

Third Sector Research Centre

Working Paper 14

**Economic analysis and the third sector**  
**Overview of economic analysis in relation to the**  
**third sector**

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# Economic analysis and the third sector

## Overview of economic analysis in relation to the third sector

### Abstract

This paper takes both a practical and critical view of economic analysis in relation to the third sector. It argues that there is no one kind of economic analysis but that a certain form of such thinking, and associated techniques, has become dominant in thinking and practice. That mainstream approach is appropriate for certain functions and understandings but can also act to funnel or prioritise certain dimensions of third sector activity, ignoring others. It is important therefore in any economic analytic work on the third sector to engage with different forms of economic theory and practice (such as ecological, or institutional economics) as well as cross-disciplinary approaches (such as geographical or socio-economics).

Economic analysis may often just apply to the relative impact of the third sector on accepted statistical dimensions of the economy, such as employment or GDP. This paper argues that this approach misses the many and complex ways in which different parts of the third sector may impact on economic activity in the UK. Ultimately, the aim of this paper is to range over issues of both practical and conceptual importance, in order to enable a more informed and contextualised sense of options, priorities, and possibilities for further in-depth work in the economic analysis of the third sector.

### Keywords

Third sector, economics, measurement, economic models, market failure

## Introduction and overview

The Third Sector Research Centre, both in the original tender by the Office of the Third Sector (OTS) and the ESRC and in the successful bid, stressed economic analysis as a core part of its activities. The first briefing paper produced by the TSRC set out four areas for research. The fourth, that of analysis of the impact of the third sector, includes economic analysis, social enterprise, service delivery and black and minority ethnic (BME) sectors as key streams of work. More specifically, the economic focus is:

*'Economic analysis, seeking to use economic models and measures to assess the key features of the sector and the contribution it makes to the economy and society. This will include analysis of employment and employment trends in the sector.'* (Alcock, 2009)

In essence, this outline is open-ended but indicates a dual concern with:

- measurements of aspects of the sector's activities;
- models which seek to understand and explain the nature and impacts of activities and organizations.

Part of the reason for this emphasis on economic analysis reflects a need for 'rigorous', credible and generalisable evidence. For example, the OTS is particularly interested in robust and comparable statistics that place the third sector firmly within, and contributing to, the mainstream economy, both over time and currently. This need has a practical basis in asserting the relative size and hence relative requirement for public money and policy attention.<sup>1</sup>

The academic discipline of 'economics' has focused much attention on conceptualising and operationalising core concepts and dimensions of economic activity, and, in its analytic methods, has focused on achieving rigour. In addition, government analytic requirements tend to stress economic analysis as providing the rationale for, proof of, and the ability to choose between potential policy options.

An example of the powerful impact of economic techniques in relation to government is recognised by parts of the third sector, for example, Age Concern Scotland.

**Age Concern Scotland** have appointed an economics adviser in order to work on their proposals and interactions with the Scottish Government. John Adams, Professor of Economics at the School of Accounting, Economics and Statistics at Napier University in Edinburgh, initially worked on an economic analysis of the relative income and wealth effects of local income taxes and council tax (with abolition of charges for pensioners). This piece of work attracted a great deal of attention and acceptance from different quarters, it has been suggested, because of the use of government figures to increase credibility, as well as rigorous research using projections and forecasts. The media was able to easily use the summarised data which added to the research's impact. Equally as important was the use of an external academic for this work, removing or reducing potential concerns over bias. Age Concern themselves have seen the benefits to be gained by properly using and exploiting economic data and analysis and linking this with their policy strategy.<sup>2</sup> A quote from Age Concern (in Gorden, 2009) summarises their view: *'It's important in terms of giving us real weight and credibility. If we have solid academic research behind our proposals, they will stand a better chance of getting funding.'*

However, it is important not to automatically equate rigour with economic analysis since other forms of analytical technique or cross-disciplinary approach can be rigorous in their own terms. Equally, economic analytic techniques or conceptual categories in common use may be more or less appropriate to different dimensions or types of third sector activity. In fact, the 'third sector' itself, could be seen primarily as an economic category, often compared in economic models (as non-profit) with for-profit activities and government. This distinction informs much academic work (particularly from the US) but its limits are increasingly being addressed by academic thinkers and challenged by third sector activities and organisations which cross-boundaries and blur accepted 'distinct' motivations or attributes (for example, through forms of social enterprise and social entrepreneurship).

It is also important to ask: to what extent does economic analysis act as a potential funnel which therefore includes or prioritises certain dimensions of third sector activity and may, by design or neglect, ignore others.

However, there is a tendency for existing evidence of third sector impact on the economy or on society to be anecdotal and overly celebratory as well as based on poor statistics with very different scopes of coverage. Economic analysis is therefore a core part of rectifying this situation.

There is also mention in the original outline of the TSRC of looking at how wider economic trends affect, and are affected by, the third sector, for example, the implications of the recession. It was also suggested that economic analysis techniques could be used to create practical 'new tools' for the third sector and for policy and research analysts.

This paper, by reviewing and analysing a broad swathe of literature, is very much a working and exploratory piece, designed to range over broad issues of both practical and conceptual importance, in order to enable a more informed and contextualised sense of options, priorities, and possibilities for further in-depth work.

This paper sets out ways in which an economic analysis thread of work could be understood, and what it could include. It also addresses:

- some of the potential scope and limits of particular forms of economic thinking and analysis;
- the extent of economic research on the third sector;
- alternative views and disciplines of economics and cross-disciplinary studies.

In addition it covers:

- what is economic analysis?
- third sector statistical economic data;
- government views of economic analysis relevant to the third sector;
- business or economic consultancy view of economic analysis;
- academic view of economic analysis;
- mainstream economics used in third sector research;
- challenges to mainstream economics;
- wider economic analysis and the third sector;
- third sector and the 2008- recession;
- beyond market and government failure.

