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Grants vs. credits for improving the livelihoods of ultra-poor: Evidence from Ethiopia

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ABSTRACT

Reaching the ultra-poor and enhancing graduation have long been challenges in many social protection programs. This paper compares the behaviors and performances of most vulnerable, ultra-poor and risk-averse households, who have been granted cash transfers for livelihoods investment, with the behaviors and performance of credit recipients, who are relatively better-off and willing to take credit risks. Using data from the Ethiopian pilot program, we tested if freely provided cash is used less efficiently as the sunk cost hypothesis portrays. Our data revealed that credit recipients indeed perform better than grant recipients. However, when we control wealth and other household characteristics, grant-based investments perform better than credit-based livelihood investments. Grants were allocated more likely to the planned investment than credits and the performances of the former is higher than the latter, both with and without controlling the intensive knowledge supports provided to grant recipients. The result is consistent and robust across different estimation approaches. This implies that the sunk cost hypothesis is not an important disincentive in livelihood grants. We concluded that livelihood grant (asset transfer) not only helps to reach the excluded ultra-poor but also to improve the effectiveness and productivity of rural livelihood investments. We further explained the possible reason for the superiority of grant over loan and its implication on graduation and program costs.

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1. Introduction

Ending hunger within the coming decade is targeted as an important millstone by many global and regional development programs and strategies. For example, the African heads of States have adopted Malabo declaration to end hunger in the continent by the year 2025. The strategies to achieve this target ranges from tripling intra-regional trade to social protection that provides safety nets to the ultra-poor people. However, reaching the ultra-poor who live below 1.9US$ per day has been a challenge to many developing countries particularly in Africa, despite remarkable recent economic growth (Cazzavillan, Donadelli & Persha, 2013; Kodongo & Ojah, 2016). One way—among others including safety nets, employment generation and affordable livelihood credit, to reach vulnerable groups is an asset transfer program, which had long been suggested as part of a big-push strategy to end poverty (Sachs, 2006).

Many social protection programs in Latin America (Handa & Davis, 2006) and Africa including Ethiopia (Andersson, Mekonnen, & Stage, 2011; Berhane, Gilligan, Hoddinott, Kumar, & Taffesse, 2014) have faced challenges of graduating beneficiaries partly due to the little impacts of the social cash transfers on households' asset building. This challenge has prompted governments and non-governmental organizations to purposely design asset transfers to the very poor households. The BRAC experience in Bangladesh is the case in point (Bandiera et al., 2017; Halder & Mosley, 2004; Roy, Ara, Das, & Quisumbing, 2015). Asset transfer is different from the conventional social cash or food transfers as it provides cash or livestock for long-term income generating investment rather than for short-term consumption smoothing. It serves as a poverty reduction strategy to break the poverty trap through providing a business startup fund to those households who fear overburdened and indebtedness to take credit, but they can engage in income generating activities. Thus, asset transfer offers an opportunity to the poorest households to engage in rural business, build assets, and graduate from social protection programs.

However, there are several empirical concerns that require in-depth understanding of the program (asset transfer) to further advocate as a way to break poverty trap and hasten graduation. The first concern relates to identifying proper targets to ensure efficiency as well as equity. Transfers either in the form of cash or food

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or asset, have always been challenged by improper targeting and distorting the incentive structures (Jayne, Strauss, Yamano, & Molla, 2001; Jayne, Strauss, Yamano, & Molla, 2002). In asset transfer programs, targeting should consider the poor at the margin, who are regular recipient of social safety nets; poorer than the average credit clients to ensure their rational exclusion from the credit service and truly lack any other option of financing livelihood investments. The second, concern relates to the size of the fund –being very small to be productive and attractive. Since the cost of investment grant is very huge both to governments and donors, it is usually kept as small as possible. This will cause recipients to choose those livelihood options which are less productive. The third concern relates to the nature of the target group. The ultra-poor are usually assumed to have shorter term time preferences and hence, they may allocate the funds or assets to current consumption instead of investing in future income generating activities (Carter, 2016; Laajaj, 2017). There is also a presumption that the poorest of the poor are, vulnerable to risks and suffer from information gaps (Sadoulet & Janvry, 1995).

Several studies have been conducted to evaluate the welfare impacts of asset transfers to the ultra-poor. The BRAC experience of working with ultra-poor in Bangladesh has been well-documented and its shows promising impacts of asset transfers to the very poor (Bandiera et al., 2017; Halder & Mosley, 2004; Roy et al., 2015). The transfer of livestock assets in rural Rwanda has also showed a positive impact on milk production and other indicators of household wealth particularly to those households who are offered training on how to utilize the grant (Argent, Augsburg and Rasul, 2014). More recently, a comprehensive randomized control trial has been conducted in six African countries to evaluate the impact of a productive asset transfer program on improving the livelihoods of the very poor (Banerjee et al., 2015). The result confirmed the possibility of improving the economic status of the very poor with a multifaceted program that includes productive assets and consumption transfers.

