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The Effectiveness of Entrepreneurial Aid for Poverty Reduction in Sub-Saharan Africa

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Chapter 0. Introduction, History and Definitions.

The mission to increase the quality of life in the Global South is a shared goal of hundreds of organizations and governments today. The Encyclopædia Britannica defines foreign aid as "the international transfer of capital, goods, or services from a country or international organization for the benefit of the recipient country or its population" . Aid may be bilateral (government to government), multilateral, where funds are pooled and distributed by international organizations, or nongovernmental organizations (NGOs). Aid may be subject to additional conditions for allocation or repayment. [1]

The practice of regular financial assistance to the Global South started in the beginning of the 20th century with European countries helping their colonies establish public infrastructure and meet the basic needs of the population. This type of aid usually sought to benefit its provider. Sometimes it was to garner political approval, other times it enabled the extraction and export of resources overseas. After WWII aid was increasingly reframed as an altruistic humanitarian obligation: a perceptual shift that started with America's Marshall Plan. [2] The end of the war also precipitated a worldwide political shift to international cooperation. Prominent organizations such as the United Nations, World Bank, the International Monetary Fund (IMF) and others were established. By the end of the 1960s foreign aid had become part of foreign policy for many of the world's richest countries. The newly established Development Assistance Committee (DAC) and the Organisation for Economic Cooperation and Development (OECD) sought to coordinate, evaluate and distribute aid. The aforementioned organizations process the majority of foreign aid today. When foreign aid policy stopped serving unilateral interests, it had to be informed by academia. Thus the second part of the 20th century saw the development of economic theories and research methods to critically evaluate aid programs. [3]

The scope of this report will be constrained to the region of Sub-Saharan Africa (SSA), referring to the part of Africa that lies South of the Sahara desert. There are multiple geographical, historical and ethnocultural reasons to support the utility of dividing the continent into North Africa and Sub-Saharan Africa. While those reasons are beyond the scope of this report, the distinction is commonly adopted by academics and international organizations. In 2020 the SSA region received $31 billion in ODA aid (government aid). [4] After five decades of aid, the SSA region as a whole has made massive improvements on virtually all indicators of poverty. How much can be attributed to foreign aid is harder to quantify. Though $714 billion of aid was distributed to the region in 1960-2006, income per capita grew by a measly 1% per year and poverty barely budged. [18] Since 2007 poverty rates in the world have been decreasing rapidly. [19] Some economists argue that affordable mobile phones have done more transformative good for the region than foreign aid has done in 50 years. [20] Yet there appears to be evidence that foreign aid does cause improvement. A 2015 empirical analysis of the impact of ODA, published by the Oxford Bulletin of Economics and Statistics, determines that in 34 out of 36 SSA countries foreign aid has had a net positive economic effect in 34 of them. [5] Similarly, a 2019 literature review that examines the causal link between aid and poverty reduction concludes that there is a significant effect of foreign aid in reducing poverty across metrics. [6]

This report relies heavily on existing scientific literature to evaluate and justify its assertions. Where the science is indecisive, extrapolation and interpretation are used to fill the gaps. This is not an easy task, as studies on the topic are lacking both in quantity and quality. As the charity assessment organization GiveWell remarks, “public, rigorous evaluation of programs' effects is extremely rare.” [7]

Another harsh reality to grapple brought forward by literature reviews is that many forms of aid are ineffective. The things that help are often not intuitively recognized as such. Conversely, the obvious solutions often turn out to be money burners with no observable positive effect. Well-funded and well-executed programs with great leadership and good intentions regularly fail to make an impact. Certainly then, not all forms of charity are created equal. As a 2005 IMF literature review concludes, “*NGO aid significantly reduces infant mortality while bilateral aid does not*”. Despite that, authors remark that NGO aid constitutes a relatively small piece of the foreign aid pie. [8] This report is almost exclusively focused on NGOs and other private forms of charity.