This paper also addresses implications and suggestions for further work:

- roles of the third sector within the economy;
- the need for increased baseline and overview research;
- new areas for potential research.

## What is economic analysis?

There is an implicit assumption within the use of language and scholarly divisions or practice that 'economic analysis' reflects a different or particular form of lens and approach, to 'other' analytical methods. There is also an assumption that there is one form of such analysis. This section explores the usage and application of the term to see what is covered, and how distinct or homogenous such a concept might be.

Economic analysis might generally be seen as the tools, concepts, models and theory for understanding, predicting and generalising economic (and other) phenomena. (Although having mixed and controversial applicability, economic analysis has been applied to many complex areas of behaviour such as marital instability or terrorism. See, for example, Tomassi and Ierulli, 1995; Brück, 2006; Becker, Landes and Michael, 1997; and Ermisch, 2003.)

However, the scope and understanding of economic analysis' relationship and applicability to the activities of the third sector differs according to the views, preoccupations and discourse of particular groups. Here, we look in more detail at the different ways in which government, business (in the case of economic consultancies), and academia, understand the idea of economic analysis.

But firstly, it is always important to bear in mind the popular and hence powerful impact and power of the discourse, dimensions and assumptions, of a particular and simplified economic analysis. It could also be argued that this view itself has had a reflexive impact on reality (including the conceptualisation of the 'third sector' itself) as well as narrowing the implicit and widespread understandings of economic activities and terms.

## Third sector statistical economic data

Other work within the TSRC is looking at the robustness, availability and reliability of data so only some broad points will be made here.

The National Council of Voluntary Organisations (NCVO) has widened its overviews and measurements of the voluntary sector to the wider third sector or civil society, using predominantly the work of Guidestar (although it recognises that various categories of activity and organisational forms are still omitted).<sup>3</sup> The scope and limits of third sector organisations are key elements of any such measures as is the need to find ways to break down aspects of the third sector into useful categories, whether of form, motivation, sector or outcome.

International work on the voluntary sector, such as that of the John Hopkins University, is not fully comparable to the third sector approach in the UK since it omits forms of 'economic' organisations which have mixed financing and stakeholder control.

The **Center for Civil Society Studies** at the **John Hopkins University** Nonprofit Economic Data (NED) project is *'generating critical new information on the dynamics of the nonprofits sector by synthesizing and analyzing diverse datasets on nonprofit organisations, including data on nonprofit finances, employment and wages, and volunteering'*

[www.ccss.jhu.edu/index.php?section=content&view=9&sub=10](http://www.ccss.jhu.edu/index.php?section=content&view=9&sub=10)

There has been some sectoral work mostly in relation to public services. However, the data limitations have been set out by researchers and currently limit our understanding of contributions to the economy. For example, Davies (2004) in her paper *Valuing the voluntary sector in sport: rethinking economic analysis* asks why research on sport-related economic activity is limited and asserts that data on the voluntary sector is the weakest part of the current economic assessments of the sports industry. She finds this situation surprising given the important role of the voluntary sector in providing opportunities for engagement, as well as the benefits of sport on social behaviour and wellbeing. She uses a case study of Sheffield and finds that national estimates of sport are wrong largely because of methodological issues and a lack of accessible data, which she therefore endeavours to rectify.

Such data work also suffers from a range of issues which will not be investigated in depth here but include:

- data limitations – there is no agreement on the operationalisation of the concept of the third sector or of other concepts such as social enterprise. There is also limited breakdown of official statistics to identify third sector activities or organisations;
- trends – are difficult to assert when data and concepts change over time;
- there is an over-emphasis on horizontal and aggregate measures of questionable and contested concepts such as the 'third sector' rather than looking at the impact of different types of third sector bodies within particular industrial sectors or activities.

Clearly, this approach informs the kinds of measurements and statistics that are required of third sector activity such as contributions to GDP or GVA within the UK. (ECOTEC (2003) guidelines for social enterprise mapping spell out some of the useful economic categories for data collection which may also be appropriate to the entire third sector.)

But there are also other dimensions which it may be useful to collect information on, such as:

- levels and types of innovation;
- contributions to skill development ranging from specific work-related skills to entrepreneurship and leadership;
- involvement in infrastructure support for employment and mainstream economic activity – for example, childcare;
- creation of trust and forms of social capital related to economic development and growth.

## Government views of economic analysis relevant to the third sector

It is useful to distinguish two different but interconnected ways of seeing economic analysis within government discourse and practice. The first relates to the need to justify the importance of policy and intervention towards the third sector relative to other parts of the economy, particularly when arguing for resources within cross-government allocative processes such as the Comprehensive Spending Review. In this sense, the nature of the economic analysis required relates primarily to the ability to illustrate the impact of the third sector on the priorities of government, as well as its relative importance in an economic sense in simple, comparable and justifiable statistics. The second approach relates to the methods of analysis used within government to explore and justify interventions and the relative preference for different options.

Economic analysis in relation to public policy is mainly predicated on welfare economics or new welfare economics. Put simply, welfare economics tends to be operationalised using cost-benefit analysis to choose between policy options, and conceptualised with utility functions of maximisation or optimisation under constraint, using individual preferences expressed by 'willingness to pay' (sometimes weighted for differences in income distribution). Market failures (together with equity) are also the, at least official, primary justifications for government intervention.

For a summary of modern welfare economics see Atkinson, A. B. and Stiglitz, J. E., 1980. *Lectures on public economics*. McGraw Hill which adds incentive constraints to the idea of second best Pareto efficiency. For relevant papers see the journal *Frontiers of economic analysis*, Berkeley Electronic Press or the 2007 overview book *The Economic Analysis of Public Policy* by William Bellinger which focuses on cost-benefit analysis, economics of efficiency, risk analysis, and present value discounting.

