IFF survey (2005) estimated that more than 750,000 people work in social enterprises—they employ 475,000 people, of whom 66% are full time. A further 300,000 are volunteers, contributing, on average, 2 hours per week (IFF, 2005). This constitutes approximately 2.5% of all private sector employment (excluding private sector volunteers). The Social Entrepreneurship Monitor (Harding, 2006) estimated that 1.2 million people (3.2% of the working age population) were engaged in social entrepreneurial activity. Third sector organisations are estimated to make a major contribution to paid employment in three main areas: education and research, culture and recreation and social care.

### *3.2 Income*

Income for third sector organisations is derived from three main sources: voluntary income (fundraising, donations, legacies, lottery and money raised from sale of donated goods); investment income (share dividends and interest on savings); earned income (trading, fees and contracts). According to CAF, the total annual income for registered charities was approximately £35 billion in 2004 (CAF, 2006). Many third sector organisations hold substantial endowments, and the most recent NCVO data, for 2004, indicates that the sector has total assets of £66.8 billion (Wilding *et al.*, 2006), income of £26.3 billion and expenditure of £24.9 billion. The majority (56%) of organisations are small and have an income of less than £10,000, although large organisations account for a greater share of income: 66% of income is generated by 3,200 organisations in the sector, with a super group of 14 charities with an annual income of more than £100 million. The charity super group is successful in securing public donations and legacies and has embraced the entrepreneurial strategies associated with delivering client services under contract to government.

In 2004, the proportional breakdown of income was: voluntary income (45%), investment income (8%) and earned income (47%), of which 38% was grants and fees from statutory sources. The long-term shift from grants to fees for services in the charity sector has been embraced by social enterprises, and this source of income is the mainstay of many.

According to IFF (2005) the total annual turnover of social enterprises in the UK was £18 billion in 2004. Average turnover was £285,000 and 20% of enterprises had a turnover of more than £1 million per annum. Trading revenue accounts for 82% of income, and 88% of social enterprises generate more than 50% of their income from trading. In 2006,




South East (SE), South West (SW), North West (NW), Eastern (EAST), Scotland (SCOT), West Midlands (WM), East Midlands (EM), Yorkshire and Humberside (Y&H), North East (NE), Northern Ireland (NI).

**Fig. 2.** *Regional distribution of social enterprises and other businesses. Note: Based on a survey of social enterprises conducted in 2004. Source: IFF (2005) p. 11.*

social enterprises generated more than £27 billion in turnover and contributed £8 billion to GDP, nearly 1% of UK GDP (Office of the Third Sector, 2006A).

### *3.3 The regional dimension*

The regional distribution of social enterprises is shown in Figure 2. The data, which are based on estimates by IFF (2005), show the proportion of social enterprises in each region and devolved administration in the UK in 2004 and, for comparison purposes, the proportion of all businesses in the same areas.

The highest proportion of social enterprises was in London, and comparison with the total stock of businesses indicates that the capital has a higher relative share of social enterprises. The South West also had a higher share of social enterprises compared to its share of all businesses, whereas the share of social enterprises in the East Midlands and Yorkshire and Humberside were much lower than the share of the stock of businesses.

Some of the regional variations in the location of social enterprises can be explained by the higher propensity of such organisations to be located in urban areas—according to IFF (2005), 89% of social enterprises are located in urban areas compared to 67% of the total business stock. Furthermore, many social enterprises are located in areas of high multiple deprivation;[1] according to IFF (2005) 29% of social enterprises are located in the top 20% of deprived wards in the UK and 22% are located in the next quintile of deprived areas. Although such evidence suggests that social enterprise may be both generated by, and a response to, social exclusion and deprivation, a number of important caveats should be noted. First, in areas of high deprivation there may be insufficient skills and resources to maintain the long-term sustainability of social enterprises in the locality (Amin *et al.*, 2002;

[1] Multiple deprivation at the small area level is measured by a composite index. The index includes seven types of deprivation: income deprivation; employment deprivation; health deprivation and disability: education, skills and training deprivation; barriers to housing and services; living environment deprivation; crime. And each type of deprivation is measures by a number of indicators. Further information is available at: http://www.communities.gov.uk/index.asp?id=1128440

Hudson, 2005). Second, the size and success of the social enterprise sector is rooted in the characteristics and dynamism of local communities. Thus, different communities may have similar economic and social problems but very different levels of social enterprise activity. The relatively high level of social enterprise in the South West, noted above, may in part reflect Bristol's strong voluntary sector based on a long history of community activism and civic engagements (Amin *et al.*, 2002; Hudson, 2005).

