

**WORKING PAPER / 2014.10**

# **Impact of Integrated Programs for Monthly Households Consumption Expenditure: Empirical Evidence from Northern Ethiopia**



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**WORKING PAPER / 2014.10**

**ISSN 2294-8643**

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November 2014

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## **ABSTRACT**

The “minimalist” approach that once dominated microfinance outreach in the past is now a fading memory. A growing number of studies are suggesting a more “integrative” approach to support the marginalized and ultra-poor households. This study highlights the impact of the integrated programs-Village Saving and Loan Association (VSLA) and Productive Safety Net Programs (PSNP)-in Sekota district, Northern Ethiopia on consumption expenditure of households. Endogenous Switching Regression model is fitted to minimize threats of self-selection bias, unobserved characteristics and heterogeneity effect. The result reveals that self-selected participant in the integrated program has a significant and positive impact on monthly consumption expenditure compared with the random participants and non-participants.

Keywords: Endogenous switching regression, Productive Safety Net Programme, Self-selection bias, Village Saving and Loan Association, Ethiopia.

## 1. INTRODUCTION

For decades, recurrent drought and famine have devastated the living conditions of most rural dwellers in Ethiopia. According to a FAO 2006 report, a blend of man-made and natural factors resulted in a severe and growing food insecurity problem, which exposed five to six million people to chronic and transitory food insecurity. As well, it also makes ten million people vulnerable with weak resilience every year. This chronic food insecurity is a signal of the extreme state of poverty that the greater proportions of rural poor households are confronting within their daily life. The policy response to this recurring famine has been to avert mass starvation through emergency food aid. However, this did not either stop the depletion of victims' assets or meet their sustained food needs (Gilligan et al., 2009). Temporary emergency aid was not integrated with economic development activities in Ethiopia until 2005.

There is a debate on whether support for the poor should be credit only or credit plus. The "minimalist" side of the debate would argue that the poor need only financial support. They perceive credit as a magic bullet to do away with rampant poverty (Woller and Woodworth, 2001). However, poverty is not the same across borders, and ultimately the same kind of credit treatment might not solve all kinds of poverty. There are in fact ultra-poor who are in need of credit plus services such as food aid because credit alone can only be used for tempting consumption rather than for triggering productivity (Bateman, 2010).

The "integrative" side would argue that the poor needs credit plus supports if the aim is to pull them out of abject poverty (Woller and Woodworth, 2001). This approach provides a range of social intermediaries, enterprise developments and social services, combined with financial services (Ledgerwood, 1998). Bastiaensen and Marchetti (2010) have further argued that "integrative" approach fosters rural microfinance. They have previously argued that, without compounding financial services with non-financial services, one should not expect a miracle out of any credit services alone (Bastiaensen and Marchetti, 2007). Bateman (2010) presented evidence that suggests that the use of credit-only service makes the poor channel 50 to 90 percent of their credit to tempting consumption.

The poor in rural areas and in urban slums do not get access to formal financial service at all because microfinance institutes (MFI) mainly focus on the transaction cost and profitability to operate their business (Allen, 2006). In addition to credit service delivery gap, there is also a mismatch between what the poor want and services being delivered (Allen, 2006). For instance, most MFI's are not licensed to keep financial deposits, although few have started recently to offer insurance. However, the poor prefer to beef-up and protect their asset holdings through savings (Allen, 2006). Conspicuously, it became evident to search for an alternative model that can fill in gaps stated to reach out both to the rural poor and to the urban slum dwellers.

In response to those challenges CARE has been working for more than a decade on an alternative model, namely the Village Saving and Loan Association (VSLA). This study mainly focuses on the VSLA model after it was integrated with PSNP, and provides support to ease the food insecurity problem that rural households face.

This paper makes an attempt to contribute to the existing empirical evidence on VSLA. Firstly, it investigates the impact of VSLA on consumption. Secondly, it makes use of rigorous statistical methods that minimize threats such as self-selection and unobserved characteristics in most microfinance evaluation, particularly, in the VSLA literature.

The rest of the paper is structured as follows: section 2 discusses the survey design; section 3 discusses the model specification with the estimation results in section 4 and section 5 discusses the conclusion and policy implications.

## **2. VILLAGE SAVING AND LOAN ASSOCIATION (VSLA) AND PRODUCTIVE SAFETY NET PROGRAMS (PSNP)**

### **2.1. The Principle of VSLA**

CARE International developed the VSLA model about two decades ago, with several testing and modifications done in 1991 in Niger. Currently it is being implemented in over 21 countries around the world. Different organization such as USAID, Save the Children UK and Catholic Relief Society have adopted CARE's model, while PACT International has developed its own version of the model that targets women and focus on literacy to support the poor.

All VSLA models, regardless of the agency implementing it, generally follow three basic principles. First principle is members self select into the program to save money to form a pool, or an aggregate source of loan capital from which they can borrow, with the aim of providing an opportunity for household savings and insurance to the poor, who are usually excluded from the formal financial services. Second principle, it should be autonomous and self-managed because it aims at creating institutional and financial independence, and every kind of financial transaction and decision-making would need to be carried out in front of every members to ensure transparency and accountability. Third principle is that the cycle of savings and lending is usually time bound, which means members agree to save and to borrow for a specified period of time. At the end of the agreed period, members share the money in proportion to the amount of their accumulated savings, interest earnings and earnings generated from other economic activities by the group.