Cost-benefit analysis has been extended and refined as well as criticised for not being able to incorporate complex decision-making involving different criteria; the questionable applicability of individual utility maximisation; and the proxy measure of 'willingness to pay' which in effect monetizes all choices. (See, for example, Mustafa, 1994; or Miller (ed.), 2005; or Bateman, Lovett and Brainard, 2003.)

Public choice theorists also argue that welfare economists fail to consider how actual policy choices are made, thus arguing for the inclusion of the consideration of government failure as well as market failure. (See, for example, Besley, 2002.)

In addition, whilst there has been much development of economics and the challenging and refinement or changing of assumptions, for practical purposes and/or inertia, government stays with a simple, or perhaps even simplistic, understanding of economics.

The ideal implications and operationalisation of economic analysis for day-to-day policy-making are encapsulated in what is known as the *Green Book* produced by the Treasury which sets out the rationales for policy intervention – those primarily of market failure and equity, as well as option appraisal using a variety of different cost-comparison techniques (HM Treasury, 2003). Overall, the general approach to economic analysis involves assessments of value for money and the opportunity

costs of different options for action. (For a good overview of policy analysis and choice see the Policy Hub, National School of Government for approaches and access to materials).<sup>4</sup>

The Green Book, for example, outlines the two main approaches to economic evaluation:

- Cost-benefit analysis – *‘Analysis which quantifies in monetary terms as many of the costs and benefits of a proposal as feasible, including items for which the market does not provide a satisfactory measure of economic value.’*
- Cost-effectiveness analysis – *‘Analysis that compares the costs of alternative ways of producing the same or similar outputs.’*

In these approaches, all outcomes need to be articulated in monetary terms. However, the Green Book makes it clear that appraisals can also recognise non-monetisable outcomes. Approaches such as multi-criteria analysis (MCA) are suggested (see below for more details).

There are also clear statements that other issues need to be taken into account in policy decision-making such as environmental impacts, rural issues, equality, health, health and safety, consumer focus, regional perspectives, European Union activities as well as legislation and regulations (particularly EU State Aid rules), and design quality.

Especially when using or affecting external organisations, issues which affect ‘additionality’ are stressed such as:

- ‘Leakage’ effects – *‘benefit those outside of the spatial area or group which the intervention is intended to benefit.’*
- ‘Deadweight’ – *‘outcomes which would have occurred without intervention.’*
- ‘Displacement’ and ‘substitution’ – *‘the extent to which the benefits of a project are offset by reductions of output or employment elsewhere.’*

These modifications and additions to both analysis and impacts, suggests the limitations of particular economic analytic techniques for government. This may be particularly true in the area of the third sector which includes many aspects of activities and motivations which do not fit with (at least mainstream) economic assumptions or modelling techniques, or fit into easy rationales for existence such as those propounded by government as ‘market failure’ or ‘equity’. (Market failure is a particularly contested concept. See, for example, Cowen (ed.), 1988.)

It also worth noting that the reality of policy-making often involves a much more messy and contextual process of decision-making where decisions may actually be justified post-hoc by economic analysis, or standard policy option appraisal techniques.

In relation to non-monetisable outcomes, the Department for Communities and Local Government (2009) produces a manual on multi-criteria analysis (MCA) which includes examples of its use for public-policy decision-making as well as how it fits with existing economic analysis, particularly, the cost-benefit approaches outlined above. In the case of third sector impacts, it would seem particularly useful to assess the contribution of MCA. However, much present usage appears to be in relation to environmental activities.

The European Commission in its 2009 online *Evaluating Socio Economic Development: Sourcebook 2* provides a useful overview of the process of MCA saying:

*'Multicriteria analysis appeared in the 1960s as a decision-making tool. It is used to make a comparative assessment of alternative projects or heterogeneous measures. With this technique, several criteria can be taken into account simultaneously in a complex situation. The method is designed to help decision-makers to integrate the different options, reflecting the opinions of the actors concerned, into a prospective or retrospective framework. Participation of the decision-makers in the process is a central part of the approach. The results are usually directed at providing operational advice or recommendations for future activities.'*<sup>5</sup>

Rauschmayer (2000) argues that *'multicriteria analysis needs a normative basis'*. He suggests that pluralistic ethics could provide that ethical basis since the underlying principle is that of respect for the autonomy of people and for their ethical convictions.

Dietz and Morton (2009) provide an interesting contrast between the UK's *Stern Review on the Economics of Climate Change* and the work of the Committee on Radioactive Waste Management. The former used economic modelling and cost-benefit analysis and the latter, MCA – being deliberative and participative, combining scientific evidence with public values. They point out that Stern cautioned against his results being used for policy analysis since, as others have also argued, value judgements and assumptions are embedded in his tools which may be problematic for policy decision-making, particularly the trade-offs between present and future generations.

The *Royal Society response to the Stern Review on the Economics of Climate Change* in 2005 also stressed the inadequacy of standard cost-benefit techniques when costing climate change which cannot cope with the long timescales for intended impacts. They also question the assumption of steady smooth growth in GDP and the ability to monetize what are really unmonetizable social, economic and environmental impacts.

In addition, government also conducts specific market analysis using economic techniques to better enable policy-making such as implementing competition law or assessing the costs and impacts over time of a particular policy objective, such as a low carbon economy.

PricewaterhouseCoopers undertook an *Economic analysis of the TV advertising market* for government in order to build a model of the UK television advertising market. They combined econometric modelling with industry thinking and expertise to be used, for example, as a baseline for modelling future scenarios.<sup>6</sup>

The Department for Business, Innovation and Skills (BIS) undertakes economic analysis and produces BIS Economics Papers to *'set out the thinking underpinning policy development'*. The use of economic analysis is much wider than just evaluation. For example BIS Economics Paper 1 *Towards a Low Carbon Economy – economic analysis and evidence for a low carbon industrial strategy* uses techniques such as marginal abatement cost curve analysis, assesses short and long term costs, provides regional analysis of different sectoral mixes and therefore the different impacts, and assesses market and regulatory failure.<sup>7</sup>

The UK Government also adopts much looser uses of economic analysis. For example, government undertakes macro-economic statistical analysis on broad dimensions of activity such as employment, skills, growth, trade, and regional disparities. In other words, economic analysis can mean measuring various elements of the economy in comparable ways. Often, local and regional government only use economic analysis in this way. For example, Cardiff Council produces an *Economic Analysis Bulletin* which includes, for example, statistical impacts of the social economy and articles on the impact of the credit crunch on Cardiff.

