

# Self-Employment, Microenterprise, and the Poorest

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## Abstract

Some advocates of microenterprise programs claim that self-employment is a good way to help people on welfare. Although microenterprise programs do increase the relative rate of movement from welfare to self-employment, the change in the absolute number of people who move is probably less than 1 in 100. Most poor people who use microenterprise programs are not among the poorest. Rather, they have the most assets, the most years of school, the most skills and experience, the strongest support networks, and one or more wage jobs. Cost-effectiveness analysis is an inexpensive first step to evaluate whether microenterprise programs are good public investments.

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# Introduction

The recent switch from Aid to Families with Dependent Children (AFDC) to Temporary Assistance to Needy Families (TANF) affects mostly the poorest of the poor in the United States: welfare mothers and their children. The new policy limits the number of years a person can receive welfare payments and decreases the size of payments when a welfare spell lasts too long without earned income.

If people who are now on welfare are to earn income and, more fundamentally, if they are to avert destitution in the long term, then they must work either for someone else in a wage job or for themselves in a microenterprise. Most people will choose to search for a wage job first, but, even if they get a wage job, they may still stay poor. Some people will not get a wage job at all because they lack skill or discipline, have bad luck, or face discrimination. Furthermore, the demand for jobs may exceed the supply, even at minimum wage.

Some scholars suggest that self-employment through microenterprise can be part of the solution.<sup>1</sup> Microenterprises are very small firms; most have one employee—the owner. Microenterprise programs make loans and/or give classes to help to start or to strengthen microenterprises. Worldwide, microenterprise programs are popular with the development-aid community, and advocates seek more than \$20 billion for microenterprise programs by 2005.<sup>2</sup> In the United States, the number of microenterprise programs has grown from less than ten in 1987 to more than 300 in 1996, and more

than half of microenterprise programs have at least one client on welfare.<sup>3</sup>

Microenterprise programs enjoy political support from both the right and the left, and the newest federal budget would double the more than \$130 million now earmarked for microenterprise programs.<sup>4</sup> Conservatives like that microenterprise programs promote personal responsibility and the small-business work-ethic thought to have helped immigrants climb out of poverty. Liberals like microenterprise programs because they promise to create jobs for those who cannot find jobs elsewhere.

In this paper, I address two questions. First, can microenterprise programs help some people on welfare become self-employed? I find that microenterprise programs probably do increase the relative rate of movement from welfare to self-employment. Second, can microenterprise programs help many people on welfare become self-employed? I find that microenterprise programs probably increase the absolute number of people who move from welfare to self-employment by less than 1 in 100.

Furthermore, I find that most clients of microenterprise programs are not among the poorest. Rather, they are far above average in assets, education, experience, and skills. With more luck, they may have found a new wage job or kept their old one. While they have low incomes now, they also have the tangible and intangible assets needed to earn higher incomes in the future. I conclude that although microenterprise programs do help some poor people, knowledge of their cost-effectiveness is still too scant to judge whether microenterprise programs are worthwhile uses of scarce public funds earmarked to help the poor.

## Aspects of U.S. microenterprise programs

The youth and diverse sponsorship of microenterprise programs in the United States has led to a wide range of missions, target clienteles, types of training, and lending technologies.<sup>5</sup> To avoid false comparisons, cost-effectiveness analysis must recognize this diversity and its effects on social costs and benefits.<sup>6</sup>

The mission of most U.S. microenterprise programs is either individual empowerment or economic development.<sup>7</sup> Empowerment aims to nurture self-sufficiency; development aims to unleash job creation and income growth. Missions reflect the goals of sponsors. In rough terms, public donors tend toward economic development while private donors tend toward individual empowerment. The choice of mission drives the choice of target clientele. Although application to a microenterprise program is always voluntary, empowerment microenterprise programs often accept just those applicants who are on welfare or who are disadvantaged in terms of income, sex, or race. In contrast, development microenterprise programs often focus on the newly unemployed. Although development microenterprise programs may accept all applications, they may make application and participation costly to screen those least able to bear the costs of entrepreneurship. In contrast, empowerment microenterprise programs attempt to reduce costs for participants so as to serve more-disadvantaged clients.

Almost all U.S. microenterprise programs offer some training, and about half make loans.<sup>8</sup> Empowerment classes often try to imbue self-esteem, personal habits useful in wage-employment or in self-employment, and basic economic literacy. Rather than focus on specific job skills, empowerment classes try to give their more-disadvantaged clients support and some experience of success. With less-disadvantaged clients, development microenterprise programs try to transfer technical skills such as accounting or computers.

For both types of microenterprise programs, the capstone of courses is often a business plan. The plan not only helps clients to test and to refine their ideas before they take real risks, but it also screens potential borrowers. The first U.S. microenterprise programs to make loans followed the group model of the Grameen Bank in Bangladesh.<sup>9</sup> Members of the group are liable for each other's debts and expected to screen applicants, to monitor the use of loans, and to enforce repayment. As a by-product, the group may also build social capital through peer support for both business and personal problems.<sup>10</sup> Group loans have had less success in the United States than in the third world, and now most U.S. microenterprise programs that lend do not use groups.<sup>11</sup> Without groups to screen potential borrowers, the business plan has become an important signal of creditworthiness and of business acumen.

For U.S. microenterprise programs, the basic dichotomy of mission between empowerment and development describes the most common clusters of choices for

target clienteles, types of training, and lending technologies. Still, many microenterprise programs do not fall neatly into this simple scheme.<sup>12</sup> For example, some empowerment microenterprise programs do not offer classes at all, and some development microenterprise programs target only people on welfare. Furthermore, empowerment and development are complements.<sup>13</sup> Clients who feel empowered are more likely to start businesses that create jobs and increase incomes, and clients whose businesses create jobs and increase incomes are more likely to feel empowered.

