Is this time different?

Charity funding in recession and recovery

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PRO BONO ECONOMICS

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Summary

Against the backdrop of a global pandemic and associated recession, any assessment of what might happen to the income of UK charities in the coming years must focus on three key questions: (i) where charity funding comes from; (ii) what factors drive that income; and (iii) what is likely to happen to those driving factors over the course of the Covid-19 recession and recovery. The level of certainty we can attach to our answers rapidly drops as we move down that list of questions. In this note then we don't seek to offer definitive answers or predictions for the future, but rather work through a series of talking points that might help us make sense of the changing funding setting for charities over the coming months. In doing so, we consider what lessons – if any – we might learn from the experience of the financial crisis in 2008.

In terms of the first question – the composition of charity funding – we know that almost half of the money raised by UK charities ahead of the pandemic came from the public. That in turn was split roughly 50:50 between money donated voluntarily (donations and legacies) and money earned (from charity shops and the like). The government accounted for a further 29 per cent of the charity total, investment returns added another 8 per cent, and the remainder was drawn from foundations, corporations and the National Lottery.

In relation to the second question – the factors driving trends in charity income – the condition of the economy is clearly important. Certainly charity income and GDP appeared to move broadly in line in the decade after the financial crisis. Yet the relationship was not as straightforward as the headline trends might suggest. Focusing not on overall charity income but instead its different component parts, we observe the primacy of factors other than GDP in many instances. Income earned from the public consistently outperformed economic growth for instance, helped both by the surprisingly strong performance of the jobs market and by a concerted effort on the parts of charities to diversify income and develop new revenue streams based on trading opportunities. Conversely, charity income sourced from the government fell sharply – driven not by trends in economic output, but by political choices.

Turning to the third question – the likely trends in the different factors that drive charity income in the months to come – there are two complications which make it hard to draw too many lessons from the 2008 experience.

First, the patterns described above mean that the composition of charity income in place ahead of the pandemic looked very different from that which prevailed on the eve of the financial crisis. Money raised from charity shops, events and membership fees accounted for around £1 of every £4 raised by the sector pre-pandemic, up from £1 in every £6 back in 2008. As a result, the charity sector has been particularly exposed to the current downturn – and will continue to be affected by restrictions on movements and trading activity for as long as they remain.

Secondly, the economic contraction associated with the pandemic has the potential to differ in important ways from that which followed the financial crisis. Rather than a long, broadly felt contraction characterised by wage stagnation, this time around we are more likely to see a very deep but shorter downturn that results in temporarily higher unemployment and falls more heavily on particular groups. Increased income volatility and inequality might be expected to act as a drag on public giving, as might any rise in the share of workless households. But this could be at least partly offset by evidence of increased saving among many higher income households. And the political backdrop is much-altered too. While the government's pandemic response has massively increased UK debt levels, there appears to be less appetite for a rapid rebalancing and sharp contraction in government spending – not least because debt servicing costs remain low.

Overall, the impact of the Covid-19 downturn on charity income is likely to be affected by a variety of complex and inter-related issues. Most important will be the timing of the arrival of any vaccine or means of controlling the virus, marking the point at which some form of normality can be resumed in relation to economic trading. But the nature and distribution of the downturn will also be important, with the path followed by unemployment likely proving particularly crucial. Government policy will also play a vital role, in relation to both the overall macroeconomic stance taken by the Chancellor and the balance struck in any fiscal consolidation between spending cuts and tax rises.

There is – inevitably – huge uncertainty about what comes next. But what does look certain is that the coming months and years will prove difficult for UK charities to navigate, requiring them once again to explore innovative new ways of operating, raising funds and delivering vital services to millions of people across the country. Alongside the volume of income raised then, the effectiveness with which it is both secured and spent will be a key determinant of the sector's outcomes and impacts in the post-pandemic period.

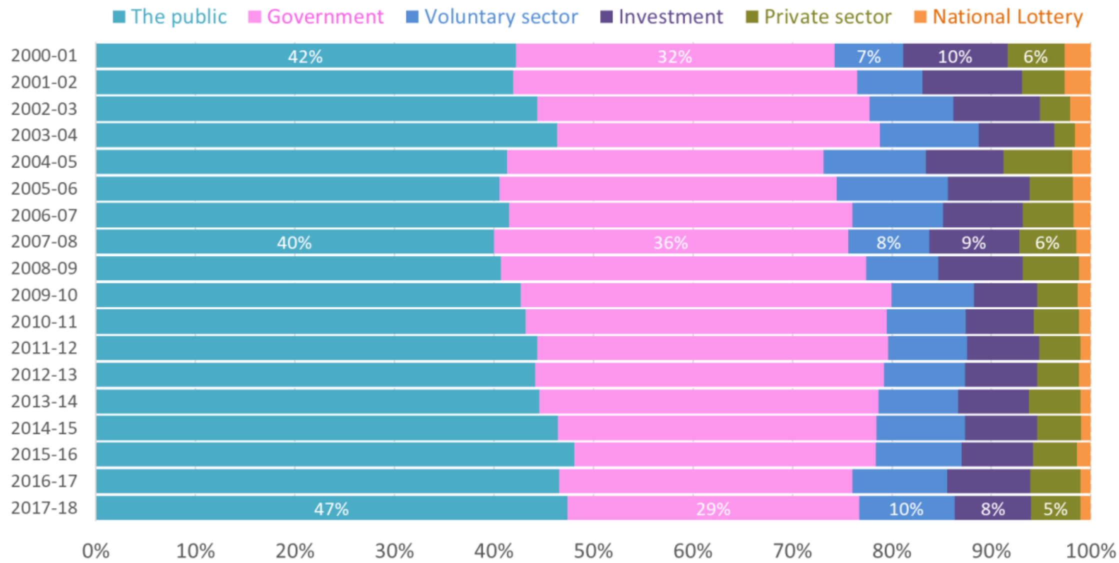
The composition of charity income has shifted considerably in the last decade, with implications for the sector's susceptibility to the Covid-19 recession

In assessing how charity sector funding might shift in the face of the coronavirus crisis, we must first ask ourselves where the money comes from. Importantly, the answer to that question has shifted somewhat over the course of the last decade. Two key trends stand out: the growing share of income sourced from the public, and the increased reliance on 'earned' rather than 'voluntary' income.

Figure 1 focuses on the first of these trends. It depicts an increase in the share of total charity income coming from the government in the pre-financial crisis period (rising from 32 per cent in 2000-01 to 36 per cent in 2007-08), followed by a sharp reversal in the subsequent decade (with the share dropping to just 29 per cent by 2017-18). In contrast, the share of income sourced from the public fell in the early part of the century (from 42 per cent in 2000-01 to 40 per cent in 2007-08), before rising to approaching half (47 per cent) of the total by 2017-18.

Figure 1: The public has accounted for a rising share of all charity income since the financial crisis

Composition of charity income (by source): UK



Notes: 'The public' covers donations (including Gift Aid), legacies, membership subscriptions without significant benefits. It excludes payments from charitable trusts set up by individuals. 'Government' covers funding grants and grants to charitable intermediaries. It relates to government and its agencies in the UK, EU and internationally. 'Voluntary sector' covers grants from charitable trusts and grants distributed by charitable intermediaries. 'Investment' covers dividends, interest and rent. 'Private sector' covers corporate donations and gifts in kind, but excludes charitable trusts set up by businesses. 'National Lottery' covers grants from National Lottery distributors.