## 4. The growth of the third sector and social enterprises

In this section we consider the forces that have led to the increase in the size of the third sector, and the emergence of social enterprises in particular. We propose that there are six main causal explanations. First, inadequate markets, that is, the failure of the private sector to provide sufficient quantity of goods and services with a social or environmental impact, or the failure to organise production to employ those who are disadvantaged in orthodox labour markets. Such market inadequacy has similarities with broad notions of market failure, although we eschew the use of that term here as its narrow interpretation in neoclassical economics is merely concerned with deviations from efficiency and Pareto optimality.

Second, inadequate public sector supply and retrenchment has led to an increased role of the third sector in supplying services to compensate for stagnant and declining public services. When New Labour came to power in 1997, its pursuit of economic orthodoxy and credibility with financial capital markets led them to continue to adhere to the previous Conservative government's public expenditure targets (Balls and O'Donnell, 2002). This placed increased pressure on public services, especially in deprived areas where the impact of public sector retrenchment was most acutely felt (see below). Third sector organisations, in particular social enterprises, grew as a means of supply compensation in areas of deficit.

Third, there are groups of the population that have increasingly found it difficult to engage with either the private or public sectors. For example, the state, even after the ravages of Thatcherism, still retains a duty to provide services to vulnerable and hard to reach groups—but it has been unable to deliver them, leaving some individuals and groups economically and socially excluded. Billis and Glennerster (1998) identify four categories of disadvantage and exclusion: financial (lack of market power), personal (unable to articulate a preference), societal (stigmatised individuals and groups), and community (lack of civil structures). In such cases, services may be better delivered by third sector organisations as they are likely to have distinctive capabilities that make them more suitable for the task (Wolf, 1979; Le Grand, 1991). The growth of the third sector can be thus explained by distinctive organisational capabilities in terms of: specialist knowledge and skills for dealing with the disadvantaged and excluded; greater flexibility to tailor services to individual needs; independence of state structures, which may be perceived negatively and resisted by some societal groups; and trust-based relationships built on long standing ties with the individuals and communities they serve (HM Treasury, 2002). These capabilities mean that third sector organisations have the potential to contribute to designing, as well as delivering, public services.

Fourth, post war structural changes in the UK economy have favoured a growing third sector. Amin *et al.* (2002) have identified the collapse in Fordism, the crisis of the welfare state and the demise of full employment as being critical to the rise of the social economy. The third sector is predominantly a service economy, and although the post war decline in production and manufacturing and growth in services have led to problems of structural unemployment and regional disparities, it has also created new opportunities for the sector. Third sector organisations supply services such as assisting employment, education, health, social care, housing and environmental recycling; a few are also active in community-owned energy supply. Most services are labour intensive, rather than capital intensive, and most third sector organisations are able to draw on a pool of volunteer labour. Although this, in effect, subsidises the full economic cost of service delivery, overall the third sector has benefited from long-term structural change.

Fifth, despite Thatcher's pronouncement concerning the non-existence of society, in terms of volunteering to help charitable organisations there is some evidence that this one aspect of societal activity has been relatively stable. Participation in volunteering activities is a reflection of deep-rooted societal values that foster and sustain individual altruism. It has been argued there has been a decline in social capital in the UK with adverse effects on the economy and the quality of life (see Halpern, 2001). However, Halpern also found that the proportion of people volunteering increased during the 1980s, although the growth levelled off during the 1990s. Hence the growth of the third sector may be associated with the rising tide of volunteering.

Lastly, and as discussed below, New Labour has adopted policies that are, in general, more positive towards third sector growth.

## 5. Government interest in the third sector

Government interest in the third sector is not new—in 1978, one of the findings of the Wolfenden Committee Report was to stress the need for cooperation between the state and the third sector (Anheier, 2005). At the time, the array of voluntary and community organisations in the UK had not been considered as a unified sector, and it was the report of the Wolfenden Committee, *The Future of Voluntary Organisations*, which labelled the sector as a unified whole for the first time (Kendall, 2000). The long period of Conservative government (1979–97), however, was associated with *ad hoc* and piecemeal attention to the sector. Between 1979 and 1997, the tax treatment of charities was simplified and the legal regulations controlling charities were strengthened and modified. But the dominant philosophy of government policy was to restructure the economy by expanding the scope and scale of the private sector. Privatisation, attempts to restrain public expenditure, and the general demonisation of the public sector, led to the off-loading of traditional public sector functions to the private sector, and the introduction of quasi-markets in selected areas, such as health and social care (Bartlett and Le Grand, 1993). The relationship between the government and third sector organisations was characterised as being instrumental, with voluntary and community organisations fulfilling a service agent role, in some cases acting as a supplier of last resort to those who fell by the wayside and lost their jobs and their homes (Deakin, 2001).