### **2.2. Productive Safety-Net Program**

In 2005 the government of Ethiopia with a consortium of donors started to implement the PSNP and was started with the aim of shifting the trend from meeting short term food needs, through emergency relief, to addressing the underlying causes of food insecurity, through a predictable food transfer (Gilligan et al., 2009). The program has been run in two phases. The phase one run from 2005 to 2009 and phase two started in 2010 and expected to end in 2014. The first phase started with 4.84 million food insecure people and scaled up to 7.57 million people in two years time. The second phase builds on the efforts of the first phase, thereby stressing means to maximize linkages with other elements of Food Security Program to attain sustainable food security.

The underlining principles and objectives of PSNP is: to assure food consumption and prevent asset depletion for food insecure households in chronically food insecure districts, thereby stimulating markets, improving access to services and natural resources, and rehabilitating and enhancing the natural environment.

The program has two components, direct support and public works. The public work component aims at building community assets and prevent asset depletion. It has short-term and long-term objectives. The short-term objective is to protect households from distressed selling of their assets holdings to fill the consumption gap they face. Accordingly, they will be paid for the time they spent for public work activities. This helps households to have a smooth

consumption while at the same time they are protected from distressed sell of their asset.

However, the long-term objective, attempts to give long-term solutions to the underline causes of the recurrent food insecurity problem, thereby rehabilitating natural (physical) resources. There are six natural (physical) resources rehabilitation activities. These are: i) Soil and water conservation; ii) Rural feeder roads, bridges and fords construction; iii) Water supply for animal and human use; iv) Social infrastructures (schools, health and animal posts); v) Small scale irrigation and dams; and vi) Agricultural activities related to composting and farmers training.

### **2.3. Integrated Programs and Evidence on Integrated Programs**

VSLA launched with the aim of promoting the culture of saving in ultra-poor households, fostering graduation from PSNP and gradually to prepare the poor to be a member of formal microfinance beneficiary. Membership to VSLA is open to both participants and non-participants of the PSNP, but the remaining packages of PSNP-plus program are restricted only to the participants of PSNP.

The VSLA model can be implemented in an array of institutional settings ranging from multi-sector rural development projects to stand-alone financial service projects (Allen, 2006). The model is based on traditional saving and lending methods that exist in different African countries, but it requires a small external investment needs in the form of training and other supports (Burns and Bogale, 2010). Adopting CARE's model, Save the Children UK has been implementing VSLA in the Sekota District since 2008. Accordingly, Save the Children UK includes VSLA as one component of its overall PSNP-plus program, which includes: VSLA, livestock fattening and honey value chains combined PSNP, and linking VSLA participants with formal MFI's graduates.

Empirical studies on "integrative" approach (PSNP-plus) are scanty and inconclusive. Hashemi and Rosenberg (2006) have stated that the Rural Maintenance Programme in Bangladesh has brought a positive change to its beneficiaries - 87 percent of poor clients who graduated from the Rural Maintenance Programme became self-employed in just three years after the program's completion. Another success story has also been documented in Bangladesh, where two-thirds of the participants who graduated from Income Generation for Vulnerable Groups Development became full members of formal microfinance institutions and increased their income and assets (Hashemi, 2001).

However, the attempt to duplicate a similar program in Malawi, or the Central Regional Infrastructure Maintenance Program, did not bring about the same level of improvement to its participants (Hashemi and Rosenberg, 2006). Gilligan et al. (2009) have indicated that the Other Food Security Program in Ethiopia, which seeks to integrate food aid with credit, soil and water conservation and other activities, did not provide a significant impact on household consumption expenditure. Using the same dataset, but focusing on the Amhara region of Ethiopia, Andersson et al. (2009) have concluded that PSNP alone shows no changes on livestock holdings, but it had a positive impact on livestock holdings when the PSNP is integrated with the Other Food Security Program.

Similarly, the empirical evidence on the impact of microcredit services is increasingly becoming controversial. It is partly because of the methodological challenges. Pitt and Khandker (1998), Morduch (1998), Chemin (2008), McKernan (2002), Khandker (2005), Menon (2006b) and Roodman and Morduch (2009) have all analyzed the same data, collected from Bangladesh from 1991 to 92, except Khandker (2005), who included additional data from 1998 to

99. The results from these studies are divergent and inconclusive. These discrepancies can be attributed to lack of managing selection biases, unobserved characteristics, different assumption and the differences in the estimation technique.

### **3. SURVEY DESIGN AND DATA**

One of the best viable measures to spurn selection bias is to conduct randomized experimental designs. Researchers have faced challenges in establishing causality through non-experimental designs (Roodman and Morduch, 2009). Nonetheless, it is extremely expensive to employ a randomized approach to every developmental evaluation. The challenges of non-experimental designs stem from factors such as unobserved variables, non-programme placement bias, self-selection and attrition biases.

The two recent studies conducted by Banerjee et al. (2009) and Karlan and Zinman (2009) are meant to overcome major threats such as selection bias that engulf quasi-experimental designs in microfinance evaluation.

Selection bias comes from two sources: self-selection and programme placement biases (Pitt and Khandker, 1998; Coleman, 1999; Ravallion, 2001). Self-selection is particularly problematic in VSLA studies. This is because individual members of the VSLA are self-selected and members pool together their savings. Although membership to the VSLA is based on the principle of self-selection, most impact studies conducted have not accounted for the potential self-selection bias (see, for instance, Allen and Hobane, 2004; Anyango, 2005 and Anyango et al, 2007).