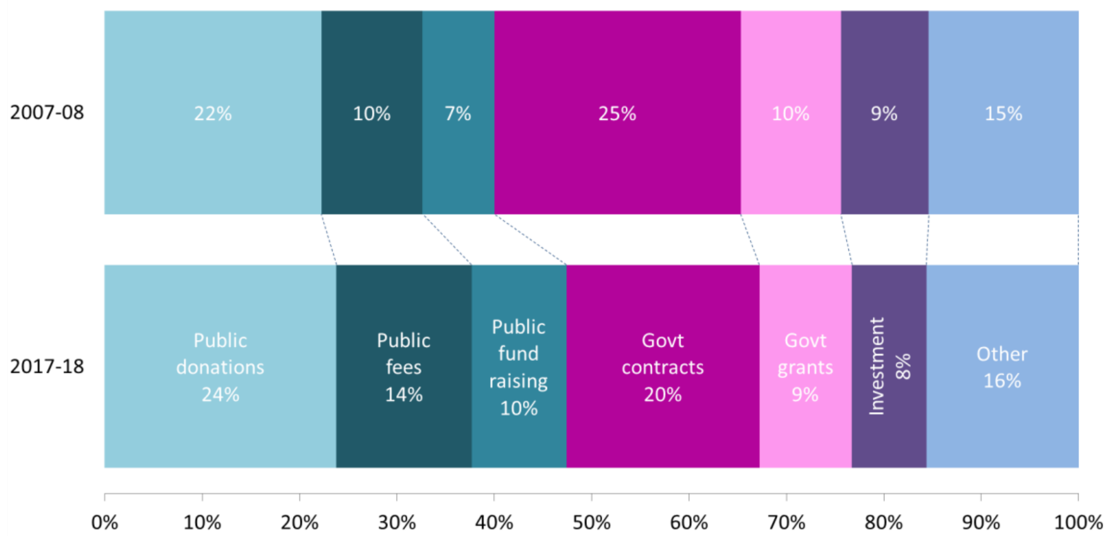
Sources: PBE analysis of NCVO, *NCVO Almanac 2020*

Figure 2 adds an additional layer to this analysis (covering a more limited period due to data restrictions), to assess the split not just by source of income but also by *type*. That is, 'earned' or 'voluntary'.

It shows that public donations and legacies ('voluntary' income) were the single largest source of income in 2017-18, accounting for 24 per cent of the total (up from 22 per cent in 2007-08). Public fees and public fund raising (together constituting 'earned' income) accounted for a further 24 per cent of the total in 2017-18. That was a jump from just 18 per cent in 2007-08.[1] In contrast, the share of income 'earned' from government contracts fell over the decade – from 25 per cent in 2007-08 (and a peak of 29 per cent in 2009-10) to 20 per cent in 2017-18. 'Voluntary' government income, in the form of grants, accounted for a broadly unchanged share of 9 per cent in 2017-18.

Figure 2: Charity shops and events accounted for a much-increased share of charity income just ahead of the pandemic

Composition of charity income (by source & type): UK



Notes: 'Public donations' covers income given 'voluntarily' by the public, mainly charitable donations plus legacies given in people's wills. 'Public fees' covers money 'earned' when voluntary organisations provide charitable services (e.g. tuition fees for training, micro-credit schemes, selling equipment and services). 'Public fund raising' covers money 'earned' from trading activity (e.g. charity shop revenues and bake sales). 'Govt contracts'

[1] Not 17 per cent due to rounding.

covers services commissioned by the public sector and therefore 'earned', while 'Govt grants' covers money given 'voluntarily' to charitable organisations by the public sector. In this context, 'government' relates to government and its agencies in the UK, EU and internationally. 'Investment' covers dividends, interest and rent. 'Other' income covers all other forms of charity income ('voluntary' and 'earned'), including that which comes from the voluntary and private sectors and National Lottery funding.

Sources: PBE analysis NCVO, *NCVO Almanac*, various

Relative to its position ahead of the 2008 financial crisis then, the charity sector entered the current pandemic significantly more reliant on income from the public – and in particular on money earned from charity shops, events and membership fees. Given the nature of the very sudden economic shutdown associated with the UK's initial pandemic response – with shops closing and events being cancelled – we might expect this to be an important development.

Before considering the specifics of the 2020 experience however, it is worth looking back to what happened after the financial crisis of 2008 by way of trying to understand what drives shifts in charity income growth during periods of recession and recovery.

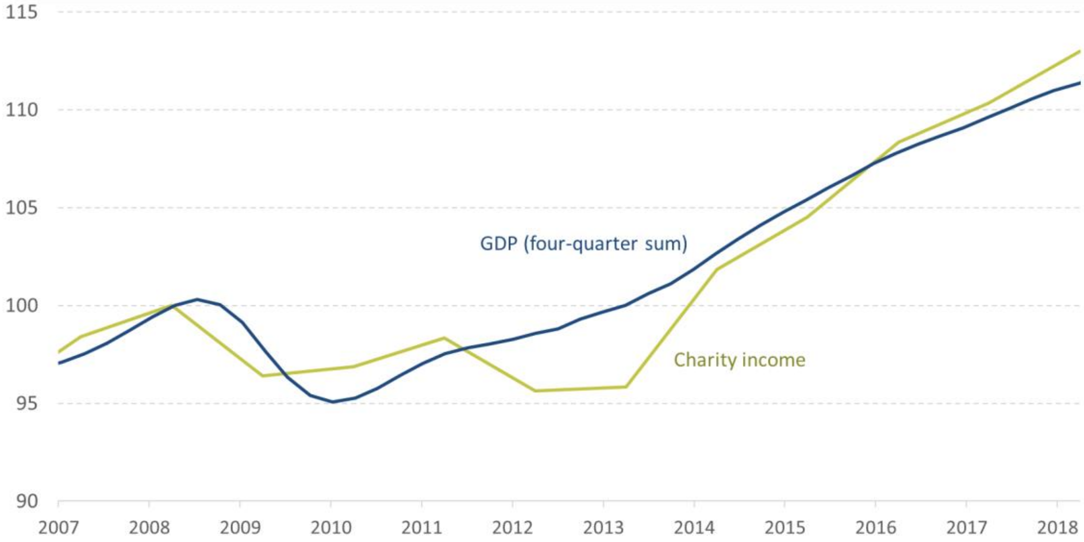
Charity income broadly tracked economic output in the decade after the financial crisis, but the relationship between the two is much more complex than this would imply

At the headline level, the relationship between overall economic performance and charity income in the decade following the 2008 financial crisis was very close.

Figure 3 shows that charity income broadly tracked GDP throughout the period, marginally outperforming it overall: by 2017-18, charity income was 13 per cent up on its 2007-08 level and GDP was up 11.3 per cent.

Figure 3: Charity income appears to have moved broadly in line with GDP

Indices of real-terms GDP and charity income: UK, 2007-08 = 100



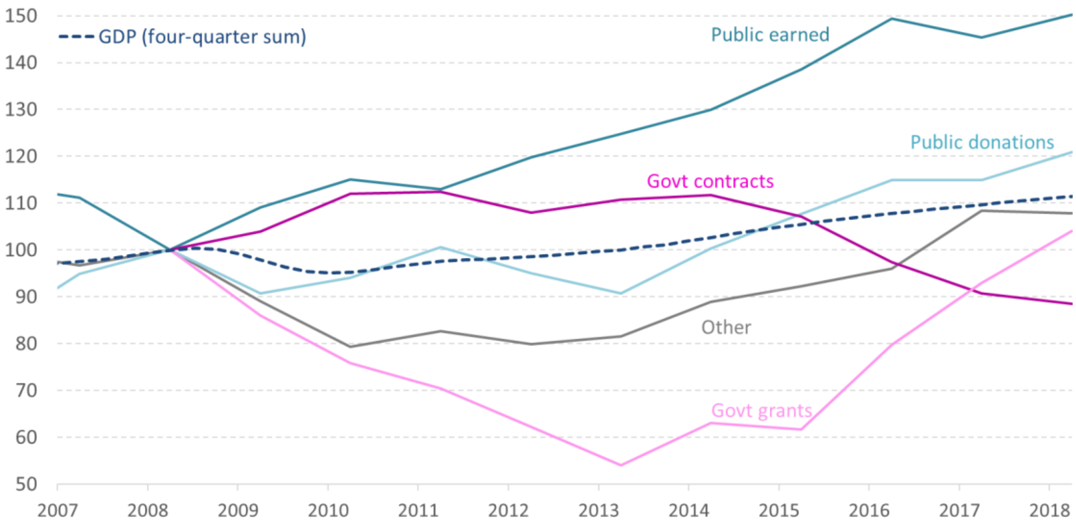
Sources: PBE analysis of ONS, *ABMI* and NCVO, *NCVO Almanac 2020*

However, once we split charity income into the different elements set out above, we quickly see that the relationship is not quite so clear cut.

Figure 4 shows that the different sources of charity income depicted in Figure 2 moved in very different directions in the post-crisis period. Some forms of charity income *did* move broadly in line with GDP, notably public donations (plus legacies) and 'other' income (combined income from the voluntary sector, investment, the private sector and the National Lottery). However, other sources appeared to bear very little relationship to the economic output of the nation.

Figure 4: Trends in charitable income drawn from the public and the government have diverged in recent years

Indices of real-terms GDP and charity income (by source & type): UK, 2007-08 = 100



Notes: See notes to Figure 2. 'Other' income here also includes investment income.

