The Impact of Conditional Cash Transfer Programs on Entrepreneurship
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Introduction

Developing countries have recently been implementing targeted transfer programs at a remarkable rate. Policymakers have cited reduced inequality, increased welfare of lower classes, and breaking poverty as potential benefits of adopting such transfer programs.

In particular, conditional cash transfer (CCT) programs have become increasingly prevalent, as the number of countries with a CCT program has dramatically risen from three to twenty-nine between 1997 and 2008 (Fiszbein et al., 2009). A conditional cash transfer is a government-administered policy that provides either monetary compensation or compensation in the form of an alternative good, such as food, to citizens that participate in a specific social program, such as schooling or health care. In addition to poverty and inequality reduction, objectives of CCT programs include improved health, increased education, and reduced child labour.

Conditional cash transfer programs originated in Latin America with Mexico's Progresa, which was later renamed Oportunidades, and Brazil's Bolsa-Escola, which later merged into Bolsa-Familia (Handa and Davis, 2006). The effectiveness of these programs in reducing poverty and inequality as well as increasing participation in social programs has led to the massive expansion of CCT programs across the developing world. The expense of conditional cash transfer programs for governments tends to be less than or equal to 0.5 percent of GDP, and poverty headcount has been reduced by up to 50 percent in some countries (Barros et al., 2008). Also, research has shown significant improvements in caloric intake, education attainment, and health care participation in many programs (Hoddinott and Skoufias, 2004), (Behrman et al., 2010).

In addition to the explicit objectives of CCT programs, many unintended outcomes materialize as a result of these policies. Examples of these recognized indirect impacts include spillover effects on non-participants, changes in migration, and differences in saving (Stecklov et al., 2006). Understanding these changes brought about by conditional cash transfers is important for evaluating the effectiveness of policies and developing future programs.

The consequence of CCT programs on entrepreneurship is one of such indirect effects that must be understood. Entrepreneurship is widely regarded as a driver of economic progress, and is a key factor for development of impoverished countries. Joseph Schumpeter (1911) first demonstrated the theoretical link between entrepreneurship and growth, claiming that more entrepreneurs lead to greater growth. Wennekers and Thurik (1999) argue that the importance of entrepreneurship is in generating a vibrant sector of small-medium sized enterprises. The authors support this claim with empirical evidence

from developed economies. Recently, the relationship between entrepreneurship, competitiveness, innovation, and growth has been extended to developing countries (Hausmann and Rodrik, 2003), (Porter et al., 2002), (Naude, 2010).

Conditional cash transfers have multiple theoretical mechanisms that could influence nascent entrepreneurial activity, which would in turn impact the rate of entrepreneurship in a country. A cash transfer could provide the liquidity needed to make capital investments in a business. Alternatively, future cash transfers may provide stable income to enable risky entrepreneurial activity. Either of these effects may arise from additional income provided by conditional cash transfers. If these effects are significant and substantial, the return on conditional cash transfers is greater than previously thought. Also, a positive impact on entrepreneurial activity would help dispel a critique of CCT programs; that they only provide short-term poverty relief through increased consumption.

This paper will analyze Mexico's Progresa (Oportunidades) and Brazil's Bolsa-Família, the world's two largest conditional cash transfer programs in terms of both participants and amount of value transferred, to understand the influence of CCT policies on entrepreneurship (Handa and Davis, 2006). The two programs share similar design, with cash being used to compensate families for school and health clinic attendance. Data on each of these papers will be presented, analyzed, and compared to reveal the total impact of conditional cash transfers on entrepreneurship, as well as to understand the mechanism by which the effect is driven. These mechanisms will be compared with the results of other policies and experiments from around the developing world.

This essay finds that the two CCT policies studied do have a positive impact on entrepreneurship. This result is primarily caused by the insurance provided by the stable transfer income. When compared with analogous isolated experiments, these mechanisms do not behave consistently. These results are discussed, and policy design implications are made.