In the early 1990s, the Labour government-in-waiting took stock of Conservative economic policy and embraced their enthusiasm for markets and the involvement of commercial organisations in some areas of policy delivery. The historic roots of the Labour party in the cooperative movement, however, and the remnants of its commitment to social justice, fed into a declared proactive stance in favour of recognising the benefits and potential contribution of a vibrant, active and engaged third sector. Under the leadership of Tony Blair, references to the third sector, in appreciation of its potential contribution to economy and society, began to appear (Kendall, 2000). Prior to the election, a review of the Labour Party's relations with the third sector led to the publication of *Building the*

*Future Together* (Labour Party, 1997) in which a compact between the party and the third sector was proposed. At the same time, Labour's review of the fundamental philosophy of state ownership of industry was made explicit in *The Third Way* (Giddens, 1998, 2000) and New Labour moved away from the view that the only alternative to private ownership was state ownership, which had been seen as a prerequisite for achieving socialist objectives.

The Third Way was a political philosophy that sought to resolve the ideological differences between liberalism and socialism; it combined neoliberalism with renewal of civil society and viewed the state as an enabler, promoted civic activism and endorsed engagement with the voluntary and community sector to address society's needs. The Third Way sought to mobilise citizens and communities, and was grounded in the belief that a strong economy and strong society, in which citizens posses both rights and responsibilities, were closely interconnected.

According to Hombach (2000, p. 1) the Third Way is 'a path between competing ideologies, a system that represents a realistic response to the changes that have taken place in the world' and which supersedes 'the extremes of free market economics on the one hand and a centralised state economy on the other'. This is a broad path, and New Labour's position has been to travel on the free market edge. And this may help explain why the term Third Way has fallen out of use in policy discourse, being replaced by more market-orientated terminology, such as the need for competitiveness, productivity and entrepreneurship and, in more arid tones, the importance of post-neoclassical endogenous growth theory and post-monetarist economic policy (Brown, 2001).

In essence, New Labour's policy has been to embrace many aspects of Thatcherism, such as the primacy of free markets and the hollowing out of demand management policies (Kitson, 2004). The Government has, in effect, developed a modern equivalent of Say's Law (where supply creates its own demand) and where economic policy is focused on improving the operation of markets. There have been some subtle shifts in policies, such as an increased focus on education, employability and innovation, but the role of state is limited: according to Coates (2002) it has been demoted to acting as the lubricator of the market.

A number of factors within this liberal market framework have led to New Labour embracing the third sector. First, the focus on markets as being allocatively efficient has led to attempts to 'marketise' (the adoption of markets or quasi-markets) the public sector. This has opened up opportunities for different delivery mechanisms for firms in competition with one another, and signalled the way for third sector organisations to work in partnership with the government, or other providers, to deliver public services. Second, there has been increasing focus on local or regional delivery of policy (although this is in tension with many of the centrist tendencies of New Labour), and many third sector organisations are viewed as locally embedded or better able to articulate the needs of local communities. Third, and related to both the former factors, is the notion that third sector organisations engender more trust than the public sector (Bubb, 2006). The empirical support for such a notion, however, is questionable (Davies, 2006) and it may reflect the continued denigration of the public sector that was so evident during the Thatcher period. And fourth, the issues of social exclusion and the environment have risen up the policy agenda—a contrast with the Thatcher period. As discussed above, these are areas where the third sector has a strong presence, and where goods and services can be delivered at low cost to a fiscally prudent government.

Wasting no time after the election, in 1997 the new government initiated the Charity Tax Review to be carried out by the Treasury. The review considered the state of charity law and led to the publication of *Private Action Public Benefit* (Cabinet Office, 2002). In turn, this produced the Charities Bill, the aim of which was to create a modern legal framework to support and encourage a strong, diverse and independent voluntary sector. Specifically, it would update and expand the list of charitable purposes, clarify the emphasis on public benefit, encourage greater efficiency and effectiveness of charities, introduce a new legal form for charities, strengthen accountability for excepted or exempt charities, improve the regulation of public charitable collections and modernise the functions and powers of the Charity Commission.