Sources: PBE analysis of ONS, *ABMI* and NCVO, *NCVO Almanac 2020*

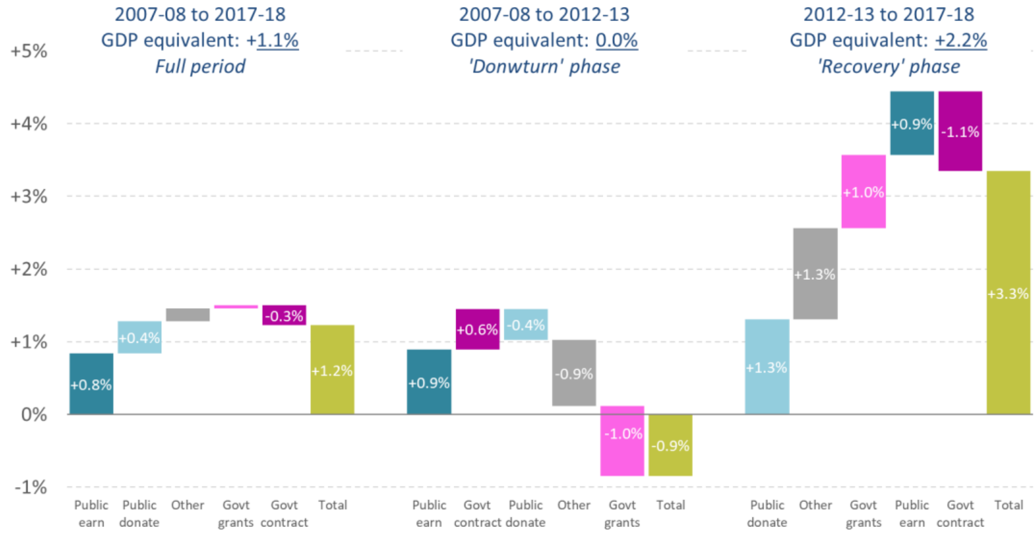
Figure 5 provides more detail. It decomposes overall charity income growth in the post-financial crisis decade into its constituent parts, in order to highlight the extent to which different sources of income boosted or pulled back on the total. It shows the overall pattern for 2007-08 to 2017-18, and additionally splits it into two separate five-year periods covering 'downturn' and 'recovery' phases.

Taking the period as a whole, we can see that the average annual growth in charity income of 1.2 per cent was driven primarily by the strong performance of public earned income (+0.8 per cent, or 69 per cent of the total) and public donations and legacies (+0.4 per cent, or 36 per cent of the total). Government grants accounted for an annual average increase in total charity income of less than 0.1 per cent a year, while government contracts *dragged* on the total to the tune of -0.3 per cent a year.

Focusing on the 'downturn' phase from 2007-08 to 2012-13, we can see that overall charity income growth of -0.9 per cent a year underperformed relative to GDP (0 per cent a year). This negative performance was driven primarily by government grants (which accounted for a -1 per cent annual average drop in total charity income, equivalent to 113 per cent of the overall drop) and by 'other' sources of income (-0.9 per cent, or 108 per cent of the total reduction). In contrast, government contracts accounted for an average annual increase in total charity income of +0.6 per cent. And public earned income added +0.9 per cent a year.

Figure 5: Charitable income sourced from the government flatlined even as the economy improved pre-pandemic

Contributions to compound annual growth rate in real-terms charity income: UK



Notes: See notes to Figure 4.. 'Other' income here also includes investment income.

Sources: PBE analysis of NCVO, NCVO Almanac 2020

In the 'recovery' phase – covering 2012-13 to 2017-18 – overall charity income significantly outperformed GDP, with average annual growth of 3.3 per cent and 2.2 per cent respectively. Increases in public donations and 'other' income made the largest contributions to the annual average, each adding 1.3 per cent. Having dragged in the previous five years, government grants supported charity income growth in this phase, contributing just under one-third of the overall average annual increase. In contrast however, government contracts flipped from a positive contribution in the earlier period to a negative one (accounting for -1.1 per cent of average annual growth in total charity income).

Given the numerous working parts at play here, it would therefore be wrong to assume that charity funding in 2021 and beyond will inevitably move in line with shifts in the economy. Prevailing economic conditions will undoubtedly be hugely important, but the feed through to fundraising is more nuanced. What then might have been driving the differing performances?

Public giving after the financial crisis appears to have been supported by strong employment growth and a concerted effort to develop new revenue streams

Turning first to income from the public, why might it have outperformed economic growth so consistently in the decade after the financial crisis?

Importantly, as Figure 5 highlights, the positive trend in post-crisis public giving was driven primarily by especially strong growth in *earned* income. We might speculate that at least some of this growth was due to a conscious effort on the part of charities to develop new revenue streams and diversify their income in the face of a tough funding backdrop. The increase was secured from a relatively low base, meaning the pace of growth might therefore be hard to sustain beyond the first few years. Indeed, Figure 4 suggests it may have already been stalling in the two years ahead of the pandemic.

Donations and legacies[2] tracked GDP growth much more closely, and actually significantly *under*-performed it in the downturn phase after 2007-08. Nevertheless, they did marginally outperform GDP growth over the decade as a whole. Research from the US provides one potential explanation for this. It suggests that individuals tend to reduce their contributions by less during economic recessions than they might subsequently give during economic recoveries. This comes about because individuals 'look through' temporary fluctuations in income, dropping their giving to "habitual levels as opposed to income-dictated levels". What appears to matter more for people's pattern of giving is their assessment of their *lifetime* (or 'permanent') income and wealth prospects.[3]

That being the case, we might expect patterns in giving to more closely match some measure of forward-looking consumer confidence rather than GDP. Figure 6 provides some support for such a theory. It compares the annual change in charitable donations by the public with a measure of variation from long-run consumer confidence. The confidence measure is a composite of four metrics, three of which are explicitly focused on expectations for the coming year. Perhaps crucially, three of the four measures also focus on individuals' *personal* prospects, rather than the

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[2] Although legacies are grouped with donations here for simplicity, it should be noted that patterns are much less likely to be driven by near-term consumer considerations. Decisions to include legacy gifts in wills are typically made 10-20 years before the income flows to a charity, and any correlation with contemporaneous consumer confidence is driven by confounding relationships with house prices and share prices rather than any link over how consumers make decisions about legacy giving.

[3] A C Brooks, *How did the Great Recessions Affect Charitable Giving?*, 2017

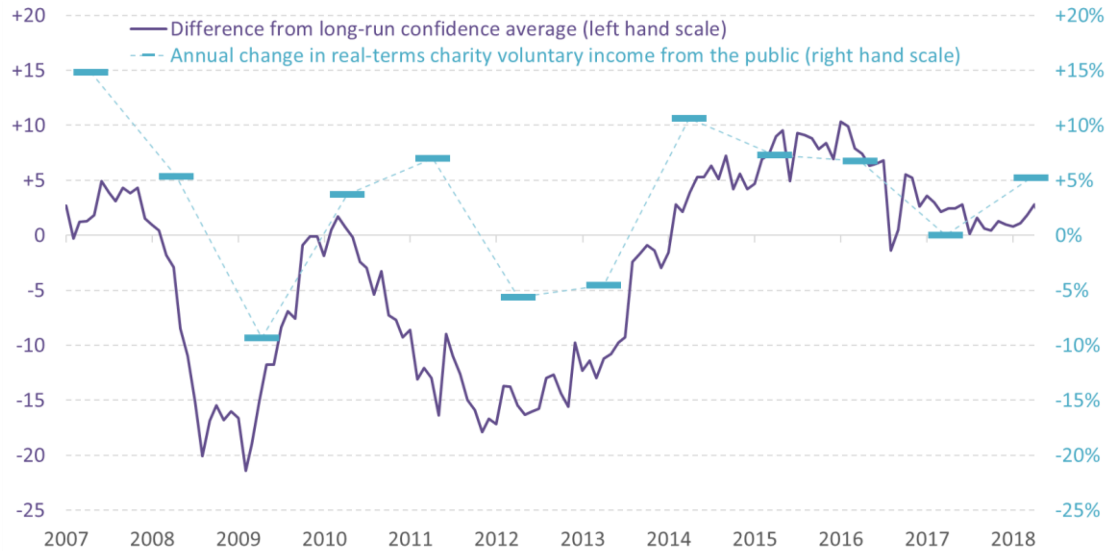
wider economy. It is therefore a good barometer of what households expect to befall them in the year to come.

In the main, the confidence measure appears a good match for trends in charitable giving. It consistently aligns with the direction of travel and seemingly offers a good indication of the magnitude of change in most instances too.