*'The **Cardiff Economic Analysis Bulletin** aims to promote greater awareness and understanding of the key economic issues facing the local economy. In addition to providing reviews on a range of research papers, the document also provides timely statistical analysis of the Cardiff economy utilising a range of key economic indicators to help identify the locality's strengths and weaknesses.'*<sup>8</sup>

## Business or economic consultancy view of economic analysis

The economic consultancy view focuses generally on specific and real market analysis or spatial aspects of actual economic systems. As such they tend to use existing economic data and modelling techniques, and often add interdisciplinary understandings and approaches in order to assess future trajectories or to better understand observed phenomena. Analysis might be at a macro or micro level, in other words, concerned with global or national economic trends, or on sectors or individual organisations.

An overview of some of the websites of the economic consultancies highlights the following areas of focus:<sup>9</sup>

- economic development;
- regeneration;
- appraisal and feasibility;
- forecasts and projections;
- evaluation and economic impact;
- market analysis;
- business development;
- innovation and technology transfer;
- inward investment;
- labour markets and training;
- social inclusion.

These are clearly not all strictly economic issues or use purely economic techniques.

Some consultancies have developed proprietary tools which may be useful to third sector analysis and which have already been used in policy reports, for example, PACEC's Local Economic Performance System.

**PACEC**, Public and Corporate Economic Consultants' **Local Economic Performance System** provides economic intelligence, trend analysis, and forecasts for the strengths and weakness of local economies aimed particularly at policy needs. This tool was used to create detailed maps of economically self-sufficient local areas for a report by the Local Government Association (LGA) (2007) *Local Government Association: Thriving Local Communities: Mapping Sub Regions*, PACEC. They also have a Third Sector team. [www.pacec.co.uk](http://www.pacec.co.uk)

## Academic views of economic analysis

Economic analysis, in an academic sense, tends to refer very broadly to the use of economic tools and theories to address real world problems. In that way, it refers to the entire scope of economic teaching and practice. However, most teaching and research on university economics courses tends to be focused on neo-classical economic approaches.

Mainstream-influenced economic research tends to be developments of various forms of neo-classical economics, as well as econometric techniques which are either based on theory or are arguably atheoretical. However, there are many extensions and refinements of these basic models which have created potentially useful models for applicability to the third sector.

We also have to be careful to distinguish between the 'mainstream' economic tools and assumptions often taught at undergraduate level in many economic departments, and which arguably have had the most external impact, and the more nuanced and adaptable work done in practice by academic researchers.

There are also specific areas of economic specialization or application, for example health or environmental economics. The particular application of economic evaluation within the welfare economics approach of cost-benefit is, for example, particularly influential in health economics.<sup>10</sup>

## Mainstream economics used in third sector research

The starting point for much US-focussed economic research on parts of, what in the UK would be called, the third sector has been mainstream economic analysis, albeit with refinements and attempts at increasing theoretical and practical applicability. This kind of work originated in a split analysis between 'commercial' non-profits and what are known as 'donative' non-profits. (Non-profits here means non-profit distributing.)

One good summary of this particular approach to economic analysis is provided by Manski:

*'agents as decision-makers endowed with preferences, forming expectations, and facing constraints. Preferences are given formal expression through utility functions, expectations through subjective probability distributions and constraints through choice sets.'* (Manski, 2000).

A good overview of the current and historical research in this vein is provided by Steinberg (2004) in his edited book *The economics of nonprofit enterprises*. In it he notes the two key questions that

such economic research poses: 'What are the objectives and constraints of nonprofits?'; and 'Why do entrepreneurs choose the nonprofit form?'

He asserts that much nonprofit research began as a result of the useful distinction between nonprofits and for-profits made by Henry Hansmann (1996) when he posed a nondistribution constraint on the former.

Steinberg distinguishes three waves of research:

**First wave** – focused on objective functions (in other words what was being maximised), and therefore looked at, for example, maximisation of budgets, service, quality and quantity, or social welfare. It also asks why that form of maximisation or optimisation happens, for example, it might be to increase managerial prestige. The most common approach was to use comparative statics.

**Second wave** – here the focus was on nonprofits within the wider economy and particular industrial sectors – for example, it asks why nonprofits might be better or worse than other types of organisation (business or government) or be the only provider in some industries or niches. The nonprofit was seen chiefly as the provider of public goods, and in correcting market failures, for example, due to asymmetric information. The latter approach led to a particularly influential body of contract theory which is neo-institutional in nature and is often credited to have begun with Hansmann.

**Third wave** – begins to link demand and supply – through the work of researchers such as Ben-Ner. For example, the questions asked here relate to the benefits or not of non-profit formation, if, for example, you can exceed operating and transaction costs. Steinberg notes that there is little formal modelling as yet.

Steinberg also recognises that there are omissions in the research such as dynamic modelling and assessments of the impact of policies such as tax regimes, or anti-trust (competition) policy.

Much of this work sees the rationale for nonprofits as overcoming market failures, for example, by providing public goods or reducing information asymmetries.