Unlike the previous studies on asset transfer, the current study compares asset transfer (in the form of livelihood investment grant (LIG) with affordable credit scheme-a widely used livelihood financing option in many graduation programs. Unlike credits, livelihood grants possibly create disincentive effect related to the assumption that freely supplied resources through grants and subsidies are usually used less efficiently. This is because of the snuck cost hypotheses, which claims that since users do not invest in the resources, they attach less value and care very little (Ashraf, Berry, & Shapiro, 2010). As a result, grant recipients could perform less than credit receipts. To verify this hypothesis and generate evidence for further learning, the paper reports the results of an empirical study conducted on a Livelihood Investment Grant project, which was piloted in Ethiopia in 2015/2016 to reach the poorest households who are too poor to access credit and take risks.

The paper reports results of comparison between the investment behaviors and performances of grant and credit recipient households. Fund allocation, income generation and asset building were used as indicators of behavioral and performance outcomes as they are directly related to the selection and management of livelihood investments. The major theoretical argument of the paper is that the selection and management of livelihood investments depends on the nature of the investor, incentives/disincentives created by the financing schemes and other technical and managerial supports. Several econometric specifications are used to control and isolate the effect of these factors. Hence, by controlling the characteristics of the investors (Households), and other program supports, we can robustly test the relevance of incentive effect in livelihood grant.

The rest of the paper is organized as follows. The next section explains the social protection activities in Ethiopia and describes the livelihood investment grant pilot. Section 3 presents the sampling methods used to select respondent households and collect the data used for the analysis. Section 4 describes how the empirical comparison between grant and credit recipients is made. In Section 5 we present and discuss the empirical results. Finally, conclusions and potential implications for scaling up and scaling out are highlighted.

2. Social protection and asset transfer in Ethiopia

Ethiopia has adopted one of the largest and most innovative social safety net programs in Africa called Productive Social Safety Net Program (PSNP) in 2005. PSNP has aimed at addressing the food insecurity problems of about eight million poor people in Ethiopia through direct transfers and public works. Ethiopia has experienced significant economic growth and poverty reduction but still challenged by limited progress in reducing food insecurity and vulnerability at the lower income quintile of the society (Moller & Wacker, 2017). One third of the population live under extreme poverty. Therefore, PSNP was designed and implemented to safeguard chronically food insecure households from seasonal food shortage and depletion of household assets. Many studies indicated that it has contributed to public asset building and environmental protection through its extensive public work projects. However, clients of PSNP have shown little progress in getting out of poverty, building assets and graduating from the program (Adimassu & Kessler, 2015; Andersson et al., 2011; Berhane et al., 2014; Porter & Goyal, 2016; Sabates-Wheeler & Devereux, 2010; Shigute et al., 2017). Some critics have argued that such little impact have led recipients to develop dependency on the program.

As a response to low graduation rate of PSNP, credit-based Household Asset Building (HAB) program was initiated to help the households to diversify their livelihoods and accumulate asset. The program was motivated by a large body of evidence suggesting a strong link between improved livelihoods and household asset (Babulo et al., 2008; Block & Webb, 2001; Woldenhanna & Oskam, 2001). The program has provided credit access and demand driven extension and knowledge support to PSNP beneficiaries to build assets and help them graduated. When this program launched in 2010, 318 woredas were targeted. Selection of beneficiaries was designed to be made at community level based on household assets (landholdings, oxen) holdings and income from non-agricultural activities and from alternative sources of employment. However, communities were given substantial discretion to modify this approach and to update their lists of food-insecure households annually based on local criteria. So, for instance, households who suddenly became more food insecure because of a severe loss of assets and were unable to support themselves, as well as any household without family support and other means of social protection and support could be included in beneficiary lists (GFDRE, 2014). The number of woredas covered by the HAB has increased over time, partly as larger woredas have been split in two and partly because of the expansion of the program. So far, about 300,000 households were benefited from the program. Credits were channeled through microfinance institutions and Rural Saving and credit Cooperatives (RuSaCo). The program allocates fund to the institutions or to the cooperatives and they provide the fund to households who prepared a livelihood investment plan with an affordable interest rate. Until 2016, close to 2.4 billion ETB (88 million USD) is disbursed to support rural livelihoods

Unfortunately, the program is unable to benefit those households or individuals for whom taking credit is understandably too risky and hence rationed out of the program. These are households at the margin who can do business but do not have the social and economic capacity to borrow. Rural micro credits in general

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