In considering why consumer confidence, and therefore donations, may have held up better than GDP in the post-crisis decade, it is likely that the UK's remarkable employment recovery played an important role. While employment did drop when the financial crisis hit, it fell by much less than most predicted given the scale of the economic contraction. It recovered more quickly too and, having returned to pre-crisis levels by 2016, continued rising. Immediately ahead of the pandemic the 16+ employment rate peaked at 61.9 per cent, far surpassing the 60.4 per cent rate in place on the eve of the financial crisis. That's the equivalent of an additional 805,000 people in work.

Figure 6: Public donations appear closely related to consumer confidence

Consumer confidence and year-on-year change in public donations: UK



Notes: Consumer confidence measure is the average balance of four questions relating to: personal financial situation over the last 12 months; expectations of personal financial situation in the next 12 months; expectations of general economic condition over the next 12 months; and expectations for making major purchases in the next 12 months. The results show the difference in this average from the long-run average sentiment recorded since 1985.

Sources: PBE analysis of European Commission, *Business and consumer survey database* and NCVO, *NCVO Almanac 2020*

Although household incomes were slow to recover from the recession – with a broadly felt wage squeeze and cuts to social security payments combining to depress growth – strong employment fed into a broadly positive outlook among the British public. Against this backdrop, the solid performance of charity donations makes sense.

Funding from the government dropped even during the recovery from the financial crisis, driven by the programme of austerity

What about the reduction in government sources of charity funding recorded in Figure 5? They appear to have been driven not, directly at least, by economic conditions; but rather by a political strategy of austerity designed to lower government borrowing following the spike associated with the fallout from the financial crisis.[4]

The differing trends in contracts (boosting overall charity income growth) and grants (dragging on growth) in the first five years after 2007-08 was in part the product of the continuation of a deliberate shifting on the part of government from the former to the latter that pre-dated the financial crisis.[5] This trend was likely accentuated by the particular funding pressure being felt by local government in this period, with the closure of many local authority grant programmes and reductions in community budgets.

The reversal of the position in the five years from 2012-13 to 2017-18 (with a drop in income from government contracts acting as a drag on overall growth and a rise in grants providing a boost) was likely something of a reaction to what had come before, with government grants notably picking up from a very depressed level. But it is also worth noting that the latest NCVO *Civil Society Almanac* includes a note detailing the difficulty of splitting government income by contracts and grants given the blurring of the concept in practice, suggesting that the apparent trend may also partly reflect statistical inconsistencies.[6]

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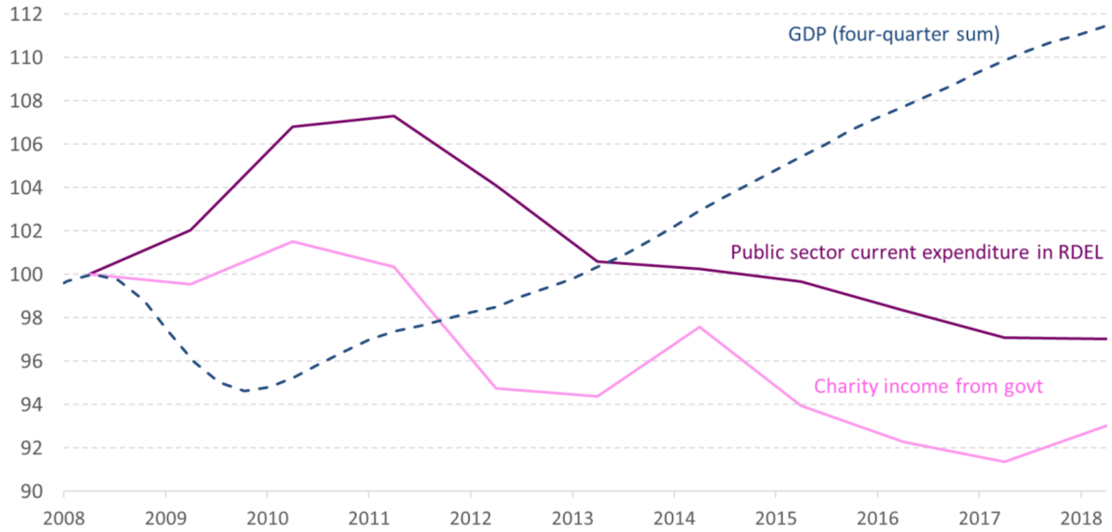
[4] Public sector net borrowing (PSNB) jumped from 2.9 per cent of GDP in 2006-07 to a post-war peak of 10.1 per cent in 2009-10. Source: OBR, *Public finances databank*, October 2020.
[5] Select Committee on Charities, *Stronger charities for a stronger society*, Report of Session 2016-17, HL Paper 133, 26 March 2017
[6] NCVO, *Civil Society Almanac 2020*, "Spotlight: government grants versus contracts

Figure 7: Charity income from government has tracked government departmental expenditure much more closely than GDP

Indices of real-terms GDP, government current departmental expenditure and charity income from government: UK, 2007-08 = 100



Notes: 'Public sector current expenditure in RDEL' covers that part of current (not capital) government spending spent through the resource departmental expenditure limit. It therefore excludes current spending on annually managed expenditure (such as benefit payments). It is adjusted to remove historical discontinuities.

Sources: PBE analysis of ONS, *ABMI*, NCVO, *NCVO Almanac 2020* and OBR, *Economic and Fiscal Outlook*, March 2020

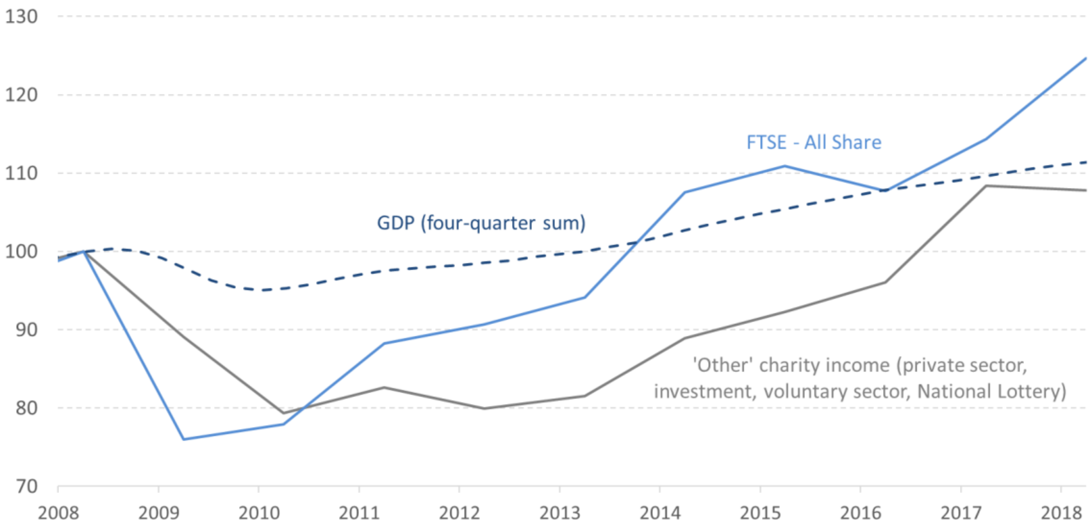
The bigger picture though is one of a general fall in charity income derived from government over recent years – and one that has borne no real relationship with GDP. Instead, as Figure 7 makes clear, it has moved broadly in line with overall government resource spending. The chart compares trends in GDP and charity income from the government with the path of the government's resource departmental expenditure limit (RDEL) – that is, the day-to-day resource that is allocated to and spent by government departments. The amount and how it is split across departments is set at Spending Reviews every few years, and has been on a clear downward trajectory since the adoption of austerity policies by the coalition government that came to power in 2010.

Other forms of charity income appear to have tracked economic performance more closely

Turning finally to the changes in "other" sources of income set out in Figure 4,, we can see that they are primarily driven by movements in income from corporate fundraising and charity investment income. These are likely to be cyclical effects driven by shifts in the profitability of firms, share values and property prices. Figure 8 provides some detail. It compares the post-financial crisis path of income from other sources with both GDP and the FTSE All Share index, and shows that it more closely matched the latter – dropping sharply in the immediate fallout from the crisis, but recovering strongly after 2013.