Program costs depend on the choice of mission and on the choices of how to achieve that mission. For example, empowerment classes tend to cost more than skills classes because they require more staff time and lower teacher-to-student ratios. In general, costs increase with the poverty of clients because poverty and disadvantage increases the assistance required for successful entrepreneurship. Although training consumes much of the resources of U.S. microenterprise programs, few clients are willing and able to pay for classes.<sup>14</sup> In principle, loans have greater potential to cover their own costs, and some microenterprise programs who lend in the third world do turn a profit.<sup>15</sup> In practice in the United States, however, loans from microenterprise programs are far from profitable. Individual loans usually cost more than group loans, but even group loans have not led to the cost-savings promised by the experience in the third world.

All else constant, increased effectiveness implies increased cost. Microenterprise programs that train more-disadvantaged clients and/or who make individual loans may have higher costs, but the potential for social gains may also be higher. Cost-effectiveness analysis should consider not just the cost of services but also the worth of services to clients, the poverty of clients, the number of clients, the length of time a microenterprise program survives to serve clients, and the scope of services.<sup>16</sup>

## Evidence from two U.S. self-employment programs

Scholars disagree about how to interpret the results of the two most-important self-employment programs in the United States. Salome Raheim says that the results “suggest that self-employment can be an effective strategy for income generation and asset-building for welfare recipients.”<sup>17</sup> Likewise, Raheim, Catherine Foster Alter, and Donald Yarbrough say that “overall, the evaluations of U.S. [microenterprise programs] indicate that small-scale enterprise development is a viable strategy for creating economic opportunity for self-selected individuals who are low-income, unemployed, or receiving public assistance.”<sup>18</sup>

In contrast, a review of the literature by Cynthia Sanders did not find support for strong claims that microenterprise is an effective tool to fight poverty.<sup>19</sup> Likewise, William Dennis says that “the number moving directly from welfare to self-employment will be quite small. . . . Welfare recipients appear to be a group with a low propensity to become self-employed.”<sup>20</sup> Finally, Timothy Bates says that “Scholarly studies have failed to produce hard evidence that entrepreneurship in the United States today is an effective strategy for bootstrapping one’s way out of poverty.”<sup>21</sup> The new evidence on this question presented below suggests that microenterprise programs can probably help just a few people on welfare.



## *The Unemployment Insurance Self-Employment Demonstration*

The Unemployment Insurance Self-Employment Demonstration (UISED) was an experiment that tested the difference in self-employment with and without access to microenterprise programs for new claimants of unemployment insurance (UI). Although UISED measured effects not for those on welfare but for the unemployed, its results inform the question of how microenterprise programs affect people on welfare in two ways. First, UISED is the only experiment to test the effect of microenterprise programs on anyone. Second, the effect of microenterprise programs on the unemployed is probably an upper bound on their effect on people on welfare because the unemployed are less disadvantaged.

*UISED as an experiment.*-UISED randomly assigned qualified applicants to a treatment group with access to microenterprise programs or to a control group without access. If random assignment produced two groups with the same joint distribution of all observable and unobservable traits that affect self-employment, then all systematic differences in outcomes between the two groups were due to differences in access to microenterprise programs.<sup>22</sup>

UISED is unique because it compared outcomes between one group with access to microenterprise programs and a second group without access—all other studies compare outcomes for a single group before and after access. The analysis of outcomes

before-and-after ignores that some unobserved and unobservable traits likely affect outcomes regardless of access to microenterprise programs.<sup>23</sup> A treatment/control framework can distinguish between outcomes caused by microenterprise programs and outcomes that would have happened without microenterprise programs; the outcomes of the control group stand in for the outcomes of the treatment group without the treatment.<sup>24</sup>

Experiments require a lot of time, money, and effort, and they may still fail to produce the same distribution of all pre-experiment traits in both treatments and controls.<sup>25</sup> Thus some evaluations of microenterprise programs use comparison groups, panel data, or natural experiments.<sup>26</sup> These techniques are, however, imperfect substitutes for an experimental framework because they often require complex statistics and strong assumptions.

*Effects of UISED on self-employment for the unemployed.*-UISED ran from 1990 to 1993 at sites in Washington state and Massachusetts. Sponsored by the states and by the Unemployment Insurance Service of the U.S. Department of Labor, UISED aimed to test “the ability of the U.S. employment security and economic-development systems to work together to help UI recipients create their own jobs by starting businesses.”<sup>27</sup> New UI claimants were invited by mail to a one-day orientation that described the risks, costs, and potential benefits of self-employment. Those still interested then

applied to participate. Half of the qualified applicants were assigned to treatment groups.

In Washington, members of the treatment group who attended a four-day sequence of classes within 10 days after assignment were eligible for 10 weeks of regular UI benefits without standard work-search requirements. The completion of a business plan also qualified them for a lump-sum payment equal to their remaining UI-benefit eligibility. About 60 percent of members of the treatment group got an average lump sum of about \$4,200. Other than the four-day sequence of classes, clients in Washington received almost no training or advice from the project.

Unlike Washington, Massachusetts did not invite all new UI claimants but rather just those who were most likely to exhaust their benefit-eligibility. Members of the treatment group in Massachusetts were not eligible for a lump-sum payment. Instead, Massachusetts offered standard UI benefits for 24 weeks without work-search requirements to those who attended a one-day seminar, who went to six biweekly small-business workshops in a stretch of twelve weeks, and who met at least once with an individual business counselor.<sup>28</sup>

*Results.*-Members of the treatment group in both states were more likely than members of the control group to start a firm within 31-33 months after assignment.<sup>29</sup> The increase was 54 percent in Washington and 23 percent in Massachusetts (see table 1).