Entrepreneurship's Impact on Development

Early neoclassical theory of development economics prescribed technological adaptation, good institutions, and capital accumulation to aid the convergence of underdeveloped countries. This view has since been expanded upon to include elements of endogenous growth theory. Hausmann and Rodrik (2003) draw attention to facts that refute the basic neoclassical growth model. Their research compares the economic progress during the 1980's and 1990's of Asian countries including China, India, South Korea, and Taiwan with Latin American countries in relation to government policy.

The authors find that Latin American countries adopted many reductionist policies and greatly improved key institutions, but regressed in terms of GDP per capita as a percentage of USA GDP per capita from 22.9 percent in 1985 to 17.7 percent in 1999 (Hausmann and Rodrik, 2003). Meanwhile, policies in the Asian countries included more protectionist policies with more active industrial policy, but these were some of the

fastest growing economies during this period. Given that many other economies with protectionist policies fared quite poorly during this period, Hausmann and Rodrik claim that there must be a significant missing aspect of the neoclassical growth model.

The proposed missing aspect is "learning what one is good at producing", which is achieved by entrepreneurs through trial and error (Hausmann and Rodrik, 2003). The authors suggest that this aspect is often undersupplied in developing economies, and that governments should use policy to increase supply to the socially optimal quantity. It is also stated that institutions to discipline inefficient firms are necessary. Hausmann and Rodrik point to the interventionist policies used by Asian countries as drivers to discover their current competitive advantages. Using this analytical framework for development, policies that encourage entrepreneurial activity are deemed beneficial to economic development.

The view that entrepreneurship is a driver of economic development is not held unanimously, and many opposing theories exist. Naude (2011) questions the empirical link between entrepreneurship and development, concluding that entrepreneurial activity is not a constraint to development. Boettke and Coyne (2003) maintain that institutions are the more fundamental to development, and entrepreneurship is a result of growth rather than a cause of it.

Whether or not the rate of entrepreneurship impacts a country's growth path is uncertain, though recent literature generally supports a positive causal link between entrepreneurial activity and development (Goedhuys et al., 2011). Regardless of the general effects, self-employment provides income for marginalized citizens, leads to higher savings, and increases socioeconomic mobility (Quadrini, 2000).

Constraints to Entrepreneurship

There exist many possible constraints that limit entrepreneurial activity in developing countries. Two of the most binding potential constraints are a liquidity constraint and an insurance constraint. The prevalence of either of these restrictions in a region can result in the number of entrepreneurs sitting below the socially optimal amount for the economy.

Liquidity constraint refers to a lack of access to financial support that prevents business investment by an entrepreneur. In theory, investment would only be made when capital is expected to have positive returns, so the inability to make said investment would limit the output of the individual and thus limit economic activity as a whole. Liquidity constraints are prevalent across the developing world, as evidenced by survey results from Sri Lanka and Tanzania in which access to finance was the leading constraint reported by Small and Medium-Sized Enterprises (SMEs) (Levy, 1993). Extensive literature reports the necessity of access to finance for economic development to relieve the liquidity constraint (Karlan and Morduch, 2009), (Levine 2005).

An insurance constraint pertains to the avoidance of risky incomes from entrepreneurship due to risk-averse household consumption preferences. Entrepreneurial returns are more volatile than wage income and, given that many developing country households are especially sensitive to income shocks due to their poverty level, households cannot afford to engage in the risk associated with entrepreneurship (Kihlstrom and Laffont, 1979). That is, even if the expected return from entrepreneurship is greater than the expected return from working, the expected utility from entrepreneurship may be less than that obtained from working due to risk aversion and diminishing returns to consumption.

Conditional cash transfers may have the potential to help entrepreneurs overcome either of these constraints. Accumulation of past and current transfers could enable necessary household saving. This would provide potential entrepreneurs with the cash to invest in operational capital for launching a business. Also, if the transfers are stable, predictable, and provided for a prolonged period of time, they may act as insurance against income drops, capacitating households to pursue riskier entrepreneurial activity rather than wage income. Households are expected to be more responsive to past and current transfers if the liquidity constraint is more binding, and are expected to be more responsive to expected future transfers if the insurance constraint is more binding.