When asking the question *How can we best help Africans out of poverty?* , one should ask the related question *What is the most impactful form of aid per dollar spent?* This is what’s known as cost-benefit analysis and is critical to separate the outliers from the mediocre. This paper proposes that incentivizing individual entrepreneurship through capital injection is cost-effective and has an outsized positive effect when compared to most traditional forms of aid. Chapter 1 identifies 3 common deficiencies that limit the impact of charities. Chapter 2 defines major types entrepreneurial, analyzes their effectiveness and makes the case for capital injection as cost-effective giving. Chapter 3 presents the case study of Rwanda to connect entrepreneurial aid to the broader themes of economic liberalism, demonstrating the profound effects of free markets. The last chapter briefly concludes the report’s findings and makes tentative political suggestions in light of the conclusions.

Chapter 1. Inefficiencies of foreign aid programs.

Charity isn't easy to do right. Though backed by good intentions, most initiatives fail to move the needle on poverty. When analyzed, organizations' impact follows the ubiquitous Pareto distribution, where roughly 20% of charities are responsible for 80% of impact. At the same time the top charities are hundreds of times more effective than half. These findings highlight how important it is that charity is informed by science. Despite evidence of their impact, however, outlier charities rarely receive outlier sums. The reason goes beyond the scope of this report, but owes to complex phenomena in human psychology and economics. Nevertheless, effectiveness is becoming a factor for more and more givers, as evidenced by the growth of charity evaluation organizations and the increase in scientific output on the matter. [9]

This chapter of the report explains 3 major culprits of ineffective charities. First of all, they focus too much on immediate good and ignore the long-term. Secondly their organization is too complex and contributes to financial overhead, limited scalability and the risk for unintended consequences. Finally, ineffective charities target institutions rather than individuals, thus opening the door for systemic corruption, discrimination and the exercise of power.

I. They overvalue short-term benefits

Many charities provide services that address the immediate needs of their recipients without consideration for their future well-being. One of the most prominent examples of this mode of operation is food donations. Food aid is one of the oldest forms of foreign aid and historically the most common and well-funded type of aid. It appeals to common sense and emotion; the Western public is all too familiar with imagery of starving African children, accompanied by emotional pleas for help. The general reader might then be surprised to learn that despite its popularity, there is inconclusive evidence that food aid lowers national poverty rates and diminishes malnutrition in individuals. Food-for-work programs, which account for 63% of all food aid, generally benefit low-income people in the short term but do nothing to address their food security in the long run. This is despite the idea of food-for-work as a way to regularize food aid and increase the instances of food receipt by individuals. [10, 11]

This is not to say that one-off types of aid should be immediately discarded. For example, in disaster relief situations, there is no single better way to support the disaffected than by providing immediate medical and food assistance through humanitarian aid. It is hard to argue that meeting individuals' urgent physical needs in times of calamity doesn't save lives and secure well-being. Nevertheless, the evidence suggests that such stopgap initiatives do not translate into a sustained improvement in living standard. [10]

The search for cost-effective forms of aid should direct our focus to interventions that produce continual effects overtime. This type of analysis naturally suggests that the best initiatives should harness the laws of compound interest to increase benefits over time, rather than diminish them. Examples of interventions with long-term impact include vaccination, malaria prevention, installing water wells, providing entrepreneurship grants. In contrast, the provision of food, clothes and toys can be regarded as short-term aid that does not stand to cost-benefit analysis.

II. They are too complex and inefficient

Charity is complex by its very nature. It requires exceptional leadership, innovation, incredible amounts of planning, smart capital allocation and efficient fundraising. Yet many of them suffer from unnecessary complexity that is a hindrance to their goals. Complexity may manifest itself at the organizational level. In some cases senior management is expanded not as a response to finances may be badly allocated and accounting deliberately made opaque to hide that. Internal processes may be excessively bureaucratized, executives paid enviable salaries, leaving no room for critical hires. [12]

Complexity may show up in its operations, where supply, logistics and deployment of the solution impose a big financial burden if not done in a lean manner. On top of that, there is likely a tendency for organizations to become inflexible and inefficient as they grow. Charities certainly are not immune. [12, 13]

Nevertheless the presence of complexity in an organization is not a red flag by itself. It is often inevitable. Some initiatives inherently require more auxiliary expenses than others. For instance, mentorship programs require costly infrastructure and human capital to deploy. Other ones may only need volunteer work of local coordinators and cheap scalable technologies such as mobile or internet. High degrees of complexity remain detrimental to the key metrics of effectiveness: charitable commitment (the proportion of funds spent towards its actual goal) and fundraising ROI (the cost to raise money). Convoluted processes have the additional effect of increasing the domain of the "unknown unknowns", which may negatively affect performance and introduce unintended side-effects.