For example, Burton Weisbrod created a theory of the voluntary non-profit sector in a three-sector economy – seeing nonprofits as suppliers of public goods which are undersupplied by government to heterogeneous populations (Weisbrod, 1975). (The public good and trustworthiness model of non-profit organisations is looked at again in, for example, Kingma, 2006.) Weisbrod (1997) looked at the new phenomena of the nonprofit sector crossing sector boundaries and asked questions such as: 'How does their growth affect other parts of the economy?' 'Has the increasing revenue push generated side effects as they become more commercial?' 'How does overall social welfare respond to the competition between nonprofits and businesses?'

Other relevant publications in this vein include:

Easley, D. and O'Hara, M., 1983. 'The Economic Role of the Nonprofit Firm', *The Bell Journal of Economics*, 13, 531-538. A nonprofit may be superior to for-profit firms if the output cannot be costlessly observed. They use the theory of optimal contracts under asymmetric information. Under certain conditions nonprofit firms are socially optimal mechanisms for the provision of goods or services when the benefits are difficult to observe or measure.

Ortmann, A. and Schlesinger, M., 1997. 'Trust, repute and the role of non-profit enterprise', *Voluntas: International Journal of Voluntary and Nonprofit Organisations*, 8:2. Springer. This paper

looks at the trust hypothesis to explain existence in certain markets. However, through the use of modern agency theory they think that this analysis is problematic and requires particular conditions that have been neither described in theory nor empiricised.

Enjoiras, B., 2000. 'Coordination failure, property rights and non-profit organisations', *Annals of Public and Cooperative Economics*, 71, 3. Blackwell. This paper brings the different explanations for nonprofit existence – contract failure, government failure, philanthropic failure – together around the idea of coordination failure where a specific distribution of property rights creates a governance structure which helps to mitigate coordination failures.

Uzawa, H., 2005. *Economic analysis of social common capital*. Cambridge University Press – aims for optimization and extending economic analysis through seeing 'social common capital' as having three categories – natural capital, social infrastructure and institutional capital.

Rushton, M., 2005. *Government Contracting with Faith-Based Providers: an economic perspective*, Working Paper 05-04. Nonprofit Studies Program, Andrew Young School of Policy Studies, Georgia State University.

It is likely that a full overview of US and US-inspired research might lead to some insights and understandings of useful approaches to the third sector within the UK. However, that work has to be recognised from the context from which it comes and its scope of applicability:

- most of the US-inspired work relates to nonprofits, in other words, those organisations that do not distribute profit. Some third sector organisations (and increasing numbers it has been suggested) do distribute (often limited) profits and so do not come under the ambit of such work or are complex amalgams of different motivations. (Helmut Anheier (2000) approaches this subject of multiple dimensions and motivations of a single non-profit in *Managing non-profit organisations: towards and new approach* whereas the research, for example, of the EMES network ([www.emes.net](http://www.emes.net)) in Europe illustrates the rise of the hybrid economic form of social enterprise);
- the UK does not have commercial nonprofits of the same kind or to the extent of the US, and are equivocal about whether the ones that are, are part of the third sector, for example, BUPA;
- and a broader question relates to how far different forms of economic analysis can shed light on processes and outcomes of different types of third sector activity, and how much might be excluded by doing so.

This narrowness of scope and assumptions is a fairly recent phenomena. A 2001 overview by Ingrid Rima in her *Development of Economic Analysis* sets out why economics as a discipline separated from moral philosophy and wider political economy, became more scientific and divorced from history and institutionally-oriented work. Manski (2000) argues that part of the reason was in order to make economics more rigorous, by adopting clear concepts and a priori assumptions. He argues that institutional economics which thought '*broadly but loosely about social interaction*' gave way to neoclassical general competitive equilibrium but this narrowing ended by the 1970s and: '*Since then a new phase has been underway, in which the discipline seeks to broaden its scope while maintaining the rigor that has become emblematic of economic analysis*'.

## Challenges to mainstream economics

However, the omissions and alternative approaches to economics are being stressed, whether from within academia, from students, or from outside. A more populist discussion is partly being aired through, for example, comments and discussions in the media following the credit crunch which was partly seen as a failure of economic models and their assumptions.

Academics from other disciplines or different approaches to economics have attacked either the fundamentals or the extent of application of dominant economic theory and practice. Much of the debate concerns the primary focus of economic analysis on individual preference maximisation without regard for others or incorporating collective action and goods, the doctrine of the nirvana of perfectly clearing markets, or natural rates of unemployment.

Nelson (1996) argues in *The Masculine Mindset of Economic Analysis* that economic assumptions are based on an ideal masculine culture. In other words, only selected aspects of human behaviour are used – those of abstraction and self-interest – ignoring how people are linked to others and concerned about their welfare.

The scope of economic activity has been equated with markets and in relation to the third sector, this conception is particularly being questioned. Often this work draws on, for example, Karl Polanyi's 1944 model of the economy, including reciprocity or barter in addition to market economic principles and practices.

One result of revolts by students against the narrow scope of economics was the Post-Autistic Economics network ([www.paecon.net](http://www.paecon.net)) which offers a variety of critiques on mainstream economic analysis and sources of alternative thinking and ideas.

There has also been concern about the assertion that economics is value-free. For example, Hausman and McPherson (1996) argue that not only is it impossible to have a positive and value-free economics but that the inclusion of a moral dimension or discussion to economic analysis is beneficial for economists and policy-makers. They also show how applying economic understandings and analysis can enrich moral philosophy and ethics.

There have always been alternative approaches to economic discourse which have implications for economic tools and understandings and have had more or less practical relevance in different areas:

- (new) institutional economics;
- post-Keynesianism;
- behavioural economics;<sup>11</sup>
- Austrian neo-Hayekian;
- ecological economics (this seems to have much promise for third sector work and has been behind the concepts and work of the Sustainable Development Commission<sup>12</sup>);
- development economics, for example, the work of Amartya Sen;<sup>13</sup>

## Ecological economics

Ecological economics has different underpinnings to neoclassical economics and has risen in interest and influence in recent years with the recognition of the need to incorporate environmental factors and resources into analysis and decision-making. Ecological economics is in some ways a theoretical underpinning to sustainable development, being concerned with the interaction of social justice, environmental resources and economic activity.