Participants in the VSLA program are systematically different from the general population for two main reasons. Firstly, the participants are self-selected, which implies that either they might have some entrepreneurial skills. Secondly, a conjecture can be made such that the ultra poor are systematically eliminated from the VSLA because they cannot contribute their own finances. But as we shall see later on we made an attempt to minimize this selection problem. As indicted above membership to the VSLA is open to both the non-participants and participants of the PSNP households. Therefore, non-participants of PSNP are better compared to the participants of the PSNP households even though the former do not have access to formal financial services. The inclusion of the non-participants of the PSNP households into the study sample would thus introduce selection bias.

Selection bias can be overcome in three ways: using instrumental variables, using panel data, or by assuming normality in the error distribution of the outcome variable before the treatment happens (Moffitt, 1991). The third way, however, is inherently problematic approach (Coleman, 1999). To minimize selection bias, non-participants of PSNP were not included in our sample. Yet, this counter measure does not fully resolve selection bias. Holvoet (2005) recommended minimizing selection bias by gaining a good understanding of the subject under study and potential selection processes, which can help identify the persistent matching characteristics of participants and non-participants and controlling of other differences statistically. As a result, we looked at characteristics related to households, such as socioeconomic status and whether the household is a PSNP recipient or not, and whether programme placement strategies is non-random or random. In this study, the endogenous switching regression model is used to minimize the problems of self-selection bias and unobserved characteristics.

#### 4. SURVEY AREA

The study area, Sekota district, is located in the eastern part of Waghimra Administration Zone (WAZ) of the Amhara National Regional State (ANRS) of Ethiopia. WAZ, which is one of the 11 administrative zones in ANRS, comprises of six districts: Sekota, Dehana, Gazgibla, Abergelle, Sihala and Ziquala. The major ethnic group in the Sekota is Agew, which accounts for more than 95 percent of the total district population. The local language is Agewegna (Himtigna). Orthodox Christianity is the dominant religion in the region, up to 99.5 percent, and the rest 0.5 percent are Islam, Protestant Christians and other religions (SERA, 2001).

Sekota district's agro-ecological zone is characterized by tepid to cool sub moist mid highland and hot to warm sub moist lowland (MOA, 1998). The topography of the district is characterized by rugged and chained mountain terrains most of which could be covered by patchy grasses during the small rainy seasons. For the remaining season the terrain is covered by bare rock. Certain areas in Sekota district's agro-ecological zone are not suitable for agriculture: Only a quarter of the district topography has a slope less than 2% while 37 percent of the topography has a slope more than 30% (SERA, 2001). Agriculture is the major livelihood enterprise for the rural population; more than 99 percent of rural households dwell on subsistence farming on the hills, which rarely provides sufficient amount of grain even during a good rainy season. The remaining, or 0.5 percent, of the rural population lives on non- agricultural activities, such as handicraft, trade and as a daily labor.

Sekota is classified as one of the most food insecure districts in Ethiopia (Adefress et al., 2000). The main sources of food are: relief, labour, purchase, livestock production and own crop. Crop production in the area is not a promising enterprise due to shortage of farmland, depletion of soil fertility and moisture stress. As a result, the people are suffering from continuous food shortage. Furthermore, according to Kabeta et al.'s (2004) need assessment, the source of food differs considerably by the economic status of households in the district. High livestock holdings in the area serves as a prime buffering strategy for crop failure and minimize the risk of vulnerability due to recurrent drought (SERA, 2001). The average livestock holdings is high, particularly, small ruminants. In rural Sekota, ownership of oxen is a chief indicator of wealth and prestige of households (Kabeta et al., 2004).

Households in Sekota are categorized as "poor" or "better-off" based on their ownership of paired oxen. Households with none or fewer oxen usually plough their land through a labour sharing arrangement. Sometimes, these extraordinary poor households who do not have any agricultural inputs other than owning their land usually make a sort of "contractual agreement" called sharecropping with the better-off households.

The major crops that are grown are barley, *Teff* (the most popular staple in Ethiopia), wheat, sorghum, beans, lentils and peas. Based on the local wealth indicator ranking 15-25 percent are considered better-off, 25-35 percent are surveyed as medium in wealth and 35 -55 percent are labelled as poor (Kabeta et al., 2004). However, had the international standard been used in place of local wealth indicator ranking, the result would have been much different.

## 5. STUDY POPULATION AND SAMPLE

For a long time, the policy direction in Ethiopia towards famine and food insecurity problems triggered by drought was to curb hunger using food relief. This policy did not change much the structural problems the poor faces in the Sekota district as with problems those in other drought prone areas in the country.

At the end of the PSNP program, or the phase-out period, all PSNP recipients are expected to graduate; some have already graduated while others still looking for an additional support in order to graduate. PSNP households who have not yet graduates received one or more of the PSNP-plus programmes (VSLA, honey and fattening value chains) to facilitate their graduation. Except the VSLA, which is open to both the participants and non-participants in the PSNP households, the other PSNP-plus programmes are restricted only to the PSNP beneficiaries. Non-participants of the PSNP households were not considered in either the treatment or control group because non-participants are relatively better-off economically compared to participants of the PSNP households, and the inclusion of the non-participants of the PSNP might further exacerbate selection bias, which has already been introduced by self-selection principles of the VSLA. VSLA participants who benefitted from honey and fattening value chains are also excluded from the sample.

Our treatment group specifically targets those poor households who only benefitted from the integrated programs, namely the PSNP and VSLA, while the control group targets the households who benefitted from the PSNP only. In other words, the two groups are similar in all aspects except that the treatment group benefitted from VSLA.