Building on their pre-election report into the third sector, in 1998 the New Labour government launched a compact between the new government and groups claiming to represent the third sector (Home Office, 1998). The compact set out the agreement between government and the voluntary and community sector in England to improve their relationship for mutual advantage and mainstream the sector into the Government's policy agenda (Kendall, 2003). It defined how government and voluntary and community organisations should engage, and endorsed the fundamental importance of third sector organisations to the well-being of society and their role in public policy creation and service delivery. Since 1998, compacts have been implemented at national and local levels and have, in effect, served to incorporate third sector organisations into public policy. Partnerships to deliver local services have been formalised in Local Strategic Partnerships. The compact scheme was innovative in that it aimed to unify the government's policies relating to the third sector and draw the latter into its central policy agenda (Kendall, 2000).

With two policy initiatives underway by 1998, the Government set about creating an administrative structure to deal with the enhanced role of the third sector. At the time, third sector issues were not a high priority and were dealt with in various departments across Whitehall. For example, the Voluntary Services Unit had been established in the 1970s and was a small, low profile unit (Kendall and Knapp, 1996) that administered low cost and low status programmes. In 1999, the Active Communities Directorate (ACD) was established at the Home Office to deal with third sector issues. The ACD brought together the Voluntary and Community Unit and the Voluntary Services Unit with the aim of fostering a society in which more people from different backgrounds, especially those at risk from social exclusion, participated in improving communities and strengthening society. Alun Michael, MP, who had led the review of relations with the third sector in the period 1994–97, was appointed Minister with responsibility for the voluntary sector and secured increased resources and staffing for the unit (Kendall, 2000). The importance of partnerships between the government and third sector organisations, and recognition that such organisations could deliver better services on behalf of government, was made explicit in its policies. New metrics to assess performance were introduced: for example, data would be gathered on the proportion of those at risk of social exclusion who regularly volunteer, formally or informally, on the capacity of the voluntary and community sector to deliver public services, and the levels of planned, regular, tax efficient giving to good causes would be monitored.

The Government's support of third sector organisations was further endorsed in 2002 when the *Cross Cutting Review* (HM Treasury, 2002) reported on the role of third sector organisations in the provision of public services in the UK. In the foreword to the review, the Chief Secretary to the Treasury wrote (p. 4):

> We believe that voluntary and community sector organisations have a crucial role to play in the reform of public services and reinvigoration of civic life.

The review made explicit that third sector organisations would have a key role to play in the reform of public services and in the delivery of statutory services (Osborne and McLaughlin, 2004B). It identified the barriers to effective involvement that lay in inadequate infrastructure, which in turn influenced the establishment of *Futurebuilders* (HM Treasury, 2003), a capital investment fund to build the capacity of third sector organisations at community level. A second investment programme, *ChangeUp* (Home Office, 2004B) was introduced to strengthen infrastructure in priority areas of: performance improvement, governance, workforce development, volunteer recruitment and management and income generation. The review increased funding to the third sector to almost £70 billion, the majority of which was to provide housing, with £20 billion allocated to health and social care.

In recognition that the third sector was comprised of a range of organisations, which adopted different approaches to service delivery, in 2002 the Government acknowledged the entrepreneurial potential of the sector and established the Social Enterprise Unit (SEnU) at the Department of Trade and Industry (DTI). This was followed quickly by the launch of the social enterprise strategy (DTI, 2002). This reflected the emergence of non-profit organisations, which were rejecting grant dependency in favour of pursuing financial independence through trading. The aims of the SEnU were to gather evidence on the size and scale of social enterprise activity in the UK, to create an enabling regulatory and business support environment for social enterprises, and to find ways to help them improve their performance. Since then, the government has supported the development of Community Development Finance Institutions (CDFI) and introduced Community Investment Tax Relief to investors in them, created a new legal framework of the Community Interest Company with a community asset lock, extended the Small Firms Loan Guarantee Scheme to include social enterprises, encouraged the supply of appropriate business support to them, and supported the development of the Social Enterprise Coalition to provide a unified voice for the sector when dealing with the government and other stakeholders.

More recently, in 2006, the Office of the Third Sector was established in the Cabinet Office and a Minister for the Third Sector was appointed. The former ACD, made up of the Charities and Sector Development Unit, Partnership and Delivery Unit and the Volunteering and Charitable Giving Unit, was moved to the Office of the Third Sector, as was the SEnU from the DTI. The new Office of the Third Sector has a broad remit across the entire range of organisations in the social economy. It brings together the former work of the ACD and the SEnU, namely responsibility for the government's work to support greater participation in society through volunteering, charitable giving, fostering a stronger voluntary and community sector through better regulation, investment in the capacity of the sector, creating an enabling environment for social enterprises and opening up greater opportunities for third sector organisations to deliver public services. Soon after, the Social Enterprise Action Plan was launched (Office of the Third Sector, 2006A).