Bolsa-Familia as an Experiment

Bolsa-Familia, formerly Bolsa-Escola, is a conditional cash transfer program that has been operational in Brazil since 2003. The aim of the program is to alleviate poverty in the short-term by transferring cash to extremely poor families and pregnant women. Receiving benefits from Bolsa-Familia is contingent on various activities including school enrolment of children, attending health clinics, and keeping vaccination records. Increased participation in these activities is proposed to accelerate the country's development through improved health and increased human capital.

Monthly transfers are valued between $40 and $80 (2010 USD), dependent on the number of children enrolled in programs (Lichand, 2010). Given that the eligible income bracket is under $85 of monthly household earnings, these transfers increase total income by an average of nearly 50 percent (Lichand, 2010). Bolsa-Familia has led to substantial poverty reduction, with many marginalized citizens raised above the poverty line since the introduction of the program. Barros et al., (2007) report a recent 50 percent fall in inequality in Brazil, largely due to Bolsa-Familia. Figure 1 shows the annual rate of change of poverty headcount. The vertical line in 2003 represents the implementation of Brazil's CCT program.

Guilherme Lichand (2010) studied the effects of Bolsa-Familia on entrepreneurship, using household data from 2004 and 2006, by analyzing if receiving the transfer changed the probability of becoming self-employed. The paper attempts to segregate the effects of relieving a liquidity constraint and of providing insurance among recipient households on occupational choice. Self-employment in this article includes part-time activity as well as full time.

Figure 1

Brazil: Rate of Change in the Poverty Headcount Ratio
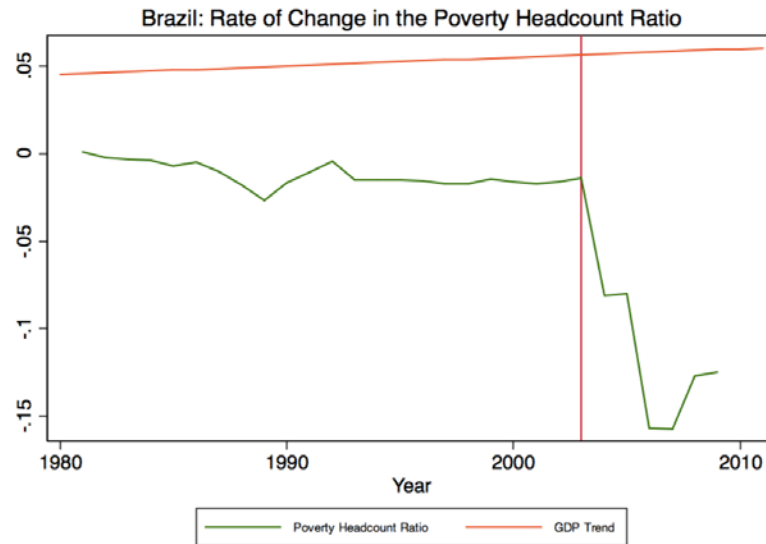
(Ávila, 2010, p. 48)

To assess the program's impact on the liquidity constraint, households with equal wealth prior to the administration of transfers are compared. Wealth is proxied with asset ownership in this case. Thus, comparative households have equal capacity to pay and equal borrowing capacity to make investments prior to the transfer. After the transfer is made, recipients (treatment group) should have a greater probability of ability to afford start-up costs than non-recipients (control group). If the treatment group shows a higher rate of entry into entrepreneurship than the control group after the transfer, one can conclude with a high degree of confidence that households were previously liquidity constrained.

After controlling for observable characteristics, the paper finds that the specified treatment group has a 1.76 percent greater probability of starting a new venture than those in the control group (Lichand, 2010). This effect is only found to be significant in increasing self-employment part time, as supplementary income to a wage-paying job. Thus, the liquidity constraint is partially alleviated to enable part-time entrepreneurship, but possibly not enough to invest in a full-time venture. The difference in firm start-up is entirely from services business, which has higher investment costs than commerce does.