For this study, the plan was to interview 500 randomly selected households from a list provided by the Sekota District agriculture office. However, 51 households declined to fully cooperate for the interview. As a result, responses were collected from 449 households only (89.8% response rate). Of the 449 sampled households, 188 were participants (“treatment group”) and 261 were non-participants (“control group”) of the VSLA.

In order for the VSLA to return on investment it requires one year (Allen, 2006). For the treatment group we considered only mature VSLAs, which have been operational in 13 Peasant Associations (PAs) since the beginning of the intervention, or April 2008. In these 13 PAs there are about 153 VSLAs. We randomly selected one household from each VSLA, which gives a total of 153 households, and for the remaining 35 households, from the total 188 “treatment group”, we randomly selected from the same 153 VSLAs to get a total of 188 households as the treatment group.

The control groups are those households who are identified by a team of experts in the Sekota district Agricultural bureau as future beneficiaries of the PSNP-plus components. The households are also located in 20 PAs 13 of which include households in the intervention group. To avoid a possible contamination effect, we excluded 9 PAs, which were in the process of starting VSLAs. Accordingly, using the list that we obtained from the district’s agriculture office, we randomly selected 261 PSNP beneficiaries that did not receive the PSNP-plus components but identified as future potential beneficiaries of VSLA intervention.

## 6. MODELING IMPACT EVALUATION USING ENDOGENOUS SWITCHING REGRESSION

Switching regression modeling is an extension of the classic Heckman selection model. It is often employed for programme evaluation purposes because it minimizes biases in the form of self-selection, unobserved characteristics and estimation of treatment effect when there is a non-random allocation of individuals to treatment and control groups (see Fuglie and Bosch, 1995; Maddala, 1983).

Let  $Y$  be an outcome variable of either consumption expenditure or livestock asset holding. Assume  $I$  to be the programme variable, then the usual programme evaluation would be:

$$Y = \delta + Z\beta + \delta I + \varepsilon_{it} \quad (1)$$

where  $Z$  is a vector of exogenous variables that may include the household demographic characteristics, such as socio-economic status, and village conditions, such as agro-ecological zoning.  $I$  is a dummy variable which indicates either participation in the programme when  $I = 1$  or not participation in the programme when  $I = 0$ , hence the programme impact is measured by estimating  $\delta$ .

However, the decision to participate in the VSLA programme for an individual is based on the expected utility or benefit obtained because of participation. Therefore, the dummy variable of participating in the VSLA programme, cannot be treated as the same as the exogenous variable. If so, estimating equation (1) using OLS will definitely bias the results (Fuglie and Bosch, 1995).

To adjust for self-selection into the VSLA programme, let us assume that  $I_i$  be a criterion function, which is determined by whichever regime the agent is facing. That means households will either decide to participate or not to participate in the VSLA programme. Let  $\beta_1$ ,  $\gamma$  and  $\gamma$  be the vectors of parameters. Consider also that  $u_i$ ,  $\varepsilon_{1i}$  and  $\varepsilon_{2i}$  are idiosyncratic error terms having trivariate nominal distribution with mean zero and covariance matrix.

$$I_i^* = \gamma Z_i + u_i \begin{cases} I_i = 1, \text{ if } I_i^* > 0 \\ I_i = 0, \text{ otherwise} \end{cases} \quad (\text{Decision function}) \quad (2)$$

$$\text{Regime 1: } Y_{1i} = \delta_1 + \beta_1 X_i + \varepsilon_{1i} \text{ if } I_i = 1 \text{ (For the participants)} \quad (3)$$

$$\text{Regime 2: } Y_{2i} = \delta_2 + \beta_2 X_i + \varepsilon_{2i} \text{ if } I_i = 0 \text{ (For the non-participants)} \quad (4)$$

Here equations (3) and (4) portray the relationship among the exogenous explanatory variables in the respective regimes while equation (2) shows the probability that individuals would decide on either of the two regimes (Lokahin and Sajaia, 2004).

$$\Omega = \begin{pmatrix} \sigma_u^2 & \sigma_{1u} & \sigma_{2u} \\ \sigma_{1u} & \sigma_1^2 & \cdot \\ \sigma_{2u} & \cdot & \sigma_2^2 \end{pmatrix}$$

where  $\sigma_u^2$  is a variance of the error term in the criterion function (decision function)

while  $\sigma_1^2$  and  $\sigma_2^2$  are the variance of the error term in the respective equation (3) and (4).  $\sigma_{1u}$  is a covariance of  $u_i$  and  $\varepsilon_{1i}$ , whereas  $\sigma_{2u}$  is a covariance of  $u_i$  and  $\varepsilon_{2i}$ . However, the covariance between the error term  $\varepsilon_{1i}$  and  $\varepsilon_{2i}$  do not appear because  $Y_{1i}$  and  $Y_{2i}$  will not be observed simultaneously (i.e.  $Y_{1i}$  is observed only when  $I_i^* > 0$  and  $Y_{2i}$  is also observed only when  $I_i^* \leq 0$ ) (Lokahin and Sajaia, 2004; Maddala, 1983). Following the conditional of normal distribution the log likelihood maximization is given as below.

$$\ln L = \sum_{i=1}^n \left\{ (1 - I_i) \left[ \ln \phi \left( \frac{u_{2i}}{\sigma_2} \right) - \ln(\sigma_2) + \ln \left\{ 1 - \Phi \left( \frac{W_{i\alpha} - \rho_2 \frac{u_{2i}}{\sigma_2}}{\sqrt{1 - \rho_2^2}} \right) \right\} \right] \right. \\ \left. + I_i \left[ \ln \phi \left( \frac{u_{1i}}{\sigma_1} \right) - \ln(\sigma_1) + \ln \Phi \left( \frac{W_{i\alpha} - \rho_1 \frac{u_{1i}}{\sigma_1}}{\sqrt{1 - \rho_1^2}} \right) \right] \right\}$$

where  $\rho_1 = \frac{\sigma_{1u}}{\sigma_u \sigma_{\varepsilon_1}}$  is the correlation coefficient between  $\varepsilon_{1i}$  and  $u_i$  and  $\rho_2 = \frac{\sigma_{2u}}{\sigma_u \sigma_{\varepsilon_2}}$  is the correlation coefficient between  $\varepsilon_{2i}$  and  $u_i$ .