Although the role of the third sector was quickly incorporated into New Labour's policy agenda, the recognition of its potential economic contribution and its incorporation into Treasury policy was slower to emerge. For instance, the Treasury's statement of the foundations of its supply side policy (Balls *et al.*, 2004) makes little mention of the role of the third sector or social enterprises. However, in his foreword to the statement, Brown notes that the government is 'now stepping up efforts to pioneer decentralised public service delivery', which will include empowering 'private and voluntary sectors to deliver services in innovative ways which meet local needs' (Brown, 2004, p. xiii). In 2000, Brown had called for ‘more investment in the UK in social enterprises—projects which have social objectives, and are not simply profit orientated’. But by 2006, the economic role of the third sector was becoming more defined and explicit. According to Brown (2006A):

> The truth is that much of the best work in communities takes place through third sector organisations and their alliances with you, including social enterprise—a term not widely recognised five years ago. Fifty five thousand social enterprises founded for a social purpose, united by a commitment to social innovation and today finding new ways to tackle existing social challenges with . . .—a major role to play in environment, jobs and investment.

And later in that year he remarked (Brown, 2006B):

> I am optimistic first of all because of the dynamism and power of what I see as the great forces of change today in British civic society: the growing role of social enterprise, the expanding corporate social responsibility of companies, the proliferation of local community and environmental action, the innovation and diversity of the third sector as a whole.

The increasing recognition of the range of potential impacts of the third sector has led to policy initiatives to improve the economic performance of the third sector (DTI, 2002): to enhance its economic impact (HM Treasury and Cabinet Office, 2006); and especially to improve its delivery of public services (HM Treasury, 2002). Furthermore, there has been increasing recognition of the financial constraints under which the third sector operates (Bank of England, 2003; SQW, 2007) and of the need to make the relationships between the third and public sectors more transparent and accountable (HM Treasury, 2006), particularly at the local level (National Audit Office, 2007).

## 6. Impact

Much of the focus on the performance of the third sector has been on its role in providing goods and services not available, or affordable, from the private and public sectors. Specifically, the performance of social enterprises has been concentrated on their ability to achieve social and environmental goals, such as reducing social exclusion and poverty, and reducing harmful environmental impacts. The performance of the third sector in terms of primary economic indicators, such as output and employment, although important, has been given less attention. In part, this reflects the fact that (prior to the creation of the Office of the Third Sector in 2006) the responsibility for third sector policy lay with the ACD and responsibility for social enterprise policy with the DTI (latterly with the Cabinet Office),[1] and not with the Treasury, which has a virtual monopoly on the formation of economic policy. In the Government’s strategy report, *Social Enterprise: Strategy for Success* (DTI, 2002), there is a brief mention that social enterprises ‘create new goods and services and develop opportunities for markets where mainstream business cannot, or will not, go’ (DTI, 2002, p. 21). But the thrust of the report is concerned with social exclusion, neighbourhood renewal, ‘bringing excluded groups into the labour market’ (p. 7) and ‘helping to develop an inclusive society and active citizenship’ (p. 8). Similarly, a joint Treasury and Cabinet Office Report on the future of the third sector does not focus on the direct economic impact of the sector but highlights its role in ‘building social capital . . . providing community services . . . promoting participation and empowerment . . . (and) contributing to local regeneration’ (HM Treasury and Cabinet Office, 2006, p. 11).

[1] The Social Enterprise Unit (SEnU) was established in the Department of Trade and Industry but in May 2006 the Office of the Third Sector (OTS) was established in the Cabinet office. The OTS brought together the work of the former Active Communities Directorate (ACD), originally in the Home Office and the SEnU.