The economy is not seen in isolation but as a subset of the ecosystem. Value-free economics is believed to be impossible and neoclassical economics is believed to be fundamentally and falsely premised on utility maximisation and infinite economic growth. Ecological economists tend to be technological pessimists rather than optimists, preferring the precautionary principle. They believe that neoclassical theory confuses growth and development, or welfare with wellbeing. They also assess complex forms of ownership such as those of the commons, trustee, or multi-stakeholder which implies decision-making and control that is broader than that of the state or shareholders.<sup>14</sup>

These alternative economic analytic approaches are important to consider when looking at third sector activities and understandings since they are based on different behavioural assumptions or conceptualisations which may be more or less suited to different parts of the third sector or different types of action.

There are also potentially useful cross-disciplines and techniques such as:

- political economy
- socio-economics (An interesting approach is being taken by the Plymouth Marine Laboratory by bringing together marine science and socio-economics using Decisions Support Systems to assess risk and distributional impacts in a form of interdisciplinary science to create policy-relevant sustainable management. They produced a paper for the UK Government's Prime Ministers Strategy Unit *Net Benefits: A sustainable and profitable future for UK fishing*<sup>15</sup>);
- geographical economics (Geographical Information Systems and spatial economic analysis and modelling) (See, for example, the journal of *Spatial Economic Analysis* produced by the Regional Studies Association with articles such as 'Increasing Returns and the Growth of Industries in the EU regions: Paradoxes and Conundrums', 'Outsourcing vs FDI in oligopoly equilibrium'; or Martin, 1999 for a more critical approach);
- complexity and systems science – (For a recent application to 'social entrepreneurship' see, for example, Goldstein, Hazy and Silberstang, 2009);

## Wider economic analysis and third sector

New and existing bodies of scholarship provide economic analysis and approaches for different parts of the third sector, for example:

- social entrepreneurship theory and evidence – this is very eclectic and tends to cover work originating in the US on enterprising non-profits (for example, Greg Dees, 1998) as well as international work on different dimensions of the subject such as fair trade businesses, different organisational models, innovative supply chains or ‘social investment’. (International social entrepreneurship research networks which can provide gateways to relevant work include EMES (Europe) [www.emes.net](http://www.emes.net), ARNOVA [www.arnova.org](http://www.arnova.org) (including the voluntary sector) and SEKN Social Enterprise Knowledge Network [www.sekn.org](http://www.sekn.org));
- social enterprise research – originating from a UK or more European base, tends to focus more on organisational forms, and how such entities bridge concepts of political decision-making and socio-economics. They often use different economic concepts such as the solidarity economy and have a strong focus on participatory governance structures. (For good overviews see Borzaga and Defournay, 2001 and Evers and Laville, 2004. The latter argues for different paradigms to understand a mixed economy or a civil and solidarity-based economy as well as the different social enterprise forms and implications across Europe.) The French see the third sector or social economy as an integral part of the economy. Bridge, Murtagh and O’Neill, 2009 in their *Understanding the social economy and the third sector* argue that if the ‘social economy’ is used instead of third sector as a collective category it implies the role of organisations within the economy rather than being marginalised or predominantly about welfare. Some of the work of EMES refers to organisations that fill market failures and others that are hybrid and transformative within markets. European conceptions of the third sector may also stress principles of reciprocity over redistribution and the market as well as assessing the hybridisation of market, non-market and non-monetary resources. (See for example, Kendall (ed), 2009);
- co-operative research;<sup>16</sup>
- employee ownership research;<sup>17</sup>
- grey literature particularly on multi-stakeholder governance models with different forms of limited profit distribution;<sup>18</sup>
- possible similarities in business and economic literature which looks at the complex motivations and values of small firms, family businesses and also commercial businesses with non-commercial dimensions or values such as creative or craft-based businesses. See for example, Peattie and Morley, 2008.

Non-mainstream or economic analysis from non-economic or more multi-disciplinary perspectives are also found in the literature of non-profits, for example:

Rose-Ackerman, S., 1996. 'Altruism, nonprofits, and economic theory', *Journal of Economic Literature*, 34. argues that economists are relooking at the psychological and organizational premises of their discipline. Altruism and nonprofit entrepreneurship cannot be understood within standard economics and theoretical progress requires a richer conception of utility functions and psychological motivations. Analytical efforts are trying to preserve distinctions between for-profit, nonprofit and public but this looks increasingly problematic.

James, E. and Rose-Ackerman, S., 1986. *The Nonprofit Enterprise in market economies* stresses the weaknesses of both profit and social welfare maximisation which does not explore the black box of institutional forms and behaviour. There is a need for a wider set of interactions, actions and decisions than standard models and questions need to be asked such as 'Who establishes them', 'How do they work with weaknesses'. There is a need to go beyond the caricatures of both sectors with, for example, ideology being an independent rationale for existence.

Anheier, H. K. and Ben-Ner, A., 2003. *The study of nonprofit enterprise: theories and approaches* argues that the two state model has been superceded by the increase in economic importance of nonprofits, and, for example, the new policy agenda of global governance. They look at future challenges such as increased collaboration and competition with the private sector.

Dollery, B. E. and Wallis, J. L., 2003. *The political economy of the voluntary sector: a reappraisal of the comparative institutional advantage of voluntary organisations*.

Kendall, J. and Knapp, M., 1996. *The Voluntary Sector in the UK* looks at different rationales for third sector bodies and how they are conceptualised, address the policy implications of economic theorising and address the focus on market failure. They recognise the success of economic theorising but also criticise its limits, looking, for example, at the need to address voluntary failure as well as social capital and leadership, and look for rationales that go beyond entrepreneur theories.