Consider that  $Y_{1i}$  is expected outcome or expected benefit of either consumption expenditure or livestock asset holding when household choose to participate in the VSLA. Let  $Y_{2i}$  be expected outcome (for the same outcome variable as in the case of participants) for those who choose not to participate in the VSLA. Suppose that  $X_i$ 's are vectors of exogenous variables, including household demographic characteristics, such as head of household's education status, socio-economic status, and district characteristics, such as agro-ecological zones, means of food source, saving and lending rates for both participants and non-participants.

Let  $Z_i$  be another vector of explanatory variables, which describes the probability of decision to participate in VSLA programme intervention. Since, the model is recursive model there is a need to include at least one identifier variable in  $Z_i$ . We have thus included an additional five variables in  $Z_i$ 's (which are not in  $X_i$ 's), but which do not directly affected the expected outcome. The variables in  $Z_i$  includes household demographic, household head education status, socio-economic characteristics, agro- ecological zones, means of food source, saving and borrowing together with idiosyncratic shocks such as illness, death of livestock or household members, distress selling, and food aid intervention<sup>1</sup> etc.

[1] In the variable food aid intervention-all participants and non-participants are recipient of food aid. However, it only indicates the recentness of reception.

Considering the outcome of equation (3) where the conditional expectation to consumption expenditure of participants in the VSLA programme is:

$$\begin{aligned}
 E(Y_{1i}|I_i = 1) &= E(Y_{1i}|I_i^* > 0) = E(Y_{1i}|\gamma Z_i + u_i > 0) \\
 &= E(Y_{1i}|u_i > -\gamma Z_i) \\
 &= \alpha_1 + \beta_1 X_i + E(\varepsilon_{1i}|u_i > -\gamma Z_i) \\
 &= \alpha_1 + \beta_1 X_i + \sigma_{1u} \left[ \frac{\phi(\gamma Z_i)}{\Phi(\gamma Z_i)} \right]
 \end{aligned} \tag{5}$$

Similarly, the conditional expectation for the non-participants in the VSLA programme is expressed as:

$$\begin{aligned}
 E(Y_{2i}|I_i = 1) &= E(Y_{2i}|I_i^* < 0) = E(Y_{2i}|\gamma Z_i + u_i < 0) \\
 &= E(Y_{2i}|u_i < -\gamma Z_i) \\
 &= \alpha_2 + \beta_2 X_i + E(\varepsilon_{2i}|u_i < -\gamma Z_i) \\
 &= \alpha_2 + \beta_2 X_i - \sigma_{2u} \left[ \frac{\phi(\gamma Z_i)}{1 - \Phi(\gamma Z_i)} \right]
 \end{aligned} \tag{6}$$

where  $\left[ \frac{\phi(\gamma Z_i)}{\Phi(\gamma Z_i)} \right]$  and  $\left[ \frac{\phi(\gamma Z_i)}{1 - \Phi(\gamma Z_i)} \right]$  refer to the inverse miller ratio for participants and non-participants in VSLA programme, and  $\phi(\cdot)$  and  $\Phi(\cdot)$  refer to probability density and cumulative distribution function for the standard normal distribution, respectively. Both equation (5) and (6) show selectivity in the sample.

Most prior studies that employed the endogenous switching regression fitted their models with either two-step least squares or maximum likelihood estimation. Lokshin and Sajaia (2004) have warned that both of these estimation methods suffer from inefficiency and demands of cumbersome correction even though they yield consistent standard errors. We have thus employed the Full- information Maximum Likelihood Method (FMLM), which simultaneously fits both the binary and continuous equations (2), (3) and (4) that gives a consistent standard error (Lokshin and Sajaia, 2004). We can measure the possibility of both observed outcome in equations (5) and (6) and the hypothetical outcome condition.

## 6.1. Conditional Expectations, Treatment, and Heterogeneity Effects

The endogenous switching regression model can be used to compare the expected consumption expenditure of the households who participated in VSLA 7(a) with respect to the households who did not participate in VSLA 7(b), with the counterfactual hypothetical cases 7(c) with the participated households granted that they did not themselves participate, and 7(d) with a set of third hypothetical cases where non-participated household participated. The conditional expectations for consumption expenditure in the four cases are presented in table 1 and defined as follows:

$$E(Y_{1i} | I_i = 1) = \beta_1 X_{1i} + \sigma_{1u} \lambda_{1i} \quad 7(a)$$

$$E(Y_{2i} | I_i = 0) = \beta_2 X_{2i} + \sigma_{2u} \lambda_{2i} \quad 7(b)$$

$$E(Y_{2i} | I_i = 1) = \beta_2 X_{1i} + \sigma_{2u} \lambda_{1i} \quad 7(c)$$

$$E(Y_{1i} | I_i = 0) = \beta_1 X_{2i} + \sigma_{2u} \lambda_{2i} \quad 7(d)$$

Equation 7(a) to 7(d) derived from equation 5 and 6 above and where

$$\lambda_{1i} = \left[ \frac{\phi(\gamma z_i)}{\Phi(\gamma z_i)} \right] \text{ and } \lambda_{2i} = \left[ \frac{\phi(\gamma z_i)}{1 - \Phi(\gamma z_i)} \right]$$