[13, 14]. Thus charity organizations should strive for the simplest organizational and operational model to be more cost-effective and maximize their impact. Efficient charities are created at the design stage and maintained such by good leadership, transparency and independent evaluations. [15]

III. Aid is directed to the government

The literature is clear: foreign aid, when distributed to governments or governmental institutions, is significantly less effective than NGOs. Despite that, less than ⅓ of all foreign aid is distributed through NGOs. [16] Giving aid in the hands of local governments and para-governmental organizations exposes the donor-beneficiary chain to a number of risks. Official bodies in SSA are notoriously rife with corruption, money laundering, asset fraud. Funds may be used as a tool to assert dominance, win sympathy and peddle ethnic and religious discrimination. In one such case the government of Zimbabwe was accused by the Global Fund to Fight AIDS, Tuberculosis and Malaria of having misused $7.3 million in aid. The event happened near the peak of the Zimbabwe hyperinflation crisis and led to the imposition of foreign aid sanctions by international organizations. The effect was that Zimbabwean people suffered heavily for months due to reduced access to foreign aid. [17]

The misuse of foreign aid is hard to measure and quantify as it is usually secretive in nature. It happens in many places of the aid supply chain at different levels in the authority hierarchy. Estimates by economists from offshore bank data put the leakage of funds at around 5% for less aid-dependent countries and 15% for more aid-dependent countries. They point out that fraud is much more likely on the recipient side. [21]

To ensure that resources are allocated as intended, the chain should be as short and transparent as possible. This means that the local distributors of the resources should ideally be individuals close to and trusted by the NGO overseas.

Chapter 2. The case for entrepreneurial aid.

Entrepreneurial aid is a form of foreign aid that seeks to encourage individual entrepreneurship. It targets diverse sets of people from the poorest rural dwellers that wish to sell produce to aspiring urban entrepreneurs who seek funding for their innovative startups. The idea of supporting business is recent and entrepreneurial aid accounts for a relatively small part of the foreign aid distribution. Few high-quality scientific studies of initiatives that are solely intended for entrepreneurs. Nevertheless the capital allocated to such initiatives is rapidly increasing and not without a reason. Before diving into the science, we can already see the promising facets of entrepreneurial aid in the context of the 3 common inefficiencies of foreign aid expounded in Chapter 1. Entrepreneurial aid is antithetical to short-term band-aid type solutions. Rather, it seeks to kickstart the economic engine for fledgling businesses to start generating capital and increasing employment. While businesses often fail or stagnate even in stable economies, supporting individual entrepreneurship bolsters the atomic units of markets. In isolated rural dwellings petty businesses can create long-term value not only for their owners but for the community as well. In regards to the prior point about organizational complexity, entrepreneurial aid programs can vary depending on the variety. As we shall see in the rest of the chapter, the idea of simplicity as a heuristic for cost efficiency applies to entrepreneurial support as well. With respect to the last point in Chapter 1, entrepreneurial aid is usually implemented by the NGOs, thus circumventing the major risk factors for theft.

One undeniable advantage of SSA countries is its demographic profile. Recent changes in childbearing and mortality patterns contributed to an unprecedented population boom in population from 186 million in 1950 [22] to over 1.1 billion in 2019 [23] . The population in SSA is predominantly young and 8 of the 10 countries with the youngest populations in the world are in the region. This fact is a massive opportunity to catalyze change throughout the region led by youth endeavours. It comes to no surprise that so many programs target young innovators. Some of the most prominent examples are the Tony Elumelu Foundation based in Nigeria and the Africa Young Entrepreneur Support (YES) Centre in Kenya. But as we have already learned, policy should be informed first and foremost by scientific knowledge. There is not enough scientific evidence of the outcomes of such programs. We are left to investigate forms of aid that encompass but don’t solely pertain to entrepreneurship. Here are the three most common ones:

I. Microfinance (mixed effectiveness)

The term microfinance refers to the provision of banking services to poor individuals whose access to such services is limited. Usually microfinance initiatives focus on providing loans of small sums ranging from hundreds to a few thousand USD. Other forms of services that fall under the microfinance umbrella include savings accounts and microinsurance. The goal of such programs is to provide the opportunity for low-income people to become self-sufficient. Often the plans of its users is to invest the money into income-generating activities. [24]