The increase in the relative rate of movement from unemployment to self-employment implies an increase in the absolute number who move of about 8 per 1,000 invited in Washington and about 2 per 1,000 invited in Massachusetts.

These are the signs and the sizes of the self-employment impacts of UISED. Policy makers must still judge whether the effects are big enough—given costs, budget constraints, and other ways to reach the same goals—to justify more public support for microenterprise programs. The central task of social scientists is to argue how big is big enough.<sup>30</sup>

Jacob Benus, Terry Johnson, Michelle Wood, Neelima Grover, and Theodore Shen argue that microenterprise programs are “a cost-effective approach to promote the rapid re-employment of unemployed workers and should be permanently incorporated into the U.S. employment security and economic development system.”<sup>31</sup> My own argument is that although microenterprise programs help a few people a little, they are unlikely to help many people a lot. For example, UISED increased the rate of firm starts by 20-50 percent, but it increased the absolute number of starts by less than 1 per 100 unemployed people. Furthermore, wage rates in self-employment were low for users of UISED, and about a third of new firms closed within one year.<sup>32</sup> microenterprise programs are unlikely to help many poor people become self-employed.

*Effect of UISED on total employment for the unemployed.*-The effect of microenterprise programs on self-employment matters less than the effects on total employment, be it wage-employment or self-employment. In Washington, increased entry into self-employment was offset by decreased entry into wage-employment. Thus members of the treatment group were just as likely as members of the control group to have had at least one employment spell in the 33 months after assignment and were about 1 percent more likely to be employed when surveyed 33 months after assignment.<sup>33</sup> Likewise, microenterprise programs in Washington had no effect on annual earnings. Members of the treatment group did work about 1.3 months per year more than members of the control group, but their wage rates were about 13 percent lower.<sup>34</sup> The excellent benefit-cost analysis by Benus and colleagues estimates a net gain to society of about \$700 per person in treatment. But, without one case who reported an annual income of \$500,000, this net gain becomes a net loss of \$500.<sup>35</sup> Therefore the results of UISED in Washington are not enough to support the conclusion that microenterprise programs are a good way to help the unemployed, much less people on welfare.

In Massachusetts, microenterprise programs had bigger effects on total employment, and the estimated net gain for society was about \$13,900 per person in treatment.<sup>36</sup> Members of the treatment group in Massachusetts had annual earnings of about 60 percent more than members of the control group, and their wage rate was about 10 percent higher.<sup>37</sup> Moreover, members of the treatment group were about 5

percent more likely to have had at least one employment spell in the 31 months after assignment and were 7 percent more likely to be employed when surveyed 31 months after assignment. The results of UISED in Massachusetts do support the conclusion that microenterprise programs are cost-effective.

Although UISED is probably the best study of the effectiveness of microenterprise programs in the United States or abroad, at least four important questions remain unanswered.<sup>38</sup> The first is whether microenterprise programs are worthwhile for society: social benefits exceeded costs in Massachusetts but not in Washington. The second question is why Washington had less impact than Massachusetts. Washington invited all UI claimants, but Massachusetts invited just those most likely to exhaust their UI benefits. Thus Massachusetts excluded precisely those most likely to succeed in self-employment.<sup>39</sup> Washington provided classes faster and offered a lump-sum payment, although Massachusetts provided much more counseling and longer work-search waivers.

The third unanswered question concerns the impact of financial services. Unlike many microenterprise programs aimed at the poor, the microenterprise programs in UISED did not make loans.<sup>40</sup> More generally, the results of UISED may not transfer to microenterprise programs that supply different services to different target groups. The diversity of microenterprise programs in the United States affects their costs and possible impacts. The fourth and final unanswered question is how microenterprise

programs affect wage employment. Members of the treatment group in Washington had lower earnings and lower wage rates from wage jobs than members of the control group, yet most of the increase on total earnings and wage rates in Massachusetts was due to wage jobs. It is unclear how small-business classes and work-search waivers help people to find and to keep good wage jobs. These unanswered questions highlight the difficulty of impact evaluation. Policy choices require not just the measurement of results but also the knowledge of what drives results.

*UISED and people on welfare.*-If microenterprise programs cannot help very many unemployed people very much, then they probably can do even less for even fewer people on welfare. Four factors make it more difficult to assist the move from welfare to self-employment.<sup>41</sup> First, although most people on welfare are women, most people on unemployment are men, and self-employment is more difficult for women.<sup>42</sup> Second, the unemployed can collect UI regardless of their wealth, but welfare programs place limits on the assets owned by recipients. Assets limits affect the movement to self-employment because more wealth increases the rate of entry into self-employment and decreases the rate of exit.<sup>43</sup> Third, the average person on welfare has fewer skills than the average person on unemployment. Often the unemployed just left jobs where they learned a skill. Fourth and finally, the jump from unemployment to self-employment is easier

than the jump from welfare to self-employment or even the jump from welfare to a wage job.<sup>44</sup>

On average, people on welfare are poorer than unemployed people. If users of UISED were among the poorest of the unemployed, then they might overlap with the richest people on welfare. If this were the case, then UISED might suggest that microenterprise programs could help people on welfare as much as they help the unemployed. Those who chose to use UISED, however, were among the least disadvantaged of the unemployed. Compared with the average new UI claimant, users were more likely to be male, white, to have attended some college, and to have technical or professional skills.<sup>45</sup> Furthermore, the impact of UISED on the length of employment spells was much greater for users who already owned a business at the time of application or who had owned a business in the past. In fact, UISED decreased total earnings for users who had never owned a business.