Lohmann, R. A., 1992. *The Commons: Perspectives on nonprofit organization and voluntary action* critiqued economic theorizing arguing that the main body of voluntary action remains beyond the analytical limits of economic theory. There is a need to look at collective action, common goods and group standards rather than utility maximisation.

Some literature also relates to the impact of economic theorising and language on third sector development, for example, Parkinson and Howorth (2008) argue that there is a marked difference between the language of policymakers, proponents of social entrepreneurship, and the activities, identity and language of people classed in this way.

### Third sector and the 2008- recession

There is little or no current academic work as yet on this topic but a variety of grey literature draws on current and past practical experience, surveys and academic literature, including:

ESRC/SCVO Public Policy Seminar Series, *Recession and the Third Sector*, 13<sup>th</sup> February 2009 papers available from:

[www.esrc.ac.uk/ESRCInfoCentre/about/CI/events/esrcseminar/third\\_sector\\_scotland.aspx](http://www.esrc.ac.uk/ESRCInfoCentre/about/CI/events/esrcseminar/third_sector_scotland.aspx)

including Harrow J (2009) *Thistles, roses, thorns: some reflections on third sector/government relations and policy expectations in economic downturn*, Cass Business School, City University London.

A good overview of literature is available in London Voluntary Service Council, LVSC (2009) *Third Sector Economic Downturn Research*

[www.lvsc.org.uk/files/101301/FileName/TSDownturnmapping.pdf](http://www.lvsc.org.uk/files/101301/FileName/TSDownturnmapping.pdf)

Mohan, J. and Wilding, K. 2009. *Economic downturns and the voluntary sector: what can we learn from historical evidence?* [www.historyandpolicy.org/papers/policy-paper-85.html](http://www.historyandpolicy.org/papers/policy-paper-85.html)

Economic downturn and the voluntary and community sector webpage on the NCVO includes summary papers produced by Karl Wilding, as well as the outline and results of a summit on 25 November 2008 [www.ncvo-vol.org.uk/policy-research-analysis/research/economic-downturn](http://www.ncvo-vol.org.uk/policy-research-analysis/research/economic-downturn)

From the US, the John Hopkins Institute for Policy Studies produced the *Impact of the 2007-09 Economic recession on nonprofit organisations*, Communique No 14 29/6/09 written by Lester M. Salamon, Stephanie L. Geller, and Kasey L. Spence

[http://www.ccss.jhu.edu/pdfs/LP\\_Communique/LP\\_Communique\\_14.pdf](http://www.ccss.jhu.edu/pdfs/LP_Communique/LP_Communique_14.pdf)

## Implications and suggestions for further work

As a result of looking at the different roles of the third sector within the economy, it is difficult to assert or theorise rationales for their existence as being primarily:

- public goods;
- filling market failure.

Equally, when looking at reasons for government intervention in the third sector, it is difficult to just apply market or government failure. For example, promoting or encouraging ethical markets and hence inclusion of plural organisational models is not market failure but more transforming markets and the promotion of local civil renewal or democracy by third sector activity is not in response to market failure.

In some ways such analysis may be the result of focusing on third sector organisations in isolation. The forthcoming work of the Carnegie UK Trust Inquiry into the future of civil society in UK and Ireland's work includes specific consideration of the idea of the 'civil economy' to recognise the many associative activities within the economy which contribute to its functioning.<sup>19</sup> This approach means that there is no easy and hard edge between business and the third sector or government and that there is a need to look at different conceptualisations of activity and organisations in how third sector activity relates to the economy.

## **Roles of the third sector within the economy**

There has been work on measuring the direct contribution of third sector activities of different kinds to aggregate measures of economic activity such as employment levels, GDP or GVA. However, a thorough understanding of how the third sector, and its various parts, are part of the economy is currently mostly in the form of assertions, anecdotes, limited evidence or examples. A great deal of work needs to be done to fully understand its contribution.

In order to initiate those discussions, it is first necessary to break out of current preoccupations in research with either third sector:

- within public service delivery;
- as a response to market failure.

The third sector includes organisations that directly affect market behaviour, structures and activity. These could include:

- indirect contributions to the extent and quality of labour force – job opportunities for the disadvantaged, skill and attitude development etc.;
- economic infrastructure such as workspace or childcare;
- quality of life for inward investment or for employees (for example, there is some evidence of a link between cultural outlets and the desirability of locations for business);
- developing social capital – seen as important for competitiveness and innovation, job search, trust, motivations etc.;
- elements of a working economy – for example, trades unions, professional bodies, organisations for standards setting, sectoral agreements or codes;
- enabling entrepreneurship;
- potential impact on mainstream corporate social responsibility (CSR) and behaviour – helping create ethical markets/organisations – through, for example, plural economic models;
- changing people, not just goods and services – altering cultural norms of behaviour and consumer preferences;
- finance provision and innovation.

## **The need for increased baseline and overview research**

This paper has begun to skim the surface of what might be possible with a revised and expanded economic analysis for the third sector. In order to progress understanding further and choose between potential areas for further in-depth study, several baseline overviews could be carried out. These could include:

- further analysis of predominantly US economic nonprofit work for relevance to parts of UK context and third sector;
- exploration of alternative and cross-disciplinary economics for possible tools and appropriate theory;
- scoping of latest economic theory and practice for relevance to furthering third sector understanding;

- overview of economic analysis to date within UK based voluntary and community sector work;
- exploration of the European social economy model/s for developing theory and practice;
- overview of developing social entrepreneurship and social enterprise theory and evidence (some of this is directly economic using objective functions and others question narrow economic theorising);
- overview of co-operative and employee ownership research;
- collection of existing case studies and academic work of boundary crossing social businesses including, for example, John Lewis, Scott Trust;
- a thorough review of the potential of ecological economics to offer theory and practice to third sector analysis and activities.