Microfinance is the giant in the world of entrepreneurship-focused aid. In 2015 more than 211 million people borrowed from microfinance institutions, 114 million of which self-identified as the poorest cohort in their communities. [24] There are a few major problems with microcredit. They usually have high default rates, high maintenance costs and double to triple-digit interest rates. This makes borrowing risky for individuals, as business revenue is uncertain and they rarely have reserve collateral. [25] A large 2015 review on microcredit finds no evidence to support that access to credit leads to a better financial situation for individuals in the long term. [26] Another well-cited review that focuses on microfinance in the region of SSA concludes that the evidence is ultimately mixed: when there is a positive effect of microfinance, it is usually small; in some communities, microfinance even worsens poverty. [27] Studies on less popular financial services such as savings and insurance are scarce. Nonetheless, their association with decrease in poverty appears to be inconclusive. [25] The question of why microfinance continues to expand [24] in the face of lukewarm evidence remains open.

II. Skills training (ineffective)

Another popular idea to support entrepreneurial success in low-income communities is skills training. In general, skills training refers to a structured educational program that spans at least a week and teaches business, technical (vocational), or non-technical (soft) skills. A caveat: the existing analyses don't differentiate programs for employees from the programs designed for self-starter entrepreneurship. We assume that the impact of entrepreneurship-specific training stays close to the average for the encompassing category.

Enrolment in skills training programs is in the tens of millions. They have been deployed in diverse demographic settings. Unfortunately, the scientific verdict on skills training is negative. Blattman and Ralston conclude, "there are very few examples of evaluated programs that have had positive effects, at least on men." [25] Whether the outcome can be ascribed to poor program design, bad prospecting or unmotivated enrollees, is unknown. A general theme, however, can be observed across skills training initiatives: low enrollment among the eligible, high dropout rates among the enrolled. High program cost and modest effects on long-term well-being for participants. When additionally examined under the microscope of cost-benefit analysis, the vast majority of such programs do not pass the test. [25]

III. Capital injection (effective)

Capital injection is a charitable transaction of financial or non-financial assets. Under the goal of stimulating entrepreneurship, interventions in the capital injection are typically in the form of cash grants or livestock. Often capital injection programs are combined with short skill training courses and other forms of mentorship or supervision. In some instances, a more hands-off approach is taken, where capital injections are given unconditionally and without additional guidance. [25]

Capital injection programs, in contrast to the latter approaches, are relatively rare. Studies point out that capital injection is a cost-effective form of intervention. They show increases in employment, household consumption and earnings after years. They have low overhead compared to the other methods and tend to generate durable increases in earnings. [25]

Taken to the extreme, the hands-off capital injection approach leads to unconditional cash transfers (UCTs). Despite decisive evidence that they work, UCTs are a heavily underrated method of aid. The idea of unconditional money often meets resistance with experts and lay people, raising concerns about potential misuse. Many people would assume that given large sums of money out of the blue, low-income individuals will spend them on so-called “temptation goods": alcohol, tobacco, drugs and gambling. This could not be further from the truth. Among 19 cash transfer studies in different countries (mostly in SSA), there is no evidence that recipients increase spending on temptation goods [28]. Furthermore, randomized controlled trials carried out by GiveDirectly (the largest UCT non-profit), shows outstanding effects months after the intervention. Not only do they not squander it on temptation goods, but they usually address their biggest pain points first. Many recipients use the money to make low time preference investments such as covering the start-up costs of microbusinesses or enabling children to go to school.

GiveDirectly beneficiaries in rural Kenya report buying land and equipment, boats, stalls and livestock to bootstrap sustainable petty trade businesses. [28] Unconditional cash transfers have yet another advantage that helps them pass the cost-benefit test: their low overhead. GiveDirectly reports as little as 5% overhead and capital efficiency between 80% and 90% for its 6 years of operations. [29], a number that is regarded as very low for charities. Despite promising, capital injection-based interventions remain few and far between. UCTs are even rarer.

Chapter 3. The bigger picture. Markets matter.