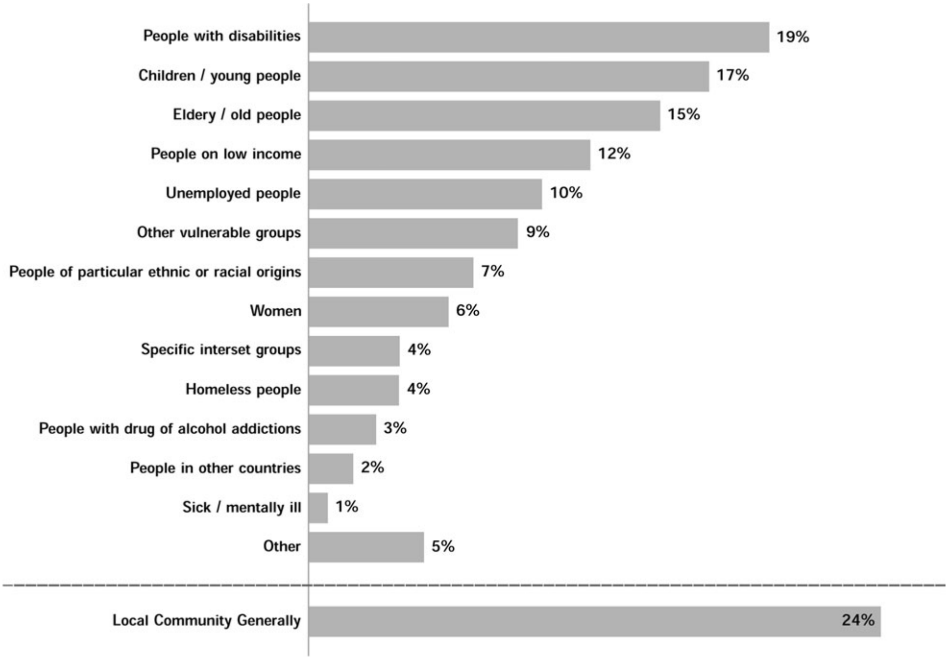



**Fig. 3.** *Beneficiaries of social enterprises. Note: Based on a survey of social enterprises conducted in 2004. Source: IFF, 2005, p. 28*

*6.1 Social exclusion and poverty*

Third sector organisations have adopted enterprising solutions to address social and environmental issues (HM Treasury, 2006). Much of the assessment of the impact of social enterprises has focussed on their social impacts and, in particular, whether they can reduce social exclusion (IFF, 2005). Some detail on the beneficiaries of social enterprise activity is shown in Figure 3 (IFF, 2005).

The top five target beneficiaries were: people with disabilities; children and young people; the elderly; people on low incomes; the unemployed. These are groups that have traditionally relied on some support from the state and will have been adversely effected by the retrenchment and marketisation of the public sector since the early 1980s. The methods deployed to help target groups included employment and the provision of goods and services. In terms of employment, the top five beneficiaries were: people with disabilities; the unemployed; specific interest groups; young people; people from ethnic or racial minorities. All these groups have been disadvantaged in the labour market—particularly in deprived areas with high levels of poverty and unemployment. The second method of helping target groups was through the provision of goods or services, and the top five groups benefiting from such provision were: people with disabilities; children and young people; the elderly; the unemployed; those on low incomes. A range of goods and services was provided to the target groups, the most important being training and education, social assistance, housing and nursery and childcare. Although social enterprises have helped address the problems of social exclusion, it should be stressed that they are not able to replace the role of the state. Instead, they can act as agents of local delivery and, perhaps more importantly, agents that can understand and articulate local need. To be effective they must work in alliance with the state but not as low-cost, subservient partners.

### *6.2 Environment*

The third sector has been active in promoting the benefits of environmentally sustainable business strategies, and a driving force in encouraging recycling. An increasing number of social enterprises are engaged in environmental activities. According to the IFF (2005) estimates, 23% (3,500) of social enterprises are engaged in improving the environment.[1] Such activities have included: recycling and the sustainable use of resources; conservation; raising environmental awareness.

### *6.3 Social capital*

The active engagement of local people in the management and governance of third sector organisations makes a positive contribution to civil society. The contribution to building local communities and generating social capital occurs alongside their formal outputs and outcomes. Social capital refers to the networks between people through which interpersonal trust is created (Coleman, 1988; Iyer et al, 2005; Putnam, 2000). Although findings concerning the impact of associational activity on economic performance and growth have not been conclusive (Putnam, 1993; Knack and Keefer, 1997), trust and cooperation have been found to be associated with stronger economic performance (Knack and Keefer, 1997). Social capital has also been identified as an important determinant in the development of young people (especially those at risk) (Furstenburg and Hughes, 1995); thus, the role of third sector organisations in working with disaffected youth has the potential to foster at the same time the development of social capital.

### *6.4 Output and employment*

The third sector, including social enterprises, makes a contribution to national output. According to government estimates, social enterprises contribute approximately £8.4 billion to GDP (HM Treasury and Cabinet Office, 2006, p. 29), around 0.7% of the total economy. However, there are several problems that prevent reliable estimates being made about the size of the contribution, and, as such, data limitations may lead to underestimating the size of the sector. First, it is difficult to identify the separate contributions of the different categories of third sector organisation in many sectors such as education, health, social and personal services. Second, as with other parts of the mainstream economy, there is often a failure to capture the contributions to national output if the activity does not include a financial transaction. Third, the contributions of volunteer labour are likely to be underestimated, especially where output estimates are based on wage bill measures, such as for much of the service sector. Fourth, there may be a countervailing effect, as the growth of the third sector may be displacing economic activity in the private and public sectors.