**Table 1 Conditional Expectations, Treatment, and Heterogeneity Effects**

Subsamples	Decision Stage		Treatment Effects
	To Participate	Not to Participate	
Households that participated	(a) $E(Y_{1i}   I_i = 1)$	(d) $E(Y_{1i}   I_i = 0)$	TT
Households that did not participate	(d) $E(Y_{1i}   I_i = 0)$	(b) $E(Y_{2i}   I_i = 0)$	TU
Heterogeneity effects	$H_1$	$H_2$	TH

Note: (a) and (b) represent observed expected consumption expenditure; (c) and (d) represent counterfactual expected consumption expenditure.

$I_i = 1$  if households participated in VSLA;  $I_i = 0$  if households did not participate in VSLA;

$Y_{1i}$ : Consumption expenditure if households participated;

$Y_{2i}$ : Consumption expenditure if households did not participate;

TT: the effect of the treatment on the treated;

TU: the effect of the treatment on the untreated;

$H_i$  the effect of base heterogeneity for households that participated ( $i = 1$ ), and did not participate ( $i = 2$ );

TH= (TT - TU), i.e., transitional heterogeneity.

To attribute measured benefit to the participants, we need to net out the potential outcome to the non-participants of the VSLA programme. Therefore, a Heckman et al. (2001) step was taken to calculate the effect of the treatment “to participate” on the treated (TT) as the difference between (a) and (c),

$$\begin{aligned}
 TT &= E(Y_{1i}|I_i = 1) - E(Y_{2i}|I_i = 1) \\
 &= X_{1i}(\beta_1 - \beta_2) + (\sigma_{1u} - \sigma_{2u})\lambda_{1i}
 \end{aligned} \tag{8}$$

It represents the effect of participation in VSLA on the consumption expenditure of households among those that actually participated in VSLA. By the same intuition, the effect of the treatment on the untreated (TU) for households that actually did not participate in VSLA is given by the difference between (d) and (b),

$$\begin{aligned}
 TU &= E(Y_{1i}|I_i = 0) - E(Y_{2i}|I_i = 0) \\
 &= X_{2i}(\beta_1 - \beta_2) + (\sigma_{1u} - \sigma_{2u})\lambda_{2i}
 \end{aligned} \tag{9}$$

To calculate the heterogeneity effects, we use the expected outcomes described in equations (7a), (7b), 7(c) and (7d). For instance, households who participated in VSLA may have more consumption expenditure than households who did not participate in VSLA -irrespective of participants’ decision to participate in VSLA- due to unobserved characteristics such as entrepreneurial skills.

Carter and Milon’s (2005) “effect of base heterogeneity” is, in this study, defined as households who decided to participate in VSLA and is reflected in the difference between 7(a) and 7(d).

$$\begin{aligned}
 H_1 &= E(Y_{1i}|I_i = 1) - E(Y_{1i}|I_i = 0) \\
 &= (X_{1i} - X_{2i})\beta_{1i} + \sigma_{1u}(\lambda_{1i} - \lambda_{2i})
 \end{aligned}$$

Similarly, the effect of base heterogeneity for the households who decided not to participate in VSL is given by the difference between 7(c) and 7(b).

$$\begin{aligned}
 H_2 &= E(Y_{2i}|I_i = 1) - E(Y_{2i}|I_i = 0) \\
 &= (X_{1i} - X_{2i})\beta_{2i} + \sigma_{2u}(\lambda_{1i} - \lambda_{2i})
 \end{aligned}$$

“Transitional heterogeneity” (TH) tells us whether the effect of participating in the VSLA is larger or smaller for households who participated in VSLA than those that did not, or for households who did not participate in the counterfactual case if non-participants did participate. To investigate TH, we took the difference between equations (8) and (9).

$$TU = TT - TH$$

$$= [(X_{1i} - X_{2i})\beta_{1i} + \sigma_{1u}(\lambda_{1i} - \lambda_{2i})] - [(X_{1i} - X_{2i})\beta_{2i} + \sigma_{2u}(\lambda_{1i} - \lambda_{2i})]$$

$$= (X_{1i} - X_{2i})(\beta_1 - \beta_2) + (\sigma_{1u} - \sigma_{2u})(\lambda_{1i} - \lambda_{2i})$$

## 6.2. Descriptions of the results

The proportion of the sample that participated and did not participant in the VSLA programme is indicated in table 2 below. The VSLA participants have, on average, greater consumption expenditure per month compared to non-participants.

Selected results of the descriptive statistics are also indicated in table 2. Male-headed households are dominant in the sample: 65 percent of the participants and 74 percent of the non-participants are male. In both categories, the average education status of the household is considerably very low. The average labour availability, dependent ratio and family size of the participants are slightly greater than the rates of non-participants. Moreover, the participants have more productive and non-productive assets compared to the non-participants. This finding supports the result of Allen and Hobane (2004) and Anyago(2005) that the VSLA participants have better asset holdings than the non-participants.