To understand the importance of alleviation of the insurance constraint, households with equal income after the transfer has been administered are compared. Again, the treatment group consists of transfer recipients while the control group consist of non-recipients. Given equal income, these groups should have equal ability to pay for start-up costs, but they differ in that the treatment group's share of income from stable sources is greater than the control's because of the transfer. If the treatment group is more likely to become self-employed than the control group, it will be attributed to a relaxed insurance constraint from the addition of stable income from the CCT.

In comparing the treatment and control groups for measuring the effect of the insurance constraint, Lichand (2010) finds the treatment group to have a 1.73 percent greater probability of starting a business due to relief of the insurance constraint. Again, this effect is only found significant for the creation of part-time businesses.

Brazil's Bolsa-Familia program is shown to have a small, but statistically significant, positive impact on the rate of venture creation among transfer recipients. Both the liquidity and insurance constraints are partially relieved, resulting in the increase in entrepreneurship. The entirety of the significance of this effect is due to an increase in part-time employment, possibly indicating that the constraints still prevent movement to full-time entrepreneurship. The effects are not completely conclusive, and only household-level panel data would show the full impact of Bolsa-Familia on entrepreneurship.

Progresa (Oportunidades) as an Experiment

Progresa, later renamed "Oportunidades", was a program implemented by the Mexican government in 1997 to break the poverty trap that existed in impoverished communities across the country (Gertler et al., 2006). Progresa (Oportunidades) sought to address Mexico's poverty problem through a conditional cash transfer program, the first large scale program in the world of its kind. Like Bolsa-Familia in Brazil, families in impoverished regions were offered bi-monthly payments to compensate for enrolling their children in school, receiving preventative health care, and attending educational health talks (ORTO, 2012).

Food stipends were distributed for participating in health programs, and cash transfers given for school attendance. Transfers increased in size with the number of children enrolled, and with the age of the children. The median value of benefits in 1998 was approximately $18 (converted USD) per month, making up an average of 28 percent of income for participants (Bianchi and Bobba, 2010).

Bianchi and Bobba (2010), and Gertler et al. (2006) provide analysis of Progresa's (Oportunidades') impact on entrepreneurship. Both papers study household level data from the late 1990's, when Progresa was still expanding across rural regions. At the time that this data was collected, Progresa had been implemented in 320 out of 506 eligible communities. The selection of the treatment regions was random, so a control group of 186 communities emerged. Both studies took advantage of this natural experiment, comparing treatment and control regions.

Gertler, et al. (2006) compare the gross probability of engaging in entrepreneurship of participant households in treatment communities with would-be eligible households in control regions. The study finds that treatment households are approximately 45 percent more likely than controls to be entrepreneurs, including part time. There is, however, no measure of the probability to become an entrepreneur, only the total entrepreneurial rate. Also, differentiation between liquidity and insurance constraint relief is not achieved. Thus, the study gives the qualitative result that Progresa positively impacts the rate of

entrepreneurship, but no quantitative answer is given for what drives this increased level, or how the policy influences business start-up.

Bianchi and Bobba (2010) analyze the influence of Progresa on the rate of entry into entrepreneurship rather than the total rate of entrepreneurial activity. The study finds that treatment households are approximately 20 percent more likely to enter self-employment than those in control communities. This is possibly consistent with the aforementioned figure from Gertler et al. (2006), measuring the total entrepreneurial rate. This is because entry into self-employment is cumulative over periods, so difference in total rate of entrepreneurship will reflect the compounding of differences of entry rate.

Bianchi and Bobba (2010) seek to expand on the understanding created by Gertler et al. (2006) by attempting to isolate mechanisms that cause the higher rate of entrepreneurship found in treatment communities over controls. To understand the influence of the conditional cash transfer in alleviating the liquidity constraint, the paper relates the amount of transfers received over the past six months to the rate of entry into entrepreneurship. If the households were liquidity constrained, it is expected that past cash transfers would provide the needed capital to pay start-up costs. Thus, if the rate of entry into entrepreneurship is positively responsive to past transfers, the result will be interpreted that the households were indeed liquidity constrained, and that Progresa relieved this constraint.