As discussed above, the third sector makes a significant contribution to employment, with 608,000 employed in 2003/4; when volunteering is included, this rises to the equivalent of an additional 1.1 million full time employees. Additionally, it is important to stress that many of those employed in the third sector are often disadvantaged or detached

[1] This includes social enterprises that also help people: approximately 18% of all social enterprises help both people and the environment and 5% are solely environment focussed. The notion of environmental focus here is concerned with 'green' issues rather than the wider definition, which could encompass the built environment.

from orthodox labour markets. The sick, the disabled and the long-term unemployed have increasingly found it difficult to enter, or re-enter, the labour market. The extent of this problem has often been masked by the official employment and unemployment statistics. For instance, as the unemployment statistics have fallen, those on incapacity benefit have risen. According to Fothergill and Wilson (2006), there are currently 2.7 million incapacity claimants,[1] and the number has increased by 200,000 since 1997. Furthermore, there are significant regional differences, with the incapacity benefit claimant rate in the North East, North West, Scotland and Wales approaching double that in the South. The government response to the rise in incapacity benefits is to introduce the *Pathways to Work Programme* (Department for Work and Pensions, 2002), which introduces a series of compulsory work-focussed interviews, training, and provides a small return-to-work premium for the first year for those entering low-paid jobs. Although such measures may help at the margin, they are limited to the supply side, like much of government labour market policy, and will do little to help in areas where there is severe lack of demand for labour. In particular, those currently at the margins of the labour market are likely to be at the end of the jobs queue. Third sector organisations, and particularly social enterprises, which target marginalised labour, help to increase the demand for such labour, provide employment opportunities, offer training and mentoring, and help such labour to move up the labour market queue. Furthermore, the social economy can create new possibilities and provide new forms of fulfilling work (Hudson, 2005). These processes have social effects, such as reducing social exclusion, and also generate tangible economic outcomes. Resorting to 'Treasury-speak' (the only language known by many in that Ministry), the growth of social enterprises can raise the trend-level of growth, reduce the equilibrium rate of unemployment, reduce the fiscal burden and help to reduce (or at least slow the widening of) regional disparities. To a large extent, these effects have not been central to the debate on the impact of the third sector—and the implications for economic policy. Although it has been argued that the third sector has been a key focus of the discourse on the Third Way (Amin *et al.*, 2002)—the sector has not been central to the development of New Labour economic policy and it is only relatively recently that it has become more central to Treasury policy (see discussion above).[2] What should be also emphasised is that social enterprises must complement the role of the market and the state, and over-emphasising their potential impact on their own may lead to unrealistic expectations (Hudson, 2005).

## 7. The third sector and the public sector

The government view that the third sector is an active agent of change for the public sector has been well documented. According to Labour policy 'The third sector has historically played an important role providing public services, identifying needs, campaigning for change and developing dynamic, innovative solutions' (HM Treasury and Cabinet Office, 2006, p. 37). The third sector, and social enterprises in particular, can be an important source of knowledge of the needs of users, and they may be more flexible in providing services and goods that reflect local capability and constraints than can centralised

[1] This figure is based on the total number of men and women in receipt of Incapacity Benefit itself (approximately 1.4 million); 'NI credits only' for incapacity (1.0 million) and Severe Disablement Allowance (0.3 million) (Fothergill and Wilson, 2006).

[2] Although it has been suggested that the third sector may become more central to economic policy in a future Labour government as Gordon Brown searches for new initiatives and as Ed Miliband (the Minister for the Third Sector) grows in influence.

bureaucracy. However, to highlight only the positive benefits of a constructive alliance between the public and the third sectors would not acknowledge the problems that drove the public sector to embrace the third sector in the first place. The initial drivers were the desire to keep to the previous Conservative government's spending plans, and to help extend the role of markets, or quasi-markets, in the public sector. As such, much of the engagement of the third sector may have been a by-product of such policies. The marketisation of the public sector and its impact on the third sector have been acknowledged by the Government whose consultation process with the sector identified the problem of 'a narrow focus on financial efficiency and value for money in the delivery of public services may have unintended consequences for the third sector's ability to help transform public services' (HM Treasury and Cabinet Office, 2006, p. 42). Furthermore, a reliance on the third sector to deliver public services may encounter problems of geographical equity because, as discussed above, the spatial distribution of social enterprises is uneven. Although the delivery of services to people by a local organisation can provide many benefits, it is important to maintain national standards for the delivery of public services. Furthermore, to the extent that some social enterprises rely on volunteer labour, there may be additional concerns related to reliability of delivery and quality control, as well as adverse effects on other businesses and the public sector providing similar services—the low cost base of third sector organisations potentially driving other firms out of business, or encouraging them to cut wages and quality of service provision.