Figure 8: Other charity income is likely connected to broader financial performance

Indices of real-terms GDP, FTSE All Share index and charity income from 'other' sources: UK, 2007-08 = 100



Notes: See notes to Figure 4.
Sources: PBE analysis of ONS, *ABMI* and NCVO, *NCVO Almanac 2020*

Overall then, we can see that different types of charity income performed very differently following the financial crisis of 2008. Income derived from investments, corporations and trusts and foundations broadly moved with economic measures. In contrast, money drawn from the public appeared to *outperform* the economy – driven by the particularly strong showing for earned income. Voluntary donations and legacies also grew a little more quickly than GDP, appearing to more closely track a consumer confidence measure that was supported by strong employment. On the flip side, government income significantly *underperformed* GDP – driven primarily by the austerity policies introduced in pursuit of lowering government borrowing.

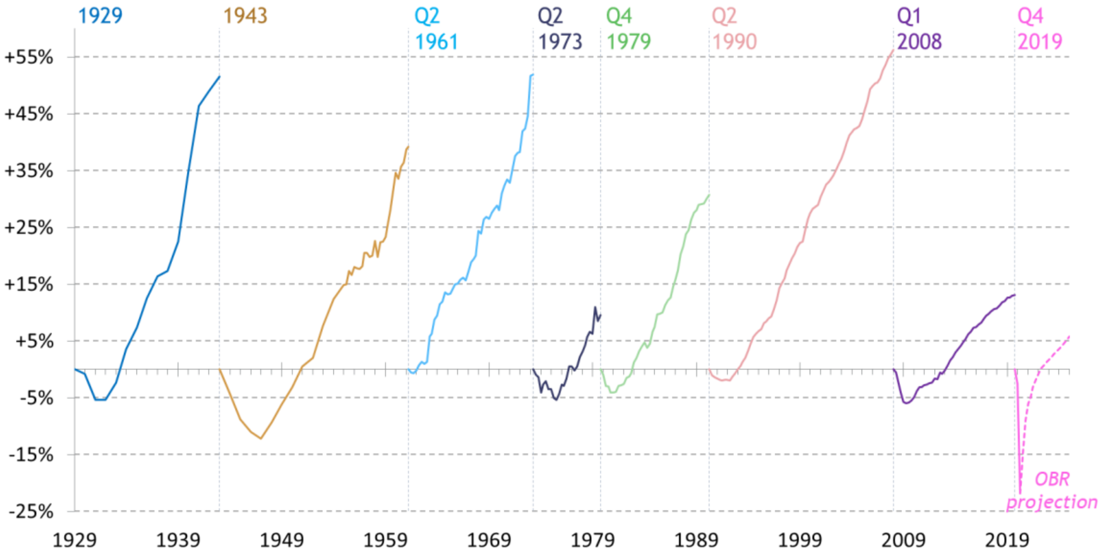
In considering what all this might mean for prospects for charity funding as we work our way through today's economic downturn and recovery, there are two key contextual differences worth exploring: the shift in the composition of charity income that has taken place over the last decade and which has left the sector especially exposed to a lockdown-led contraction; and the likely very different nature and shape of the pandemic recession and recovery relative to that experienced after 2008. This time might be different.

What happens next is very uncertain, but clearly extremely tough

There is a lot of uncertainty about what the future might hold at the moment, but it is clear that we are living through an economic shock that is unparalleled in living memory. Figure 9 makes this clear by comparing the scale of the drop in economic output associated with the Covid-19 lockdown with past recessions in the UK. It shows that GDP had plummeted by 21.8 per cent in Q2 2020 from its peak at the end of 2019. In contrast, the cumulative drop in GDP after the financial crisis maxed out at 5.9 per cent and wasn't reached until the end of the fifth post-peak quarter.

Figure 9: Today's economic contraction is unprecedented in scale and speed

Cumulative growth in real-terms GDP over successive economic cycles: UK



Note: The OBR projection assumes that, upon the conclusion of the current transition period at the end of 2020, the UK moves "in an orderly fashion to a new trading arrangement with the EU". This is assumed to have an effect broadly consistent with the terms of a conventional free trade agreement. The OBR acknowledges that any reversion to trading with the EU on WTO rules would "pose downside risks to short- and medium-term growth prospects on top of the economic challenges created by the pandemic".

Sources: PBE analysis of ONS, *ABMI*, Bank of England and OBR, *Fiscal Sustainability Report*, July 2020

Output has subsequently picked up a little, but the average 2020 growth forecast recorded across the range of forecasters surveyed each month by

HM Treasury currently stands at -10.1 per cent.[7] And the OBR central case projection displayed on the chart implies no restoration of Q4 2019 levels of economic output until the second quarter of 2022. That projection assumes that new trading arrangements are established with the EU beyond the conclusion of the transition period at the end of 2020. If no such arrangements are in place, then the near-term economic outlook would be tougher still.

Even in the absence of a hit from a no-deal Brexit, the trajectory for GDP set out above would clearly be very damaging indeed for charity income. If it were to once again move broadly in line with economic output then, relative to a counterfactual in which GDP (and, by implication, charity funding) maintained its 2019 growth rate, this scenario would result in a cumulative reduction in charity income of £22.2 billion over the five years from 2020 to 2024.

As noted above though, there are many reasons why we should not expect a one-to-one movement in economic growth and charity income. The question then is, will charity income outperform or underperform the economy? We of course can't answer that question with any sort of confidence while still in the middle of the pandemic. Much will depend on how quickly the country can recover from the health crisis and the economic crisis associated with the pandemic – with the timing of the arrival of any vaccine especially crucial. But we can at least look at some of the key elements of charity funding and assess what might help determine their trajectories over the coming years.

The scope for further large gains in public earned income appear limited

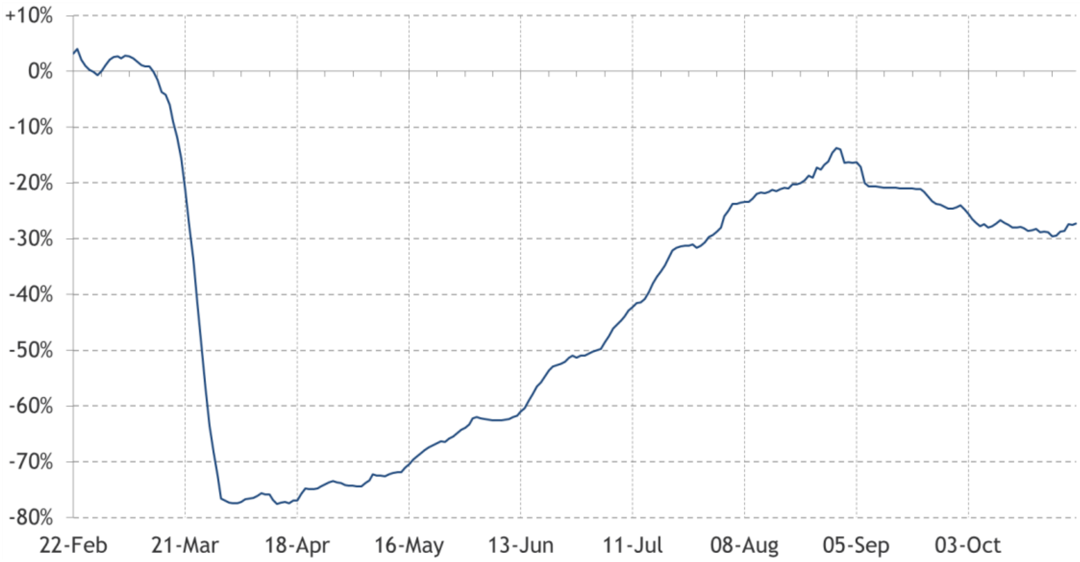
Clearly the 'lockdown' nature of the Covid-19 recession is very different from the one associated with the financial crisis, with very direct consequences for the significant share of charity income that is 'earned' from the public. With the composition of charity funding having shifted so much in the decade after the financial crisis, it would appear that the sector is likely to be more susceptible to the particular form of the downturn associated with the pandemic than would have been the case had the profile of charity income that prevailed ahead of the previous downturn still been in place.

[7] There is of course much uncertainty around this forecast, but all recent projections point to a very significant negative impact. The latest forecasts show a spread from -6.6 per cent to -12.5 per cent. See HM Treasury, *Forecasts for the UK economy: a comparison of independent forecasts*, October 2020, Table 1.

Figure 10 provides an indication of the potential impact. It measures the change in the number of visitors to retail and recreational spaces against a baseline covering the first five weeks of 2020, and shows just how large the drop associated with the start of the first lockdown was. Even as restrictions eased over the course of the summer, numbers remained some way down on pre-pandemic norms. And, with the introduction of new restrictions in some parts of the country in the autumn, visitor numbers quickly dropped once more. As of 30 October – ahead of the second national lockdown – the seven-day average sat 27 per cent down on the 3 January – 6 February baseline.