Because most users of UISED were more-advantaged than the most advantaged people on welfare, the effect of these microenterprise programs for people on unemployment is an upper bound for their likely effect for people on welfare. Microenterprise programs do help people to exit welfare sooner and to stay off longer, but the size of the impact is still unknown.<sup>46</sup> If microenterprise programs cause less than 1 percent of people on unemployment to start firms, then microenterprise programs probably will not cause more than 1 percent of people on welfare to start



firms. Likewise, given that microenterprise programs in UISED cut unemployment spells by 6 weeks in Washington and by 2 weeks in Massachusetts, microenterprise programs probably will not shorten welfare spells enough to save many people from the new TANF deadlines.

### *The Self-Employment Investment Demonstration*

In contrast to the focus of UISED on economic development for people on unemployment, the Self-Employment Investment Demonstration (SEID) focused on individual empowerment for people on welfare. Funded by the U.S. Department of Health and Human Services, SEID was the first and the biggest national microenterprise demonstration for low-income people.<sup>47</sup> The design had its roots in the ideas in Robert Friedman's book *The Safety Net as Ladder: Transfer Payments and Economic Development*, and the program was coordinated by Friedman's nonprofit think-tank and advocacy organization, the Corporation for Enterprise Development.<sup>48</sup>

SEID had about 1,300 clients from 1988 to 1993 at eight sites in Iowa, Michigan, Minnesota, Mississippi, and Maryland. Each site had its own rules and mix of loans, classes, counseling, and other services, but all sites provided one-year waivers on standard welfare rules while clients worked to start their new businesses. Raheim reports that "states contracted with various types of organizations to operate SEID programmes, including small-business development centres, a community college, a

community-action organization, and self-employment development organizations. These local programme operators provided self-employment training, counselling, technical assistance and direct loans or aid in gaining access to credit. The training included business-plan preparation, business management, self-esteem training and personal financial management.<sup>49</sup> Appendix A provides more details on each microenterprise program in SEID.

SEID was “designed to test the extent to which self-employment could offer a feasible and promising route out of poverty for welfare recipients.”<sup>50</sup> Unlike UISED, however, SEID was not a test but a demonstration—it measured outcomes for a single group before and after participation rather than for one group with access and for a twin group without access. Although some people on welfare became self-employed and used the microenterprise programs in SEID, the true impact on welfare remains unmeasured because some users would have become self-employed even without help from a microenterprise program.

SEID is often cited to support arguments that self-employment is a way for some people to leave welfare.<sup>51</sup> The evaluators of SEID acknowledge, however, that without a treatment/control framework, they cannot pin down the relationships between causes and effects.<sup>52</sup> Still, they use before-and-after measures to conclude that microenterprise programs are a good way to help people on welfare. There is nothing inherently wrong with this argument, but it should link its conclusions to its assumptions more explicitly

and state the reasons for its beliefs about the size of unmeasured impacts.<sup>53</sup> For now, public choices about microenterprise programs should not be based on evidence from SEID.

*SEID and people on welfare.*—Without a control group, SEID could not measure the impact of microenterprise programs. An alternative strategy—though still inferior to control groups—is to place bounds on the range of reasonable beliefs about unmeasured impacts. A lower bound of zero supposes that microenterprise programs, even at their worst, do not impede movement from welfare to self-employment. An upper bound supposes that microenterprise programs cause all observed movement from welfare to self-employment.

Depending on the site, 1 to 6 percent of the people on welfare attended a first meeting to learn about SEID.<sup>54</sup> About 40 percent of attendees enrolled, about 78 percent of enrollees graduated, and about 31 percent of graduates started a firm. If we assume that 1 percent of those invited attended the first meeting and that all the people on welfare in the area were invited, then the probability that a person on welfare at a SEID site would use a microenterprise program and start a firm was  $0.01 \cdot 0.40 \cdot 0.78 \cdot 0.31 = 0.00097 \doteq 0.1$  percent. If we assume that 6 percent of those invited attended the first meeting, then  $0.06 \cdot 0.40 \cdot 0.78 \cdot 0.31 = 0.00580 \doteq 0.6$  percent of people on welfare used a

microenterprise program and started a firm. An upper bound on impact is thus 1 to 6 new firms per 1,000 people on welfare.

This simple upper bound probably overstates the true impact in several ways. Most important, some people on welfare who used microenterprise programs would have started firms even without microenterprise programs. In addition, the impact of microenterprise programs for the unemployed in UISED was just 2 to 8 per 1,000, and self-employment is easier for people on unemployment than for people on welfare. Finally, the measurement of business starts included all new firms, be they part-time, full-time, or soon bankrupt. Because the upper bound overstates true impact and because microenterprise programs do not reach many of the poorest as argued below, I would guess that microenterprise programs probably increase the movement from welfare to self-employment by 1 or 2 per 1,000 at most.

*The impact of microenterprise programs for people on welfare.*-Raheim says that SEID shows that “self-employment is a viable economic independence strategy for a small number of low-income and unemployed people.”<sup>55</sup> Robert Friedman, Brian Grossman, and Puchka Sahay also say that SEID shows that “a small but significant number of welfare recipients choose self-employment and can successfully start and operate businesses.”<sup>56</sup> As with UISED, the policy question is how small is 1 or 2 per 1,000?

Whether big or small, microenterprise programs probably will not help more than 99 percent of the people on welfare become self-employed.