After controlling for observable variables, it is found that transfers received over the past six months did not significantly impact the probability of becoming self-employed. The authors interpret this result as an indication that households were not liquidity constrained since the cash provided by past transfers did not enable entrepreneurship.

The impact of expected future transfers on the rate of entry to entrepreneurship is claimed to be an indication of the presence of an insurance constraint. Transfers from Progesa acted as a stable source of income, available for a known amount of years to participating households. If households were insurance constrained, stable income from future transfers would enable self-employment because of decreased relative risk (Kihlstrom and Laffont, 1979).

Expected future transfers is measured by the value of transfers that a household would earn over the next six months, assuming enrolment decisions remain unchanged and taking into account increased transfer amounts from grade progression. Bianchi and Bobba (2010) find that the probability of becoming self-employed is significantly dependent on the size of expected future transfers. Quantitatively, a one standard deviation increase in the amount of expected transfers over the next six months causes a 12 percent increase in average probability of entry into entrepreneurship. A similar result for expected transfers over the next twelve months reinforces this result, indicating that households were insurance constrained. Bianchi and Bobba (2010) conclude that the substantial increase in entrepreneurship caused by Progresa could be entirely attributed to alleviation of the insurance constraint.

A competing theory for the increased rate of entry into entrepreneurship among Progresa beneficiaries is that the increase was a result of greater demand in treatment areas due to the influx of wealth. Comparing the rate of entry into self-employment for non-eligible households in treatment communities with would-be non-eligible households in controls, tests this. Bianchi and Bobba (2010) find that there is no difference in means for rate of entry into entrepreneurship between these groups, so this theory is not accepted.

Experiments of Liquidity and Insurance Constraints

While both an insurance constraint and a liquidity constraint are theoretically feasible, their applicable validity cannot be taken for granted. Experiments, both natural and administered, can unveil basic preferences to better understand the relevance of these two constraints. The three examples given below show that liquidity and insurance constraints are prevalent in developing countries, but also illuminate that different exogenous factors lead to varied constraints across nations.

De Mel, McKenzie, and Woodruff (2008) conducted a field experiment to test the liquidity constraint of microenterprises in Sri Lanka. Grants of $100 to $200 were given to businesses with less than $1000 of operative capital. Returns to capital from the grants were above 50 percent annually. The high returns were evidence that these businesses were operating far below optimal levels of capital. Since the investment was made only upon receiving a grant, and the investment moved businesses towards optimal production, the paper concludes that the entrepreneurs must have been capital constrained.

Dercon and Christiaensen (2011) study the use of fertilizer by farmers in Ethiopia to uncover the impact of an insurance constraint on behavior. Fertilizer is a high cost annual investment for Ethiopian farmers relative to their income, but it generates a positive average return on investment. When weather is bad, however, the sunk cost of fertilizer will cause negative returns on investment. Since many farmers are near subsistence level, the downside of negative returns causes strong risk-averse preferences, leading to low adoption rates of fertilizer. If protection against the downside was available, the paper predicts that adoption rates would be far higher. Thus, Dercon and Christiaensen suggest that farmers face an insurance constraint, preventing optimal production levels.

Macours, Premand, and Vakis (2012) analyze a control trial in Nicaragua, which provided interventions aimed at increasing households' resilience to income shocks due to drought. The study found that households that received an investment grant of $200 (USD) fared better than the controls during droughts. Recipients of the grant were more likely than controls to create a part-time non-agricultural business to diversify income, leading to higher income and consumption during drought shocks. This paper reveals a potential mechanism not previously discussed; relief of a liquidity constraint as a means to provide insurance.

Comparative Discussion of Bolsa-Familia and Progresa

The stark difference between results of Bolsa-Familia's and Progresa's impact on entrepreneurship is the effect of the liquidity constraint. Lichand (2010) finds that alleviation of the liquidity constraint is equally important as relief of the insurance constraint in Brazil, but Bianchi and Bobba (2010) show that the liquidity constraint was not at all binding in Mexico. Empirical work by the two papers used different measures for relief of a liquidity constraint, which may partially account for the difference. The measures are, however, quite similar as both cases compare the influence of an increase of wealth from the CCT on entrepreneurial activity. McKenzie and Woodruff (2006) also fail to find conclusive evidence of a liquidity constraint among Mexican microenterprises, while Gomes and Paz (2010) find support for liquidity constraints in Brazil. Thus, it is probable that the understanding of constraints in Mexico and Brazil are accurate.