In Chapter 2 we established that capital injection through direct cash transfers is a promising method of entrepreneurship support with its minimal overhead and high cost-effectiveness. In this chapter we shall look at the bigger economic picture. Why does helping individuals become self-sustainable effectively increase their living standard for years after? What economic basis effects does it have on the economy and what can countries do to stimulate it? The following case study illustrates the benefits of sovereignty and market economies on the wealth of populations.

I. Rwanda's flourishing coffee sector.

25 years ago nobody expected that the country of Rwanda would soon become the poster child of economic success in the region and the darling of the World Bank. In hindsight, its rise was unlikely. Rwanda is a tiny landlocked state in the African Great Lakes region, sandwiched between much greater powers. Its elevated hilly terrain is poor in natural resources and farming is the sole source of sustenance for the majority of its citizens. Three social groups cohabit Rwanda in centuries of systemic inequality. [30] After a long history of monarchy, Rwanda became a German, then a Belgian colony. The autonomy and labor of Rwandan citizens was exploited to serve the interest of its rulers overseas. The pre-existing class differences between the Tutsis and Hutus were transformed under the eugenics movement into a fabricated ethnic and racial divide. Tutsi superiority was soon codified in Rwandan law and ethnicity was mandated on identity cards. This gave Belgian colonialists the leverage to increase the divide. Colonial rule was superseded by a string of no less repressive dictatorial regimes who saw democratic principles as a threat to Tutsi dominance. Ethnic tensions came to a high point as the Rwandan economy was failing, state crime was rising in conjunction with harsher ethnic propaganda. These tensions precipitated power grabs and led to the eruption of a large-scale civil war in the years 1990-1994. It ended with one of the bloodiest ethnic massacres in recent history, now known as the Rwandan genocide. More than 600,000 people lost their lives - a staggering 20% of the total population - as the landlocked state plunged into one humanitarian crisis after another. [31] To say that Rwanda's future was bleak was an understatement.

Yet today Rwanda is considered one of the biggest economic successes in the SSA region. Economists often praise the forward-thinking policies of the admittedly still authoritarian government. The country ranks second in SSA on the 2021 Index of Economic

Freedom. [32]. Rwanda is making strides in reducing poverty. Measured by the national poverty line, poverty rates declined from 59% in 2001 to 38% in 2017. Life expectancy at birth improved from 29 in the mid-1990s to 69 in 2019. The maternal mortality ratio fell from 1,270 per 100,000 live births in the 1990s to 290 in 2019. [33] Its Human Development Index increased from 0.248 in 1990 to 0.543 in 2019. [34] To understand the unlikely rise of Rwanda we shall investigate a major pillar of its economy: coffee.

After the end of WWI Rwanda became a Belgian colony until 1962. Coffee was then a lucrative cash crop and swift forced labor laws required that farmers plant coffee trees on a quarter of their land. The export of coffee and income of farmers were taxed for the benefit of the colonial government. After independence Rwanda's incumbents continued the practice of mandating the growing of coffee berries. The vast majority of the production was bought by a single exporter at a price, fixed below market rates. The difference was pocketed by the government and the elite to buy loyalty and import luxury goods. As coffee prices rose throughout the 1970s and 1980s, farmers' profits were only modestly increased. The surplus was used by the regime to buy support and reinforce its power over the population.

The relatively stable period for coffee farmers ended soon after the International Coffee Agreement was terminated in the 1980s. The agreement was set up to stabilize the price of coffee to support the weak economies that relied on its export. The liberalization of the coffee market sent prices tumbling. Rwanda's government initially propped up prices but it proved unsustainable and price supports were eliminated in 1992. With a decline in profits, smallholders wanted to shift into the production of other crops, most notably beer bananas, yet the law forbade this. [35] Losing support from the agrarian sector (which was the majority of the population), the government began asserting its power through repression and violence. In the early 1990s Rwanda saw rising numbers of arbitrary arrests, massacres of the Tutsi, confiscations of property, and rapes. The poor economy, a rising rebel force and ethnic propaganda by the government led to a devastating civil war, in which 20% of all Rwandans lost their lives in 1994. [31]

The genocide was a catalyst for change. The events made international news and attracted the eyes of international organizations and NGOs. For the following years many of the state's policies were to be informed by the 44 points in Rwanda's Vision 2020 development program. The coffee sector, along with other sectors of the economy, is largely liberalized now. The government is no longer the sole purchaser of coffee and producers are free to contract with buyers from around the world. Coffee is not mandated and Rwanda's hills are also planted with bananas, tomatoes and potatoes. This constitutes a welcome diversification of the economy that makes it more resilient to price shocks.