My aim here is not to debunk all praise for microenterprise programs as premature. Microenterprise programs do increase self-esteem and business skills and thus may be worthwhile for society even if they do not prompt a single person on welfare to become self-employed.<sup>57</sup> Nor do I mean to say that SEID or its evaluators did a bad job—perhaps few people on welfare will become self-employed regardless of the help they get. Experiments are expensive, and good choices do not always require formal tests. Nor do I pretend to insist on quantitative measurement to the exclusion of qualitative judgement. Numbers for the sake of numbers serve no purpose, and evaluations of microenterprise programs often claim too much because they fumble statistics.<sup>58</sup> Finally, I do not want to ignore the fact that microenterprise programs do indeed help some people on welfare to start firms. What I do hope to do is to nudge the discussion of microenterprise programs toward more careful analysis that states assumptions explicitly and that considers the benefits and costs of alternative ways to reach goals. Better discussion would help to ensure that funds meant to help the poor are spent in the best way.

## Microenterprise programs and the poorest

If microenterprise programs reach the poorest people, then even small impacts might have high social worth. Most users of microenterprise programs, however, are not among the poorest. Furthermore, the newly self-employed earn low wages and risk bankruptcy. Those who succeed often have personal safety nets from spouses and from wage jobs. Users of microenterprise programs are usually far above-average, both in terms of intangible assets such as skills and experience and in terms of tangible assets such as education and financial net worth. Users are also less likely than the average person on welfare to be female, a single parent, or non-white.

### *The wages of self-employment are low*

At least in the short term, few poor people can use self-employment to escape from poverty. Microenterprise increases income little, if at all.<sup>59</sup> Most small firms face fierce competition because they start in sectors with few barriers to entry. In addition, most microenterprises are not very productive—they have little capital or skill to complement labor, and the owner may not be good at all the tasks that ownership requires. New firms also often face low demand because they serve poor customers in depressed areas. Demand is lowest when times are toughest because customers can save money by doing themselves or by doing without.

The Self-Employment Learning Project (SELP) provides evidence of low wages from a sample of entrepreneurs in seven of the oldest, biggest, and best-known microenterprise programs in the United States (see appendix B). For clients whose microenterprise was their primary source of income, median hourly earnings were \$5.00-6.99, and more than 40 percent earned less than \$5 per hour (see table 2). Average annual income was about \$17,000, and median income was about \$13,000.

In UISED, average wages in self-employment were \$5-7 per hour.<sup>60</sup> In SEID, average annual income from self-employment was about \$3,000.<sup>61</sup> Even these numbers overstate the return to labor because they do not deduct a return to capital investment.<sup>62</sup>

The average hourly wage for dislocated workers who started firms with help from microenterprise programs in the Economic Dislocation and Worker Adjustment Assistance Act Job Creation Demonstration (EDWAAJCD) was about \$6.70.<sup>63</sup> In standard EDWAA programs, the average hourly wage was about \$10.50. The evaluators conclude that:

“Microbusiness training under the demonstration produced total employment rates that matched outcomes from traditional EDWAA retraining services, but initial earnings from self-employment were much lower than the average EDWAA wage. . . . If immediate wage replacement is an important goal for the participant, then self-employment does not appear to be a feasible alternative, at least in the short term.”<sup>64</sup>

The wages of self-employment are even lower for women than for men, even with skills, productivity, and other traits held constant.<sup>65</sup> The average self-employed woman in the sample of Roberta Spalter-Roth, Heidi Hartmann, and Lois Shaw earned less than \$4 per hour in 1987 dollars.<sup>66</sup> Women who were self-employed full-time earned less than \$10,000 a year, half as much as full-time self-employed men. For the poor and especially for poor women, self-employment often means working poverty.<sup>67</sup>

*Risk.*-Income from self-employment is risky as well as low. In place of a fixed paycheck, owners of small firms have a claim on profits and must absorb losses. Profits and losses are variable and uncertain. For example, in a normal month 50 percent of the firms in SELP made a profit, 10 percent broke even, and 40 percent lost money.<sup>68</sup> A string of losses can kill a small firm. In EDWAAJCD, so many new firms went bankrupt that the median net annual income was \$200.<sup>69</sup> As stated by Raheim, “Individuals who pursue self-employment face greater financial risks than those who choose traditional welfare-to-work options.”<sup>70</sup> Risk is even higher for women than for men; unlike men, women face reduced returns to experience if they leave a wage job to try self-employment and then return to wage work.<sup>71</sup>

*Support networks.*-To cope with risk, the self-employed poor need strong support networks.<sup>72</sup> Family and friends provide insurance in cash and in kind as well as moral



support during crises such as exit from welfare, school enrollment, illness, job loss, birth or death, theft or fraud, or loss of personal or business partners.<sup>73</sup> The biggest source of support is most often a spouse with a wage job. Most self-employed women had husbands who worked full-time all year, and 63 percent of income in their households came from other earners.<sup>74</sup> Husbands do not always support self-employment for their wives, but women with employed spouses probably have an above-average chance to become self-employed.<sup>75</sup> Thus one way to promote self-employment may be to promote the development of more wage jobs.

The need for a strong support network does not bode well for microenterprise programs aimed at people on welfare.<sup>76</sup> “Microlending will not help those who rely heavily on a societal safety net,” says Richard Taub.<sup>77</sup> “[It] is most likely to help those who already have at least one moderately secure income.”

*Wage jobs.*-The self-employed supplement low, risky earnings from self-employment with wage jobs for both themselves and their spouses.<sup>78</sup> For both male and female entrepreneurs, Spalter-Roth, Hartmann, and Shaw found that net income from self-employment was less than income from wage jobs.<sup>79</sup> The typical low-income user of SELP patches income from 2.5 sources.<sup>80</sup> Because the cash flows of a new firm come in starts, stops, spurts, and jerks, households need a constant income from some other source if they are to consume and to repay debt. For most poor people, the importance

of wage jobs means that self-employment is part-time and often paired with elder-care or childcare.<sup>81</sup> Furthermore, entrepreneurs often start small and part-time so as to test the market and their own business acumen.<sup>82</sup>

*Non-wage rewards to self-employment.*—Although self-employment has low, risky wages, one of its main effects for the poor seems to be to diversify the total risk of the portfolio of household activities.<sup>83</sup> For example, a household with one or more wage jobs might start a part-time microenterprise to insure against job loss. Because the household controls the time and effort spent in its firm, it can adjust earnings when needed. Hours and income from wage jobs are often more rigid. Furthermore, a microenterprise may help to build a buffer of assets—be they skills, financial savings, capital goods, or social networks—that anchor income through time.