An alternative explanation for the different effect of each program on entrepreneurship is that the two countries are simply constrained by different factors. An example of this is the difference between Brazil and Mexico in alleviation of the liquidity constraint through microfinance. Data from the mid-2000's shows that the rate of microfinance usage in Mexico is four times that in Brazil (Rhyne and Otero, 2006). There is a general lack of certainty for why there exists a difference in liquidity constraints, and current research has yet to explain this comparative difference.

Lichand (2010) uncovers that new entrepreneurial activity brought about by Bolsa-Familia was entirely attributable to an increase in part-time self-employment. Bianchi and Bobba (2010) find a similar figure: new entrepreneurs are more than four times as likely to hold multiple paid occupations as wage workers. As evident in the example of farmers in Nicaragua, complementary employment is a method common in developing countries to smooth income (Banerjee and Duflo, 2008). This shared trait between Brazil and Mexico indicates that significant insurance constraints remain despite the cash transfers.

Policy Implications

Evidence from Mexico's conditional cash transfer program, Progresa, and Brazil's, Bolsa-Familia, show that transfers do indeed have a positive influence on the rate of new self-employment. Recent development economics literature tends to agree that increasing the rate of entrepreneurship increases growth and improves the maturation of a country. Positive short-term effects are found in Mexico, with higher labour earnings and food consumption among new entrepreneurs than comparison groups (Banerjee and Duflo, 2008). Additionally, long-term benefits of increased competition and comparative advantage discovery may result (Hausmann and Rodrik, 2003).

The core motivations behind conditional cash transfers are, however, to alleviate poverty, and to increase participation in social programs such as education and health care. Though these programs have a positive impact on the rate of entrepreneurship, this effect is small, possibly negligible, in comparison to the impact on main issues.

With consideration of the influence on entrepreneurship, conditional cash transfer programs have a larger economic impact, especially in the long term, than previously evaluated. Given this increased return, transfer size should be slightly increased in terms of number of recipients or amount of money per recipient to reach the optimal level. Determining the magnitude of this increase would require further research and calculation. It is expected that this increase would be very small since the influence on entrepreneurial activity is only a side effect of CCTs, as opposed to a main goal.

Should increasing entrepreneurial activity be identified as a desirable outcome by developing country governments, there exist more efficient policies for relieving liquidity and insurance constraints. Microfinance has demonstrated the potential to provide short-term working capital needed for entrepreneurs in developing countries to fund their businesses, alleviating the liquidity constraint. Welfare provision or public insurance, such as weather insurance, can relax the income constraint. These policies are much more direct in fostering new entrepreneurial activity, and can be implemented alongside CCT programs since the transfers do not entirely alleviate entrepreneurial constraints.

Conclusion

Households in developing countries face liquidity and insurance constraints to various degrees. Conditional cash transfer programs have the ability to alleviate the liquidity constraint through past and current transfers, and the insurance constraint with certain future transfers.

The two largest CCT programs, Bolsa-Familia in Brazil and Progresa (Oportunidades) in Mexico, have been studied to reveal their impact on entrepreneurial constraints. These studies found evidence that entrepreneurial activity was increased in both countries by the programs. Both liquidity and insurance constraints were partially relieved in Brazil, while just the insurance constraint was relaxed in Mexico.

These effects are not core to the objectives of conditional cash transfers. The impact on self-employment is significant, however, so it must be taken into account when designing CCT policy. Future research should aim to further isolate the insurance and liquidity constraints to better understand how to encourage entrepreneurship in developing countries. Also, benefit analysis of effects on entrepreneurship should be conducted to inform the optimal size of conditional cash transfer programs.

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