## 8. Challenges and conclusions

Since the election of New Labour in 1997, a range of policies and initiatives has led to the gradual movement of the third sector away from the economic periphery towards the socio-economic centre. Organisations in the social economy are now considered by many as important agents in the battles against social exclusion, poverty and environmental degradation, and key actors in the creation of social capital and the delivery of public services. This contention has, however, been challenged by Amin *et al.* (2002) who argue that the evidence tells of 'struggle and limited achievement' (p. 116). What is rarely considered, however, is that the sector has significant economic impact—increasing output and reducing official, and more importantly, hidden unemployment by helping those marginalised by the orthodox labour market to re-enter employment. This is not to exaggerate the potential of the third sector: it needs to complement, and is not a replacement for, the private and public sectors.

Several challenges remain before the full potential of the third sector can be realised. First, the government must carry through its commitment to providing a constructive partnership with the sector, and resist the temptation to treat it as one of the instruments for the marketisation of the Welfare State. Amicus, a trade union with workers in the public, private and third sectors, is concerned that an expansion of the third sector will be a 'stepping stone' to the privatisation of the public sector (Maskell quoted in Little, 2007, p. 31). Second, the majority of third sector organisations are small and under-capitalised and they are constrained in their growth aspirations by limited access to capital (Bank of England, 2003; SQW, 2007). Although the development of CDFI's, *Futurebuilders* and the *Adventure Capital Fund* have provided access to finance for some third sector organisations, there are many that still require capital to develop and deliver services needed by their communities. Insufficient capital can lead to either under-investment, or a re-orientation towards market objectives in order to obtain finance, and the consequent re-prioritisation of economic over social and environmental outcomes. To enable third sector organisations to maintain the balance between economic, social and environmental outcomes, the government must ensure that a pragmatic and realistic assessment of the financial costs of service delivery is incorporated into their policies and strategies (see HM Treasury, 2006). Third, a curse of successful activities in the third sector is that they themselves are prone to being privatised and consequently turned into capitalist ventures that adopt orthodox business practices, as has been the case with the demutualisation of the Building Society movement in the UK. The challenge for economically successful third sector organisations is to continue to grow whilst simultaneously maintaining their social and environmental goals. The role of the government in this is to develop appropriate business support systems that will share best practice and enable third sector organisations to deliver multiple outcomes. Fourth, as the third sector is driven by community activism, it depends for its success on local leaders who have the skills and vision to develop and grow the organisation or enterprise. Many of those in leadership positions in the third sector have acquired their skills and knowledge in the workplace since opportunities for formal education and training for careers in the third sector are limited. This might be overcome by government support for education and training to identify and teach future leaders in the sector how to achieve the balance between the multiple outcomes expected of third sector organisations. Lastly, given that the local context is important for the emergence and success of the third sector, it is important to be aware of the geographical imbalances that may arise from over-dependence on the sector in delivering public policy objectives. The government must strive to achieve a balance between encouraging the third sector to develop in areas where it is under-represented, and to supporting the further efficiency and effectiveness of the sector in areas where it is established.

To the extent that social and environmental concerns increase (as predicted by Keynes nearly 80 years ago),[1] the importance of the social economy, including social enterprises, is likely to increase. The main challenge facing New Labour is to ensure that the sector maintains its distinctive capabilities and does not simply absorb and replicate the business objectives and strategies of the private sector. They must not let it become a cut-price source of welfare provision to those unable, for whatever reason, to acquire the goods and services they require and indeed are entitled to.

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[1] According to Keynes (1930) we would have to wait at least until 2030 before such concerns rose to prominence.

'When the accumulation of wealth is no longer of high social importance, there will be great changes in the code of morals. We shall be able to rid ourselves of many of the pseudo-moral principles which have hag-ridden us for two hundred years, by which we have exalted some of the most distasteful of human qualities into the position of the highest virtues. We shall be able to afford to dare to assess the money-motive at its true value. The love of money as a possession—as distinguished from the love of money as a means to the enjoyments and realities of life—will be recognised for what it is, a somewhat disgusting morbidity, one of those semi-criminal, semi-pathological propensities which one hands over with a shudder to the specialists in mental disease . . . But beware! The time for all this is not yet. For at least another hundred years we must pretend to ourselves and to everyone that fair is foul and foul is fair; for foul is useful and fair is not. Avarice and usury and precaution must be our gods for a little longer still. For only they can lead us out of the tunnel of economic necessity into daylight.' (Keynes, 1930, pp. 329 and 331).

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