Another important effect of self-employment seems to be improved quality of life. For many, self-employment fulfills a dream.<sup>84</sup> Entrepreneurs give up higher incomes in exchange for independence, pride of ownership, and self-fulfillment.<sup>85</sup> Some people want a job that lets them work at home, that imprints a work ethic on children, and that builds assets to bequeath.<sup>86</sup> Even owners of failed firms learn skills that will serve them throughout life.<sup>87</sup>

### *The profile of the users of microenterprise programs*

Like well-known microenterprise programs abroad, most microenterprise programs in the United States serve those who are above-average and who are not among the poorest of the poor.<sup>88</sup> Instead, microenterprise programs “tend to select and to promote the most creditworthy of the impoverished, not the least creditworthy.”<sup>89</sup> According to Lisa Servon, “microenterprise programs do more to help those who exist at the margins of the mainstream economy than those who are cut off from the economic mainstream.”<sup>90</sup> There is nothing wrong with this; microenterprise programs that leapfrog the least-disadvantaged to reach the most-disadvantaged may just cause them to fail.<sup>91</sup>

*Skills.*-Compared with the average person on welfare, users of microenterprise programs have more skills in terms of education, experience in wage jobs, and experience in self-employment. With few exceptions, average users from a sample of microenterprise programs were better educated than the average American, let alone the average person on welfare (see table 3). For example, 24 percent of users of SEID, 2 percent of people on welfare, and 28 percent of Americans had a college degree. For users of SELP, 18 percent had a college degree; 8 percent had a graduate degree.<sup>92</sup> In fact, users of each of the microenterprise programs in table 3 were more likely to have attended college or to have graduated from high school than were people on welfare or Americans as a whole.

For EDWAAJCD and UISED, users were twice as likely as the average new UI claimant to have a college degree.<sup>93</sup> All else constant, increased education increases the likelihood that a spell on unemployment or on welfare is due to bad luck rather than to a lack of assets, skills, or internal oomph.

The poor who start firms are also more likely to have learned skills or to have developed networks in a wage job.<sup>94</sup> Entrepreneurs also tend to have had longer spells in wage jobs. For example, users of EDWAAJCD had held their former jobs longer than users of standard EDWAA programs.<sup>95</sup> The fact that wage jobs often precede self-employment does not encourage the hope that microenterprise programs can help many of the poorest.<sup>96</sup>

Self-employment experience can matter more than wage-job experience.<sup>97</sup> In EDWAAJCD, 18 percent of users had been self-employed.<sup>98</sup> In SEID, about 34 percent of users had started their firms before they joined.<sup>99</sup> Current or past self-employment signals at least some internal oomph. The results of UISED suggest that people who have not already started a firm on their own are unlikely to succeed even with help from microenterprise programs. Steven Balkin proposes that microenterprise programs first help poor people to get more education, then to search for a wage job, and only last to attempt self-employment.<sup>100</sup>

*Assets.*-Many microenterprise programs make loans because lack of access to loans constrains entrepreneurs.<sup>101</sup> Microenterprise programs cannot, however, do much to relax a more important constraint: lack of financial assets. Inasmuch as loans must be repaid and thus tend to go to those with wealth, lack of assets constrains access to debt.<sup>102</sup> For U.S. firms with less than 20 employees and less than \$1 million in revenue, most financing comes from the personal wealth of the owner.<sup>103</sup> Although banks may dislike small loans for non-economic reasons, even profit-maximizing banks do not lend much to small firms because, unless the owner offers personal assets as a guarantee, they cannot expect to recoup the cost to screen for creditworthiness, to monitor repayment, and to enforce contracts.<sup>104</sup>

Thus, savings are a prerequisite for loans. Self-employment also requires savings to finance the lengthy conception and gestation of a new firm and to buffer household consumption after the birth of the firm. A few new firms can finance some capital goods with debt, but most finance comes completely or mostly from savings.<sup>105</sup> Savings matter even more for women, single parents, and non-whites because they are more likely to be shut out of debt markets.

People on welfare face limits on assets that dampen their incentives to save.<sup>106</sup> The limits may be a Catch-22 for those who would use microenterprise to escape welfare. If they save to start a firm to get off welfare, then they may lose welfare before the firm gets off the ground, which dumps them back on welfare. If they do not save,

then they may stay stuck on welfare. One role for microenterprise programs beyond loans and classes is to search for ways to monitor work toward self-employment and thus to secure waivers on limits on assets.<sup>107</sup>

Most users of SELP had financial net worth in excess of the limits set by welfare programs (see table 4). The 42 percent with net worth in excess of \$10,000 were not only wealthier than the average person on welfare but also almost as wealthy as the median household in the United States.<sup>108</sup>

One form of wealth that encourages self-employment, especially for poor women, is homeownership.<sup>109</sup> Two-thirds of new firms in 1995 were started in the home.<sup>110</sup> Half the users in SELP owned their homes, and 63 percent had home-based businesses.<sup>111</sup> Entrepreneurs who own their homes not only possess an asset to back loans and to buffer shocks but they also can economize on transport and combine work with child care or with elder care.

