



Do grants to charities crowd out other income? Evidence from the UK[☆]



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ABSTRACT

We use a novel identification strategy to shed light on the effect of grant funding. We focus on charities that applied to a UK lottery grant programme. Where charities score the same on formal criteria, it is likely that informal criteria orthogonal to quality are used to break the ties, allowing us plausibly to treat a grant as a random event. We find evidence that grants have a positive impact for smaller charities, increasing their longevity and even crowding in other income.

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1. Introduction

What effect does receiving a grant have on charities' incomes? Does the funding simply substitute for other sources of funding – do donors reduce their giving and/or do charities reduce their fundraising activities – or does the grant have a positive effect, helping charities to survive and thrive? This issue is crucially important for organisations that fund charities and has been a long-standing area of research (see, e.g., Andreoni (1989), List (2011), and Andreoni and Payne (2013) for summaries). The most recent empirical evidence from the US and Canada shows that donations fall when a charity receives a government grant. The research points to a high level of “crowd out” – an extra dollar of funding reduces donations between 80 cents and one dollar on average. The main mechanism underlying this reduction, however,

is not that donors respond directly to the grant by reducing their donations but that charities reduce their level of fundraising activity, leading to fewer donations (Andreoni and Payne, 2011, 2012).

This paper studies this question using a unique sample of all the charities that applied for a grant from a programme funded out of the UK National Lottery ticket proceeds.¹ We employ a standard differences-in-differences approach to identify the effect of grant funding on charity incomes and compare the change in income before and after the funding decision across successful and unsuccessful applicants. The novelty and strength of our analysis lie primarily in the data we use. Our analysis focuses on a sample of relatively homogeneous charities that have all chosen to apply for funding. We track the charities both before and after the funding application. This allows us to control for time-invariant charity-specific characteristics that affect income. Next, we observe the assessment criteria used to award funding and can narrow our analysis to those “marginal” charities that narrowly succeeded to receive funding and those that narrowly failed. Of course, the decision to award a grant is not random; there is a particular

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¹ The grants are funded out of the UK National Lottery “good causes” funding. Lottery funding represents an important source of income for charities in a number of countries. In the UK, National Lottery funding for charities totalled £0.5 billion in 2010–11, compared to £3.0 billion in grants from the government. There has been relatively little evidence on the impact of this source of funding on charities (for a recent exception, see Jones, 2012).

concern that it may be correlated with pre-existing trends in charities' incomes. We show that there is no evidence of any differential trends and that the main findings are robust to focusing on "marginal" applications.

We find that being awarded a grant has a positive and significant effect on a charity's total income. In other words, these grants do not crowd out other funding sources. Indeed, for medium-sized charities the data lend some support for there being crowd in – £1 of grant income increases income by more than £1.

Our analysis points to a number of key reasons why our findings differ from previous studies. First, we analyse the effects separately for different-sized charities. We find the strongest evidence of positive effects among smaller charities (with incomes <£1 m a year). The size of the lottery grants varies little by charity size, so it is perhaps not surprising that being awarded a grant has a relatively bigger impact on smaller charities' total incomes and we are able to determine the effect of receiving a grant for smaller charities with greater statistical precision. However, it is also plausible that the effects of the grants are larger for smaller charities that have fewer alternative funding sources for raising similar levels of income.

Second, we show that the positive effect of being awarded a grant persists well beyond the year in which the grant was awarded (and the period over which the grant payments are likely to be made), highlighting the importance of assessing policy impacts over the longer-term. Third, we know something about the type of activities for which charities are typically seeking funding under this programme. Usually grants are for distinct, well defined activities that may be different from a charity's current activities. This is consistent with the idea suggested by Andreoni (1998) that seed funding can crowd in other income.

The plan of the paper is as follows: In the next section, we present a simple framework for thinking about the effect of lottery grant funding on a charity's total income. Section 3 describes the National Lottery good causes funding, and our data, in more detail. Section 4 discusses our empirical strategy and Section 5 presents our main results. Section 6 concludes.

2. A framework for assessing the effect of grant funding

Our data contain reliable information on charities' total income, including grant income (Y), and the amount of the grant awarded (G_1). Our empirical tests are therefore:

- (1) whether receiving a grant completely crowds out other sources of income: $\frac{dY}{dG_1} = 0$ and;
- (2) whether total income increases exactly in line with the increase in grant income, $\frac{dY}{dG_1} = 1$, or whether it increases more or less pound-for-pound, which allows us to say something about whether there is crowd in versus crowd out.