Figure 10: Retail and recreational visitor numbers remain well down on pre-pandemic norms

Change in visitor numbers to retail and recreational spaces relative to baseline in Jan/early-Feb 2020 (seven-day average): Great Britain



Notes: The data shows how visitors to retail and residential places change compared to baseline days, where a baseline day represents a normal value for that day of the week. The baseline day is the median value from the five-week period 3 Jan - 6 Feb 2020.

Sources: PBE analysis of *Google Community Mobility Reports*

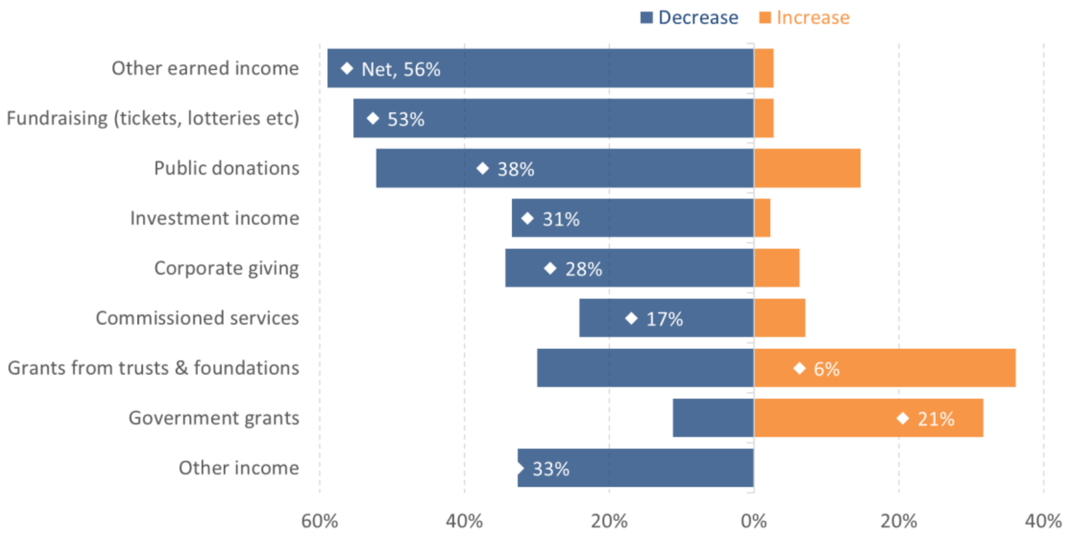
This statistic is likely to be especially pertinent for those charities that raise funds from shops and events because, unlike many high street retailers, they are likely to have limited opportunity to substitute their lost revenues through online trading.

Reports from charities themselves add further weight to this thesis. Figure 11 shows the net balance of charities reporting in September 2020 that they'd experienced a fall or rise in different income sources as a result of Covid-19. Income from fundraising and other forms of earned income do indeed stand out, with net balances of more than 50 per cent of charities reporting a drop. Within that total, more than one-in-three (35 per cent) charities said they faced a reduction in publicly fundraised income of more than 25 per cent.

More than half (52 per cent) reported a reduction in public donations too, though this was at least partly offset by 15 per cent reporting an *increase* in such funds. There were also net reductions reported in relation to investment income (31 per cent), corporate giving (28 per cent) and commissioned services (17 per cent). In contrast however, net balances of charities reported increases in income from trusts and foundations (6 per cent) and in the form of government grants (21 per cent).[8]

Figure 11: A net balance of more than half of charities say income from fundraising and earned sources have fallen as a result of Covid-19

How have each of these sources of income been impacted by Covid-19? UK, Sep 2020



Notes: n = 224. Residual not shown covers "no change" and "don't know".
Sources: PBE, *Covid Charity Tracker*, September 2020

Of course, the newly established second national lockdown will inevitably be further damaging charities' ability to earn public income from trading

[8] Answering over the summer, nine-in-ten respondents to PBE's *Charity Covid Tracker* said they expected the pandemic to lower their income over the second half of 2020 relative to their pre-crisis expectations, with PBE estimating that this equated to an aggregate drop of around £6.7 billion. At the same time, three-in-four charity respondents said they expected demand for their help to increase in the second half of the year. PBE estimates put the cash value of this extra demand at £3.4 billion, meaning the sector faced an overall funding gap relative to the country's need of £10.1 billion. Source: PBE press release, "Charities facing £10.1 billion funding gap over the next six months", 9 June 2020.

and from events. And there is every prospect that we will have to live with restrictions on movements and activity that ebb and flow well into the new year. The 'v' shaped recovery projected by the OBR in Figure 9 is now much more likely to be 'w' shaped, and there may yet be more false starts ahead.

Ultimately, once we are able to move beyond physical restrictions and effectively switch the economy back on, the hope must be that charity income earned from the public can recover relatively quickly. Yet, we must be cautious about the prospects for repeating the strong growth of the past. As discussed above, the rapid expansion of this form of income in the decade after 2007-08 came from a relatively small base, reflecting a concerted effort to diversify incomes and build new revenue streams. Even in a stronger economic climate, maintaining such speedy growth would be hard to achieve.

It is, then, hard to imagine earned charity income playing as supportive a role in the aftermath of the pandemic as it did in the post-financial crisis years. In the near-term we know the picture is difficult; further out it is likely to improve but not necessarily in line with our past experience

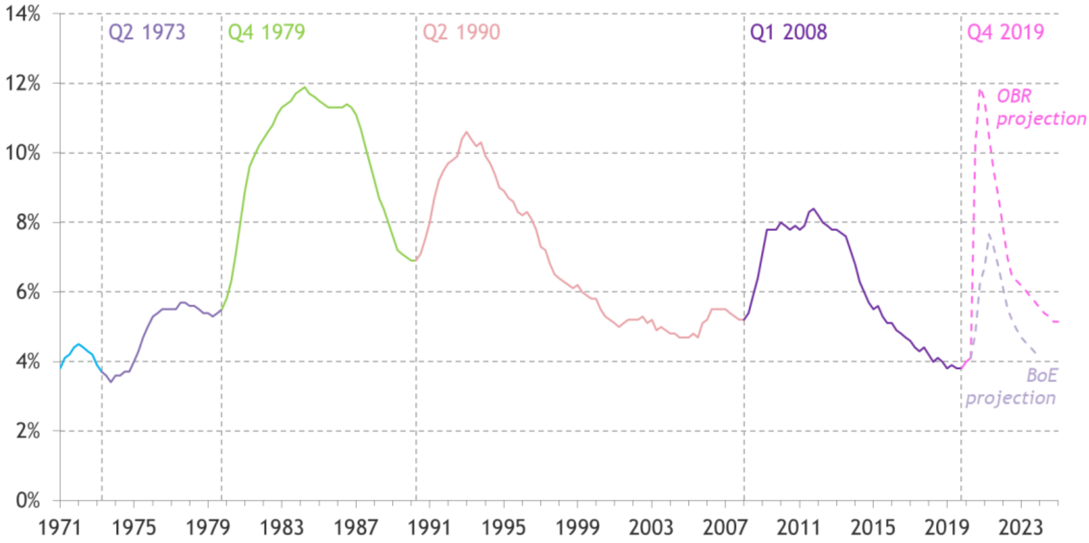
Public donations will likely be affected by the scale, duration and distribution of the labour market fall out

A second important potential difference between the nature of today's downturn and that of 2008 comes in relation to the likely labour market response – both its scale and its distribution.

Figure 12 shows how the unemployment rate has moved across several economic cycles, and highlights the relatively muted and short-lived spike after the financial crisis (an episode in which, as Figure 9 showed, GDP fell in a deeper and more sustained way than at any other time post-WWII). It highlights too that the projected path for unemployment this time might look somewhat different.

Figure 12: Prospects for unemployment are very uncertain

Unemployment rate (outturn & projection): UK



Sources: ONS, MGSX; OBR, *Fiscal Sustainability Report*, July 2020; and Bank of England, *Monetary Policy Report November 2020*

The OBR 'central' projection from July 2020 puts unemployment spiking to a peak of 11.9 per cent in the fourth quarter of 2020 – a level not recorded since the mid-1980s. It is then projected to fall back relatively quickly over 2021, though it remains some way above the pre-pandemic low by the end of the forecast horizon. The government's extension of the Job Retention Scheme to cover the second national lockdown and its announcement of the Job Support Scheme as a replacement once it ends will almost certainly have changed the profile of unemployment relative to this summer projection. The very latest Bank of England projection takes account of these developments, and suggests that unemployment might instead peak slightly later (in Q1 2021) but at a considerably lower lever (7.7 per cent).