Microenterprise programs cannot do much to promote homeownership for people on welfare other than to raise funds for Individual Development Accounts (IDAs). Deposits by the poor in IDAs are matched by public or private funds and are tax-advantaged.<sup>112</sup> After a time, the deposits, the matches, and the interest can be withdrawn to start or to expand a small business, to pay for college, or to buy a home. Other than as fund raisers for IDAs and as monitors for waivers on asset limits,

however, microenterprise programs do not have a big role in the improvement of access to saving services for the poor.<sup>113</sup>

*Demographics.*-With few exceptions, users of microenterprise programs are more likely than the average person on welfare to be married, male, or white (see table 3). Self-employment is less difficult for married people because they can get support from spouses and for males and whites because they do not face discrimination. For example, low-income males and whites in SELP earned more than females and non-whites.<sup>114</sup> Thus microenterprise programs mostly reach not the poorest but rather the least-disadvantaged of the poor. Microenterprise programs do reach some single parents, women, and non-whites, but not in proportion to their concentration in the population on welfare.

## Conclusion

Can microenterprise programs move some people from welfare to self-employment? Yes. They almost certainly increase the rate of movement. Can microenterprise programs move many people from welfare to self-employment? Probably not. They are unlikely to increase the number who move by more than 1 in 100. Furthermore, most users of microenterprise programs have above-average assets, education, experience, and skills. They are the least-disadvantaged of the poor. Microenterprise programs, like all other tools to fight poverty, are not a panacea.<sup>115</sup> Self-employment is difficult; most people on welfare do not meet the prerequisites, even with help from microenterprise programs.

### *Cost-effectiveness analysis*

Microenterprise programs do some good, but the relevant policy question is whether microenterprise programs do enough good at a low-enough cost to be a worthwhile investment of scarce funds. Cost-effectiveness analysis (CEA) is an inexpensive first step in the search for an answer.

CEA compares costs with outputs. In contrast, benefit-cost analysis (BCA) compares costs with benefits. If the analysis ignores transaction costs borne by users and displacement costs borne by non-users, then CEA is an inexpensive exercise to place a lower bound on social costs.<sup>116</sup> It is less expensive to measure output than social



benefits because, while the output of microenterprise programs is seen, the worth of output to users is unseen. Furthermore, many benefits are too complex, subtle, diffuse, or long-term to measure in dollars.<sup>117</sup> The output of a microenterprise programs could be measured in units of student-hours of classes taught, number of loans disbursed, dollar-years of debt outstanding, business plans completed, years of full-time-equivalent jobs produced, changes in annual income, changes in wage rates, or changes in net worth.

Average costs derived from CEA may inform choices almost as well as net benefits derived from BCA.<sup>118</sup> The user of CEA must still judge whether unmeasured benefits per unit of output exceed measured average costs, but not even BCA can purge all subjectivity because knowledge is never complete nor certain. As with BCA, the value of CEA is to make assumptions and judgements more transparent. Transparent judgements are more likely to be discussed and thus more likely to be improved.

Average costs derived from CEA will sometimes be so high or so low as to preclude the need for full-fledged BCA. For example, CEA suggests that the social cost of a year of membership in Grameen is about \$8.<sup>119</sup> Likewise, the social cost of a dollar-year of debt from the best-known microenterprise program in Latin America, BancoSol of Bolivia, is about 6 cents. Most experts believe that unmeasured social benefits per unit of output exceed these measured average social costs.

## *Cost-effectiveness of microenterprise programs in the United States*

The three examples below of CEA for U.S. microenterprise programs do not reveal whether microenterprise programs are good uses of scarce funds meant to help the poor. They do, however, place a lower bound on social cost per unit of output and thus expose some important implicit assumptions. Given an estimate of the social cost to produce a unit of output through a microenterprise program, the choice to entrust public funds to the microenterprise program assumes that benefits per unit of output exceed that cost, or at least that the microenterprise program will improve enough through time to have a positive present worth of benefits less costs. Such explicit assumptions are open to discussion and refinement.

The first example is from the 260 U.S. microenterprise programs surveyed by C. Alexander Severens and Amy K. Kays.<sup>120</sup> In 1996, these microenterprise programs served about 53,000 users at a social cost of about \$109 million, so the cost per user was about \$2,000 (see appendix C).<sup>121</sup>

The second example is from SELP. The CEA is exceptional because it not only estimates average cost but also compares it with the cost of alternatives. Elaine Edgcomb, Joyce Klein, and Peggy Clark argue that the cost of a job from microenterprise programs (\$6,000) is “close” to the cost of a job from federal job programs (\$3,500) because microenterprise programs reach poorer people.<sup>122</sup> This is a judgement, but it is explicit and so can be discussed. An implicit judgement is

suggested by the social cost for a dollar-year of debt from microenterprise programs in SELP of about \$1.47.<sup>123</sup> Funders must believe that borrowers and society would be willing to pay at least \$1.47 more than what it now costs to get a dollar of debt for a year from a microenterprise program.

The third example is from SEID. Although the cost study has yet to come forth, Friedman, Grossman, and Sahay report costs of \$2,200 per participant and of \$7,200 per new firm.<sup>124</sup> Although neither “new firm” nor “participant” are defined and while the CEA unrealistically assumes that no user would have become self-employed without a microenterprise program, Friedman, Grossman, and Sahay judge these costs “reasonable” and conclude that “proliferation of self-employment programs in the United States since (and because of) SEID bodes well for the broad opening of a realistic self-employment option for welfare recipients.”<sup>125</sup>

These examples show the usefulness of CEA, of precise definitions of output, and of explicit assumptions. The use of CEA is meant to inform the choice of the extent of the role that microenterprise programs will play in the mix of programs targeted to the poor. The policy questions that must be faced soon are not as simple as whether microenterprise programs can help some people on welfare become self-employed—microenterprise programs surely do help to some extent. The real policy questions are more complex: How much do microenterprise programs help? At what cost? How does the cost of help from microenterprise programs compare with the cost

of alternatives? How can cost be decreased, output increased, and the worth of output increased?