To think about the various channels through which receiving a grant might affect a charity's total income, we borrow a simple, conceptual framework from Andreoni and Payne (2012). In practice, a charity's income will come from a number of different sources including donations from individuals (D) and grants from the government (G_2) and from other foundations (G_3) – each of which may respond directly to the charity being awarded a grant.² The charity will also spend money on activities to generate income from these different sources – including fundraising activities directed at individual donors (FR) and grant applications directed at the government (GA_2) and other foundations (GA_3). The charity may adjust these activities following receipt of a grant, and this will also affect its income.

² The charity may also receive other sources of income from investments, sales and legacies that we assume to be unaffected by the grant.

Being awarded a grant will therefore have an immediate effect on a charity's income, but the overall effect will also depend on the responses by donors, the government and other foundations, as well as by the charity itself:

$$\frac{dY}{dG_1} = 1 + \frac{\partial D}{\partial G_1} + \frac{\partial D}{\partial FR} \frac{\partial FR}{\partial G_1} + \frac{\partial G_2}{\partial G_1} + \frac{\partial G_2}{\partial GA_2} \frac{\partial GA_2}{\partial G_1} + \frac{\partial G_3}{\partial G_1} + \frac{\partial G_3}{\partial GA_3} \frac{\partial GA_3}{\partial G_1}.$$

What does the existing theoretical and empirical literature say about the likely direction – and magnitude – of these elements?

The classic crowd out/neutral result of Bergstrom et al. (1986) and Warr (1982) relates to the direct effect of a grant on donations ($\partial D/\partial G_1$).³ The result is based on an assumption that donors care only about the total level of public good. Crowd out will be less than pound-for-pound, however, if donors also get some utility from the act of giving, such as a "warm glow" (Andreoni, 1990).

Recent empirical evidence has provided little support for direct crowd out of donations either from government grants (Andreoni and Payne, 2011, 2012) or from lottery funding (Borg et al, 1991; Banks and Tanner, 1997; Lin and Wu, 2007; Wu, 2012). An exception is Jones (2012) who looks at the effect of the introduction of grants to education from lottery revenues on donations in the US and finds a negative effect. However, these state lotteries differ slightly from the UK National Lottery in that their revenues are dedicated to a single purpose and allocated by the government rather than an independent body.

Alternative mechanisms suggest channels through which grant funding could actually crowd in other income. One is a signalling story in which grants provide a signal to uninformed donors about the quality of a charity (Vesterlund, 2003; Andreoni and Payne, 2003). In this capacity, the grant-funder may act like a lead donor providing information to individuals about the charity, or the specific project for which the charity is raising money. Another story is that the grant provides seed funding for a new project – for example allowing a charity to cover fixed costs and expand its operations (Andreoni, 1998). These mechanisms could be particularly relevant to the lottery grants we study here which typically provide funding for distinct – and often new – projects. There has also been some empirical support for crowd in effects in lab experiments (Bracha et al., 2011) and in field experiments (List and Lucking-Reiley, 2002; Huck and Rasul, 2011). In relation to government grants to universities, Connolly (1997) shows a positive correlation between external and internal funding for academic research while Payne (2001) shows that an increase in government grants to a university increases private donations.

What about the effect of a lottery grant on other grant income, $\partial G_2/\partial G_1$ and $\partial G_3/\partial G_1$? Similar arguments are likely to apply as in the case of donations. Government and other funders may react to a charity receiving a lottery grant by reducing their funding because the marginal benefit of their funding is reduced. Alternatively, they may increase funding because the grant provides a quality signal or covers fixed costs. Most of the evidence points to a negative effect. Andreoni and Payne (2012) provide some evidence that income from other foundations is negatively affected by a government grant, $\partial G_3/\partial G_1 < 0$. They suggest that the absence of a positive signalling effect is consistent with the view that other foundations are likely to be better informed than individual donors. Evidence from the US on the effect of lotteries on government financing of public goods also shows that the purported beneficiaries rarely experience a significant increase in state government spending ($\partial G_3/\partial G_1 \leq 0$). For example, Jones (2012) finds that education lotteries significantly increase revenue but fail to significantly increase education expenditures for education lotteries introduced between 1989 and 2008.

There is less evidence on the direction and magnitude of effects on charity activities. As has been discussed, Andreoni and Payne (2011)

³ The result is based on government grants, but similar arguments apply to lottery funding.

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