As discussed above, the link between unemployment and consumer confidence means the path that eventually emerges will likely have a significant bearing on trends in public donations to charities. A return to the unemployment levels of the 1980s – however short-lived – has the potential to suppress donations more than was observed after the financial crisis. Conversely, a temporary spike that climbed no higher than that recorded during the post-2008 downturn might be expected to have less of an impact.

The way in which the labour market hit is spread across households might also prove to be a key factor for charity income. The burden of the post-financial crisis economic downturn was relatively evenly shared across the income distribution – even contributing to a modest reduction in income inequality in the immediate aftermath. With the rise in unemployment proving relatively muted, the economic hit was instead absorbed in the form of much reduced productivity and pay growth. A generalised wage squeeze had the effect of lowering income growth for all parts of the distribution.

If the post-pandemic labour market response is more concentrated within certain groups, then the feed through to charity income growth might look different. Past work by the IFS has suggested that rising income inequality and income volatility may have explained a drop in the share of households giving to charity in the period between the mid-1970s and mid-1990s, as might a rise in the share of workless households that flows from a concentration of unemployment within certain families.[9]

There is some evidence that the labour market hit this time around was initially concentrated among younger, older, lower-paid and more insecurely employed workers, but that it has since spread to cover a broader population.[10] Nevertheless, a range of economic, health and social data from the UK and across the world point very clearly to the fact that those with lower incomes are feeling the consequences of the pandemic most acutely.[11]

Figure 13 provides one of the clearest indications of this. It shows the net balance of UK households in different income groups who reported having increased or decreased their savings as a direct result of Covid-19 as of July. The pattern is linear across the income distribution, with a net balance of 13 per cent of households with incomes of less than £20,000 reporting *lowering* their savings and a net balance of 14 per cent of households with incomes of more than £55,000 reporting *raising* their savings. That this outcome has arisen despite relatively even drops in income being reported across the distribution, reflects the greater ease with which higher income households are able to lower their expenditure in response to uncertainty and lockdown.

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[9] C Pharoah & S Tanner, "Trends in Charitable Giving", *Fiscal Studies*, 1997, vol18, no4, pp427–443
[10] M Brewer, N Cominetti, K Henehan, C McCurdy, R Sehmi & H Slaughter, *Jobs, jobs, jobs*, October 2020
[11] D Strauss, "Pandemic hits poor hit hardest as inequality rises", *Financial Times*, 3 November 2020

Figure 13: Savings have risen among higher income households, but fallen among lower income ones

Net balance of households reporting changes in savings due to Covid-19, by household income band: UK

Notes: Question: "As a result of the measures taken around the coronavirus pandemic, would you say that your household savings have increased, decreased, or stayed the same?" Data collected 3 to 6 July 2020.

Sources: Bank of England, *Monetary Policy Report August 2020*, Box 3, p36

To the extent that such unevenness of impact is sustained into 2021, we might expect it to drag on the share of households giving money to charity – in line with the IFS analysis discussed above. But the apparent lack of exposure to the economic downturn being faced by a significant number and the large increase in savings held by higher income households might leave room for a rise in average donation sizes from those who *do* continue to give.

Evidence from the Charities Aid Foundation suggests that such an effect might have been at play in the early phase of the pandemic at least. It's work shows that public giving in the first half of 2020 was well up on 2019, with those in social grades AB being especially likely to report giving to new or different causes in response to Covid-19. Worryingly however, there was a sharp increase between February and March in the proportion across all social grades saying they expected to give less to charity in the following 12 months. Among those in social grades AB for instance, the share jumped from 6 per cent to 11 per cent.[12]

[12] Charities Aid Foundation, UK giving and Covid-19: A special report, October 2020

The implication would seem to be that there *is* still money for charities to pursue in the coming months – with some households experience a significant *rise* in the disposable income this year as opportunities for spending have been curtailed. But the base of potential donors may have shrunk a little, and there is more generally a lot of uncertainty around which is likely pushing up precautionary saving and therefore potentially dragging on giving.[13]

The readiness of those higher income households who have experienced an improvement in their financial situations over the course of 2020 to direct more money towards the charity sector in the coming months might also be affected by their expectations for future movements in tax rates – something that links to the third potential area of difference from the 2008 downturn this time around: the fiscal outlook.

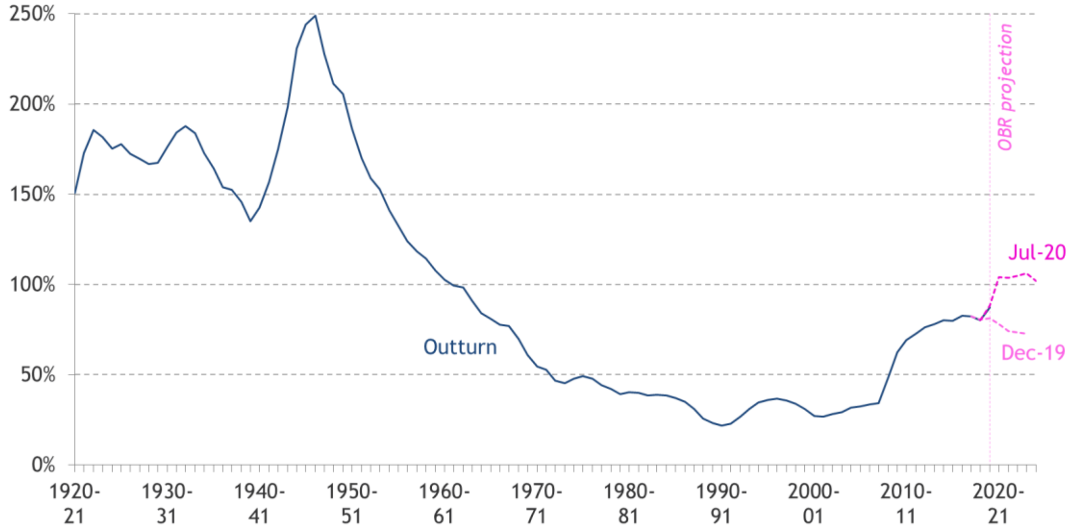
Reduced appetite for austerity could mean that charity income sourced from the government proves more robust than after the financial crisis

As discussed above, the programme of austerity introduced after 2010 appears to have played a large role in reducing the share of charity income sourced from government in the decade after the financial crisis. With the massive support packages delivered by the Chancellor in response to Covid-19 pushing the UK's stock of debt higher still, we might on the face of it expect a similar pattern of deep spending cuts to play out in the coming years.

[13] S Pinkney & K Scharf, "What are the likely effects of the crisis on charitable donations?" *Economics Observatory*, updated 21 October 2020

Figure 14: By 2024, the UK's stock of debt is projected to be 33 per cent of GDP higher than had been forecast ahead of the pandemic