The liberalization of the coffee sector naturally created competition between producers. Farmers were financially incentivized to add value in their production chains. In 2002 the government developed its National Coffee Strategy as a way to pivot production to specialty coffee with high added value. With help from the government, NGOs and other donors, washing and milling stations were established. Labor started specializing, employment increased. Entrepreneurs now had incentives to invest in efforts to improve the quality of their production. From 2002 to 2009 the total value of specialty coffee exported jumped from $90,000 to $11,600,000. [35] Rwandan's Maraba Bourbon coffee is seen as one of the highest quality specialty coffees and praised for its exceptional flavor. [36]

More than half a million smallholder coffee farmers benefited from the liberalization of the sector. Researchers observed gains in consumption, food security, employment and access to credit. Many smallholder farmers earned more than enough for day-to-day sustenance and used the surplus to pay for their children's education, buy clothing, and fix their homes. But another benefit of the improved economic environment in Rwanda is that the people of Rwanda are working together. Coffee facilities such as milling stations and washing stations are a locus for social life in communities. Hutus and Tutsis join together in cooperatives, to provide for their families. Physical proximity and economic satisfaction were significantly correlated with positive attitudes to reconciliation. [37] When antagonistic groups cooperate, they find a shared identity that reduces prejudice. [38] Before liberalization, Tutsi elites together with colonial governments, hijacked production for their personal benefit. Today the groups are more likely to cooperate. Everyone benefits entrepreneurship in Rwanda. Where the formerly hijacked commerce was a divisive force, peaceful commerce has become a unifying activity. [37]

Despite its giant strides to life satisfaction, it's not all roses in Rwanda. The country remains ravaged by communicable diseases. [39] Only 57% of the population have proximate access to drinking water, 64% have sanitation and a mere 5% have a place to wash with soap. [40] More than two thirds rely on subsistence agriculture. The country is excessively dependent on foreign aid, which covers 30% of the budget and amounts to around 20% of GDP. The economy remains poorly diversified. It primarily relies on coffee, tea, and other agricultural products, making Rwanda more vulnerable to particular shocks. Lastly, chronic budget and trade deficits have created high levels of government and external debt that will have to be repaid. [30]

Chapter 4. Conclusion.

This report puts forward entrepreneurial aid as an effective form of aid in Sub-Saharan Africa. Chapter 0 introduces the topic at hand along with a brief history of foreign aid. Chapter 1 explains major reasons that aid is ineffective. First of all, it overvalues short-term benefits at the cost of the long-term. In addition, the organization and distribution model of organizations that provide it is prohibitively complex. Finally, the path to the recipient is often fraught with theft and corruption risk. Chapter 2 gives a closer look into existing entrepreneurial aid practices. It provides evidence that microfinance and skill straining are not cost-effective forms of aid, despite their spread. Capital injection, in contrast, has a track record of effectiveness. The chapter zooms into a subcategory of capital injection, direct cash transfers. It uses scientific data to prove that UCTs are a promising form of entrepreneurial aid. It hypothesizes that the reasons for its impact are due to the circumvention of the major pitfalls explained in Chapter 1. Chapter 3 provides a case study of Rwanda’s coffee sector. It introduces historical facts about Rwanda’s social and economic issues. The chapter argues that the post-war economic liberalization of Rwanda is a major driver for its substantial improvement.

Based on the existing scientific data (which is not as complete as one would wish), UCTs appear to be a major cost-effective form of charity. Recipients use their cash not only to remedy their immediate situation, but also to invest in income-generating activities such as establishing micro-businesses. The latter also provide value communities. In light of the presented evidence, this report issues the suggestion that more non-government organizations that provide capital injection and UCTs should be established. More scientific output is needed to assess their current benefits and drawbacks and potential improvements. To stimulate individual entrepreneurship SSA countries should adopt policies to advance economic liberalization and remove bureaucratic obstacles to business.

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