**Table 2. Mean and Standard Deviation of Dependent variables and explanatory variables**

Variables Name	VSLA		VSLA	
	Participant		Non-participant	
	Mean	SD	Mean	SD
<b>Dependent Variable</b>				
Ln(Consumption)	6.47	1.07	6.23	1.34
<b>Explanatory Variables</b>				
Age	41.03	11.52	42.63	13.19
Age <sup>2</sup>	1815.6	1045.3	199.6	1259.1
Male(%)	0.65	0.48	0.74	0.44
Year of Schooling of HH	1.04	2.37	1.19	2.67
Labour(Adult Equivalent)	2.19	1.14	1.98	1.12
Dependency Ratio	1.05	1.15	0.72	0.83
Family Size	4.73	1.83	4.41	2.08
Land Size(timad) <sup>21</sup>	2.72	1.48	2.83	2.11
Ln(Asset)	6.89	0.80	5.92	1.13
Ln(Income)	7.54	1.71	6.33	2.69
Saving (ETB)	309.49	572.87	9.69	59.02
Borrowing (ETB)	731.77	951.86	4	32.5
Household Shock				
Animal Death (%)	0.61	0.49	0.54	0.50
Husband/Wife death (%)	0.35	0.48	0.27	0.44
Food aid receive (%)	0.76	0.43	0.61	0.49
Distress Selling (%)	0.34	0.47	0.45	0.50
Illness Husband/ Wife within 5 years (%)	0.51	0.50	0.47	0.50
Source of food Consumption				
Own production (%)	34.10	16.77	34.54	24.04
Asset Selling (%)	16.86	12.45	14.70	25.78
Purchase (%)	13.58	10.13	14.39	40.24
Non-farm activity (%)	23.92	13.40	24.31	20.10
Transfer (%)	11.49	12.78	12.05	243
Number of Obs.		188	261	

The participants' average saving is nearly 32 fold higher than the non-participants, yet there is a huge disparity in saving both within the participants and the non-participants groups. Similarly, the average participants borrowing are approximately 182 fold of the non-participants' borrowing, demonstrating large borrowing disparities between participants and the nonparticipants.

As to the household economic shocks, 35 percent of the participants and 27 percent of the non-participants disclosed to us that they have experienced death of a spouse within the last five years. In addition, 61 percent of the participants and 54 percent of the non-participants indicated that they have suffered from death of their livestock. The majority of both participants (76 percent) and non-participants (61 percent) have recently received food aid. Since almost eve-

[2] Timad is a local unit used to measure the size of land. One Timad is equal to a quarter of a hectare.

ryone received food aid, we only differentiated between those who received aid in the recent-past versus recipients who did not. Notwithstanding, 34 percent of the participants and 45 percent of the non-participants covered their food consumption through distress selling, or selling of livestock and productive or non-productive assets).

### 6.3. Estimation Results

The sign and magnitude of the covariate parameters ( $\beta_1$  and  $\beta_2$ ) in Table 3 depicts that the average monthly consumption expenditure of self-selected participants is greater than that of the random participants. Moreover, the average monthly consumption expenditure of those who choose not to participate consumed less than the random non-participants.

Household consumption is expected to increase with income and endowment of household asset, which was confirmed from both participant and the non-participant findings. For the average participant, consumption expenditure increased by 19.44 percent with income, while for the non-participant it increased by 15.4 percent. Similarly, assets endowment of the household is positively affected consumption expenditure. This finding portrays that endowment of assets in the household increased the consumption expenditure by 0.01 percent and 0.04 percent both for those who choose to participate and those who choose not to participate in the VSLA, respectively (see Table 3).

Among the participants, male-headed household consumption expenditure is significantly greater than that of female-headed households; the estimated consumption expenditure of male-headed households is 41.76 percent more than female-headed households. It may be due to the fact that in most rural parts of Ethiopia females do not have access to essential assets, including land, which are crucial components for the betterment of consumption expenditure. Nevertheless, gender of the head of household has an insignificant effect on consumption expenditure for non-participants (see Table 3).

**Table 3. Estimation Results of Switching Regression Model for Consumption**

Variables	VSL	
	Participants	Non-participant
	$\beta$ (Z-value)	$\beta$ (Z-value)
Ln(Income)	0.1944 (5.2400)***	0.1542(5.2200)***
Source of food Consumption		
Purchase	-0.0101(-0.7600)	0.0033(0.9900)
Non-farm	-0.0062(-0.4700)	-0.0059(-1.420)
Transfer	-0.0204(-1.5500)	0.0034(0.8500)
Distress selling	0.0056(0.4100)	0.0158(3.8200)
Own production	-0.0147(-1.1100)	0.0029(0.9100)
Asset	0.0001(2.8600)***	0.0005(3.4100)***
Male	0.4176(3.6800)***	0.1120(0.6600)
Highland (Ref=lowland)	1.0085(2.5800)***	-0.5910(-1.690)**
Mid highland (Ref=lowland)	-0.2039(-1.4700)	0.1262(0.7900)
Age	0.0025(0.0900)	-0.0400(-1.210)
Age square	0.0000(-0.0500)	0.0002(0.7000)
Year of schooling of the HH	-0.0401(-1.6400)	0.0213(0.8600)
Labour	0.0686(1.3300)	0.2504(3.6900)***
Saving	-0.0001(-1.4200)	-0.0020(-1.600)
Borrowing	0.0001(0.7400)	-0.0025(-0.970)
Constant	5.8499(4.0900)	5.1412(6.9400)
$\ln\sigma_{1u}$	0.3697 (-6.900)	
$\ln\sigma_{2u}$		0.0130 (3.2300)
$\text{atanh } \rho_1$	-0.3086(-1.9100*)	
$\text{atanh } \rho_2$		0.5485(2.3100)**
$\sigma_{1u}$	0.6910	
$\sigma_{2u}$		1.0131
$\rho_1$	-0.2992	
$\rho_2$		-0.4994
Wald test $\rho = 0$ [p value]	Chi2= 40.42 [0.0000]	

Note:  $\text{atanh}$  is a Fisher transformation is given by  $\text{atanh } \rho_k = \frac{1}{2} \left( \frac{1 + \rho_k}{1 - \rho_k} \right)$  where  $k = 1, 2$ . \*, \*\* & \*\*\* significant levels at 10%, 5% and 1%.