Public sector net debt as a share of GDP: UK



Sources: PBE analysis of OBR, *Public finances databank*, various

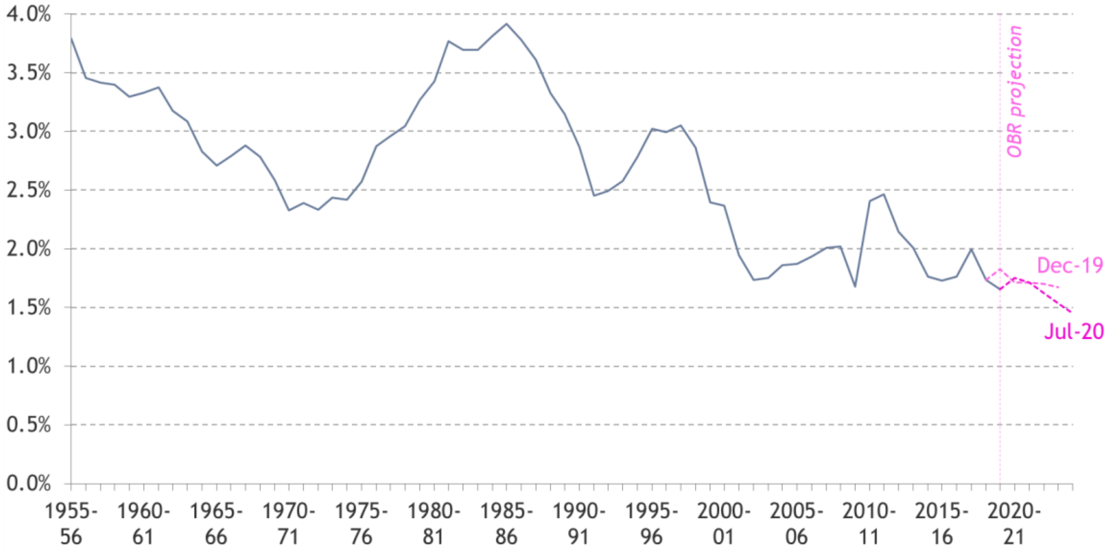
Figure 14 provides the context. It sets out public sector net debt as a share of GDP over the century from 1920-21, adding the OBR's pre- and post-pandemic projections for the next five years. Heading into the financial crisis in 2007-08, net debt stood at 34 per cent of GDP. It subsequently jumped to 63 per cent of GDP by 2009-10 and a peak of 83 per cent in 2016-18. Ahead of the pandemic, the OBR had projected that it would fall back to 72.7 per cent by 2023-24, even as the government stepped away from austerity. Following the arrival of Covid-19, the OBR is now projecting that net debt will spike once more, jumping to 104 per cent of GDP in 2020-21. If it reaches the 106 per cent of GDP level projected for 2023-24, it will be 33 per cent of GDP higher than had been previously projected – almost the entirety of the net debt figure back in 2007-08.

In cash terms, the difference between the two projections amounts to £760 billion. However, there are three reasons for believing that this jump in debt – huge though it is – won't prompt the same sort of fiscal consolidation as we saw after 2010.

First, the cost of servicing the national debt remains low. Indeed, as Figure 15 shows, annual debt interest costs have been falling over recent years and are projected to fall still further – dropping below the pre-pandemic projections. That drop is driven primarily by a reduction in interest rates, and is subject to change if rates did not follow the projected path. But the strong consensus is that borrowing costs will remain low in the coming years, leaving annual debt interest payments amounting to a lower share of GDP in 2024-25 than at any other time since the 1950s.

Figure 15: Despite higher debt levels, debt interest costs are projected to continue falling over the coming years

Central government debt interest payments as a share of GDP (net of Asset Purchase Facility): UK



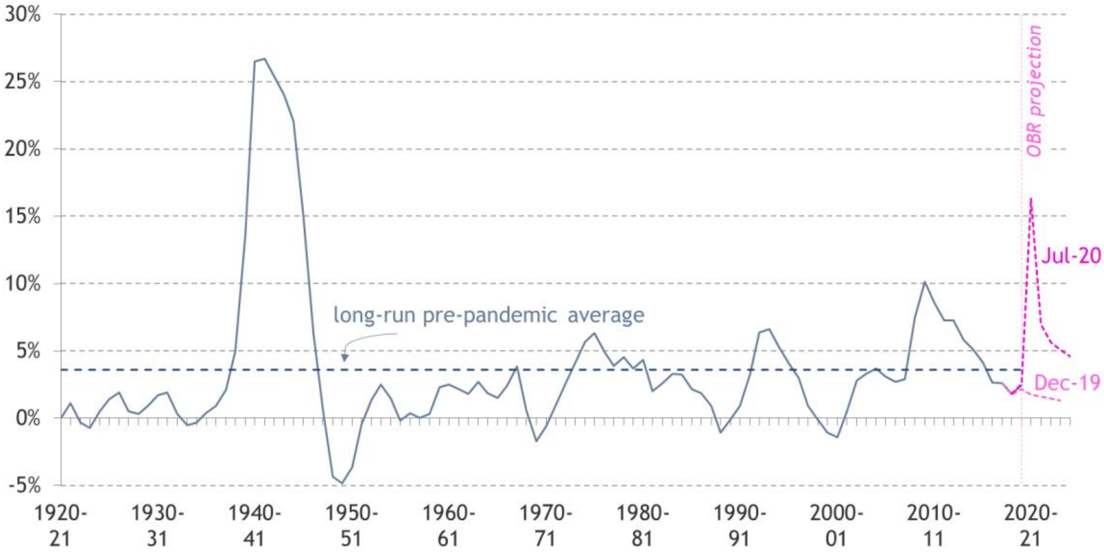
Sources: PBE analysis of OBR, *Public finances databank*, various

Second, there is little expectation of the sort of major *structural* deterioration in government borrowing that would require active corrective action.

Figure 16 shows that public sector net borrowing as a share of GDP is projected to jump to 16.4 per cent of GDP in 2021-22, its highest level since 1945-46. But it is then projected to fall rapidly back towards the long-run pre-pandemic average of 3.6 per cent of GDP – ending the forecast horizon at 4.6 per cent of GDP. That is significantly higher than the OBR had projected ahead of the pandemic, but well within what might be considered a ‘normal’ range in the post-WWII era.

Figure 16: Annual net borrowing is projected to spike sharply in the near-term, but quickly return to more typical levels

Public sector net borrowing as a share of GDP: UK



Sources: PBE analysis of OBR, *Public finances databank*, various

Third, there appears to be very little political appetite on the part of the government for a re-run of the austerity years. The Prime Minister for example declared in June that the UK would "not go back to the austerity of ten years ago", pledging instead to spend money on infrastructure projects in order to help spur recovery post-pandemic.[14] And in the near-term, the government has already directed additional resource to the charity sector to support it through the crisis with the Prime Minister indicating that more help will be forthcoming in the face of the second national lockdown.[15]

Yet despite all this, there will still be some pressure to lower the country's debt-to-GDP ratio once we enter some form of recovery from the pandemic – both to guard against an uptick in debt interest payments if interest rates start to rise, and to provide the government with headroom to deal with the *next* economic crisis. That being the case, the next important question revolves around the extent to which the emphasis will be placed on spending cuts (as after 2010) or on tax rises.

The former might be expected to more directly impact on government funding for charities – representing something of a repeat of the experience of the post-financial crisis decade. The latter might have less

[14] BBC News, "Coronavirus: PM 'will not return to austerity of 10 years ago'", 28 June 2020

[15] H Whitehead, "PM says he will do more to help charities, as public fundraising is paused by regulator", *Civil Society News*, 3 November 2020

direct impact but, to the extent that it would likely lower the disposable income of higher income households, it might feed through into lower overall donations from the public. Either way, the implication is that the massive hit to the public finances associated with the coronavirus rescue package will serve as a potential drag on charity income growth for a number of years to come – even if it doesn't act with quite the same force as it did after 2010.

And one thing that hasn't changed from the earlier experience is that the way in which it plays out will ultimately come down to a series of political decisions made by successive Chancellors.

Conclusion

There is, in the middle of a global pandemic, inevitably too much uncertainty surrounding the economic outlook to draw any firm conclusions about what might happen to charity funding in 2021 and beyond. Such is the scale of the economic shock associated with the crisis, that we can be sure that the funding backdrop will remain extremely tough in the months to come. But it is clear that we should not expect a straight re-run of the post-financial crisis trajectory.

On the downside, the strong growth in earned income derived from the public that acted as such a tailwind for overall charity income after 2007-08 looks very unlikely to blow with the same force this time around. Most immediately, much of it is cut off because of ongoing physical distancing restrictions. But even as these are eased, it will likely be hard for the charity sector to secure the same pace of growth from a new, higher baseline.

On the upside, the headwind associated with austerity and the withdrawal of government funding may subside this time around. The public finances have been hit hard by the government's responses to the Covid-19 crisis, but there are several signs pointing to the likely adoption of a more moderate approach to correcting that position.

Less clear is what might happen to public donations in the coming period. A large spike in unemployment and a rise in inequality, income volatility and consumer uncertainty will almost certainly drag on the potential donor base. But the relative financial gains enjoyed by some households might provide some opportunities for raising average donation levels. And there is the potential for the turmoil to be relatively (in comparison with past episodes) short-lived. As with each of the other factors considered here, the speed with which a vaccine can be developed and the virus controlled will be absolutely crucial.

Against this highly uncertain backdrop, one thing we can be very sure of is that charities will continue to work hard with whatever limited resources they have in order to help millions of people across the country and contribute to a better Britain. Some organisations will, sadly, fail. Other new groups will spring up to meet the needs of a changing country. They will continue to look for ways to innovate, delivering their services in new ways, achieving new efficiencies and generating new lines of income. All will seek to rise above the multitude of challenges standing in their way to make a positive difference. In that sense, this time may not be so different after all.

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