### **New areas for potential research**

In addition, there are particular areas for economic research and economic analysis suggested by this overview including:

- direct third sector engagement in the wider economy – over time and within different sectors and by different models;
- role of third sector activities and values in creating and supporting market frameworks, for example, as regulators, watchdogs, sites for deliberation, trust development, and standard setting, etc.;
- innovation;
- comparative and dynamic statics of different models within different sectors against each other and forms of private and public organisations;
- influences of economic and business discourse, language and practices on UK third sector;
- issues of pluralist economic models (i.e. third sector direct involvement) in economies – for example, in static and dynamic resilience (say in relation to economic cycles), inclusion, or for transformation and innovation;
- appropriateness of government economic appraisal and rationales (particularly market failure) of the third sector;
- analysis of third sector involvement in economic and business policy implementation and practice at EU and UK levels.

## Endnotes

- <sup>1</sup> In conversation with Campbell Robb, Director General of the Office of the Third Sector.
- <sup>2</sup> In conversation with Professor John Adams.
- <sup>3</sup> [www.guidestar.org.uk](http://www.guidestar.org.uk)
- <sup>4</sup> [www.nationalschool.gov.uk/policyhub](http://www.nationalschool.gov.uk/policyhub)
- <sup>5</sup> The full Sourcebook can be found at [http://ec.europa.eu/regional\\_policy/sources/docgener/evaluation/evalsed/downloads/sb2\\_multicriteria\\_analysis.doc](http://ec.europa.eu/regional_policy/sources/docgener/evaluation/evalsed/downloads/sb2_multicriteria_analysis.doc)
- <sup>6</sup> [www.pwc.co.uk/eng/publications/economic\\_analysis\\_tv\\_advertising\\_market.html](http://www.pwc.co.uk/eng/publications/economic_analysis_tv_advertising_market.html)
- <sup>7</sup> [www.berr.gov.uk/files/file52165.pdf](http://www.berr.gov.uk/files/file52165.pdf)
- <sup>8</sup> *Economic Analysis Bulletin*,  
[www.cardiff.gov.uk/content.asp?Parent\\_Directory\\_id=2865&nav=2866,3386,3412](http://www.cardiff.gov.uk/content.asp?Parent_Directory_id=2865&nav=2866,3386,3412)
- <sup>9</sup> Examples of such consultancies include Oxford Economics [www.oef.com](http://www.oef.com); Analysys Mason [www.analysismason.com](http://www.analysismason.com) or OXERA [www.oxera.com](http://www.oxera.com).
- <sup>10</sup> See for example a paper on *What is economic evaluation?* By the University of East Anglia (UEA) NHS Health Economics Support Programme  
[http://www.uea.ac.uk/menu/depts/med/research/research\\_econ/hesp/docs/EEPrimer.pdf](http://www.uea.ac.uk/menu/depts/med/research/research_econ/hesp/docs/EEPrimer.pdf)
- <sup>11</sup> An interesting overview of both behavioural economics as well as its applicability to policy is provided by Amir, et al., 2005. 'Behavioural economics, psychology, and public policy', *Marketing Letter*, Vol 16, No 3, pp 443-454 as well as summarised on: The Serco Institute Behavioural Economics homepage: [www.serco.com](http://www.serco.com) (with a bias towards public policy, particularly competition and contracting)
- <sup>12</sup> [www.sd-commission.org.uk/index.php](http://www.sd-commission.org.uk/index.php)
- <sup>13</sup> See for example Sen, A., 1999. *Development as freedom*, Oxford University Press for an introduction and overview of Sen's approach to economics and his concepts of development.
- <sup>14</sup> See Wikipedia for a good overview and references as well as the European Society for Ecological Economics [www.euroecolecon.org/](http://www.euroecolecon.org/)
- <sup>15</sup> [www.cabinetoffice.gov.uk/strategy/work\\_areas/fisheries.aspx](http://www.cabinetoffice.gov.uk/strategy/work_areas/fisheries.aspx)
- <sup>16</sup> See for example *The Journal of Co-operative Studies* published by the UK Society for **Co-operative** Studies [www.co-opstudies.org/Journal/journal.html](http://www.co-opstudies.org/Journal/journal.html)
- <sup>17</sup> As well as academic literature the Employee Ownership Association [www.employeeownership.co.uk/publications.asp](http://www.employeeownership.co.uk/publications.asp) supplies a range of useful grey literature and studies.
- <sup>18</sup> See, for example, the Somerset Rules for a multi-stakeholder co-operative [www.somerset.coop/node/17](http://www.somerset.coop/node/17) as well as some assessment of different governance models in Birchall, J., 2002. *A Mutual Trend: How to run rail and water in the public interest*, new economics foundation.
- <sup>19</sup> [democracy.carnegieuktrust.org.uk/civil\\_society](http://democracy.carnegieuktrust.org.uk/civil_society)

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## About the Centre

The third sector provides support and services to millions of people. Whether providing front-line services, making policy or campaigning for change, good quality research is vital for organisations to achieve the best possible impact. The third sector research centre exists to develop the evidence base on, for and with the third sector in the UK. Working closely with practitioners, policy-makers and other academics, TSRC is undertaking and reviewing research, and making this research widely available. The Centre works in collaboration with the third sector, ensuring its research reflects the realities of those working within it, and helping to build the sector's capacity to use and conduct research.

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## Economic and Social Impact

Assessing the economic impact of third sector organisations is a key research priority for TSRC. It is linked to our mapping and measuring of the sector, and has a particular focus on the role that third sector organisations play in delivering public services and contributing to general community wellbeing. We are engaged in a review of the wide range of existing methods and tools for measuring impact within TSOs including Social Return on Investment (SROI), blended impact measures and other adaptations of cost/benefit analysis. We will also develop sector wide analysis of economic impact of third sector activity and its contribution to the wider economy, including analysis of workforce trends, volunteering and third sector value.

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