The participants who are living in the highlands have 100 percent more consumption expenditure compared to those participants living in the lowlands (see in table 3). This is partly explained by the fact that in the lowlands settlements is very sparse, which makes it diffi-

cult for VSLA to operate effectively. On the other hand, the non-participants who are living in the highlands have 59.10 percent less consumption expenditure compared to the non-participants who are dwelling in the lowlands. This can be explained by households' preference to live in highlands to in lowlands, in most rural parts of Ethiopia. Whence, small, fragmented and highly degraded plots of land further exacerbate the low productivity of land in highlands, which in turn affects consumption directly. Households in lowland areas however mainly rely on livestock as their chief source of livelihood.

Labour availability increases consumption expenditure of non-participants by 25.04 percent. However, this factor did not insignificantly affect participant's consumption expenditure (see in Table 3). Non-participant's consumption expenditure increased with labour endowment because they migrated to the nearest places to work as a daily labourer in order to generate additional income, which in turn could be reflected in their consumption expenditures. Participants, however, have alternative ways of generating income. For instance, they can start income generating activities with the loans they obtain from VSLA without having to sell manual labour like their counterparts.

Interestingly, non-participant's sale of asset holdings has a significant and positive statistical contribution to their consumption expenditure. Accordingly, for each asset holding sale there is a 1.58 percent increase in consumption expenditure (see table 3). It has insignificant contribution for non-participants. This seems to suggest that non-participants are still in relatively worse condition in terms of how they meet their consumption expenditure.

Table 4 presents the expected consumption expenditure under actual and counterfactual conditions. The expected consumption expenditure of households that participated in VSLA is about 6.58 (721 Birr per month), while it is about 6.41 (608 Birr per month) for the households that did not participate. This simple comparison, however, can be misleading unless the counterfactual comparison is taken into account.

**Table 4 Average Expected Consumption Expenditure; Treatment and Heterogeneity Effects**

Subsamples	Decision Stage		Treatment Effects
	To Participate	Not to Participate	
Households that participated	(a) 6.58 (0.05)	(c)4.13 (0.21)	2.45***
Households that did not participate	(d) 6.26 (0.07)	(b)6.41 (0.05)	-0.15
Heterogeneity effects	0.32*** (0.09)	-2.28 *** (0.19)	2.6***

Note: Values in the bracket are standard errors. \*\*\* Significance at the 5% and 1% levels respectively. All expected mean values are transformed to log. Birr18= \$1US

Cells (a) and (b) are actual cases, while cells (c) and (d) are counterfactual cases as we have discussed in the methodology section. The last column represents the treatment effect for participation in VSLA. In the counterfactual case (c), households who actually participated would have consumed about 4.13 (62 Birr per month; that is about 91%) less if they did not participate. In the counterfactual case (d) for households that did not participate, if had par-

ticipated in VSLA they would have consumed at about the same level. The results seem to suggest that households who participated are still better off participating than not participating, and households who did not participate will not show much change even if they participated. This evidence suggests that there are some important sources of heterogeneity that made non-participants have same level consumption pattern across time regardless of their participation in VSLA.

## 6. Conclusions

Growing empirical evidences suggest that credit is not a panacea that cures all the problems of the extraordinarily poor. There is a rising acceptance that the positive impacts of credit are not as big as they once were touted to be, but rather they are minimal (Roodman and Modurch, 2009; Bastiaensen and Marchetti, 2007). The minimalist perspective that once dominated credit service delivery, also concentrated in urban areas for profit, is now starting to fade-away. Consequently, new alternative models are being initiated to fill the gaps through a more integrative and cost-effective way, an example of which is the VSLA that was developed by CARE. This paper attempts to investigate the impact of VSLA, which was integrated with the PSNP (food aid programme) on consumption expenditure.

The findings of this paper demonstrate the policy implications on integrated PSNP (food aid) and VSLA programmes have for drought prone and food insecure areas similar to the Sekota district in Ethiopia. The results depict that the monthly consumption expenditure of self-selected participants are significantly higher than that of random participants and non-participants. This is because the self-selected participants were given trainings prior to programme commencement on skills such as income generating and entrepreneurship. These skills enabled them to enjoy benefits that the random participants and non-participants did not have. To summarize, the ultra-poor lacks not only credit and food, but also ideas on to how to use credit to generate income and be productive.

When we further analyzed our results, what we obtained is that the participants are better off participating than not participating, and non-participants remain the same regardless of whether they participate or not. This highlights that there are some important sources of transitional heterogeneity, or unobserved, effects irrespective of participation in VSLA for non-participants to have better consumption.

The estimation indicates that a participant's monthly consumption expenditure is positively and significantly determined by asset holding, income, male-headed households and highland dwellers while for non-participants labour and income are significant and positive determinants. There is a necessity to establish enabling conditions for the VSLA to be effective in the lowlands. The implication is that there are dual needs for household to diversify income generating activities and asset holdings and for governments create opportunities so that non-farming investments could flourish.

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