## Appendix A: Microenterprise Programs in SEID

The eight microenterprise programs in SEID had a diverse mix of organizational designs, target clientele, types of training, and lending technologies.<sup>126</sup> They all aimed for empowerment and targeted low-income women on welfare.

In Iowa, SEID worked with the Institute for Social and Economic Development (ISED) in rural and urban areas of Cedar Rapids and Waterloo. In the course of six months, clients took more than 90 hours of training in business, financial management, and self-esteem.<sup>127</sup> Although ISED did not make loans itself, it did link clients to banks and guaranteed parts of some loans. About two-thirds of the clients were female, 20 percent were non-white, and more than half were on welfare. Unlike the average client of the average microenterprise program in SEID (table 3), the average client at ISED was more disadvantaged than the average person on welfare in the service area of ISED.<sup>128</sup>

Minnesota had three microenterprise programs in SEID: Mid-Minnesota Business Concepts in Brainerd, the Northeast Entrepreneur Fund in Virginia, and Women Venture in St. Paul. Women Venture, formed from the merger of two organizations that helped women in their business and career development, focused mainly on training and technical assistance, although it also offered individual loans. Its clients were almost all women, about 30 percent were non-white, and about 20 percent were on welfare.<sup>129</sup>

In Mississippi, SEID worked with Meridian Community College and with Friends of Children of Mississippi in Canton. In Michigan, SEID worked with Highland Park Community College/Wayne State University in Detroit. In Maryland, the SEID partner was the Department of Economic and Employment Development in Baltimore.

## Appendix B: Microenterprise Programs in SELP

From 1991-1996, the Self-Employment Learning Project (SELP) studied the seven biggest and oldest microenterprise programs in the United States.<sup>130</sup> The diverse group pursued both development and empowerment missions and reported deep outreach to women, non-whites, and people on welfare.<sup>131</sup> Each microenterprise program had its own mix of training and loan technology, whether group, individual, or both. Private donors provided most of the funds used by the microenterprise programs and by the SELP study itself.

The nonprofit Good Faith Fund (GFF) of Pine Bluff, Arkansas started in 1988 as part of Southern Development Bancorporation, a rural-development bank-holding company created by the founders of South Shore Bank in Chicago with the involvement from then-Governor Bill Clinton.<sup>132</sup> GFF provided training and loans. As a rural clone of Grameen, GFF at first made just group loans, but, after a long process to adjust the Grameen model to the sparsely populated rural United States, GFF switched to only individual loans. About two-thirds of clients were women, 80 percent were non-white, and less than 10 percent were on welfare.

The Women's Self-Employment Project (WSEP) was founded in Chicago in 1986 as an urban clone of Grameen. With an empowerment mission and with only women clients, WSEP provided training and support services meant to develop skills and self-confidence.<sup>133</sup> Almost 90 percent of the clients were non-white, and about 40 percent

were on welfare. WSEP now offers both group and individual loans as well as savings services. WSEP and GFF are by far the two best-known microenterprise programs in the United States.

In Los Angeles, the Coalition for Women’s Economic Development pursued its empowerment mission through individual and group loans and through peer support meant to foster self-confidence. More than three-fourths of the clients were women, about 80 percent were non-white, and less than 10 percent were on welfare.

Founded in 1987 near the Mexican border of Arizona and California, the Portable Practical Education Program/Micro Industry Rural Credit Organization (PPEP/MICRO) delivered support services and loans through business associations of 20-30 experienced entrepreneurs. The mission was development; “PPEP/MICRO places great value on encouraging its entrepreneurs to expand their businesses and to create jobs for new employees.”<sup>134</sup> Of the seven microenterprise programs in SELP, PPEP/MICRO may have had the least-poor clients—about half were female, about 85 percent were non-white, and less than 10 percent were on welfare.

A legislative act led to the 1989 birth of the Rural Economic Development Center’s Microenterprise Loan Program (REDC) in North Carolina. REDC piggybacked group and individual loans on services from other community organizations. About half the clients were female, about 40 percent were non-white, and less than 10 percent were on welfare.



Appendix A describes the final two microenterprise programs in SELP—the Institute for Social and Economic Development (ISED) in Iowa, and Women Venture in Minnesota.

## Appendix C: An estimate of the cost-effectiveness of U.S. microenterprise programs

The average operating budget for 260 U.S. microenterprise programs in 1996 was about \$330,000.<sup>135</sup> Thus these microenterprise programs spent about  $\$330,000 \cdot 260 \doteq \$86,000,000$ . The “average capital loan fund” was about \$880,000. I assume that these funds were free and that the microenterprise programs used no other funds. Given zero inflation and a social opportunity cost of 10 percent per year, the opportunity cost of these funds in 1996 was about  $\$880,000 \cdot 260 \cdot 0.10 \doteq \$23,000,000$ .<sup>136</sup> With 53,000 users, the cost per user was thus  $(\$86,000,000 + \$23,000,000) / (53,000 \text{ users}) \doteq \$2,000/\text{user}$ .

Is a cost-per-user of \$2,000 high or low? The answer requires discussion and reasoned judgement. Cost-effectiveness analysis informs that judgement, but it cannot do the real work—too much depends on the alternatives to reach the same goals. For example, we do not know the cost of each of the various ways to improve the welfare of the poor. Even if we knew all the costs, outputs differ for each alternative. In practice, we make judgements between non-comparable outputs with incomplete knowledge of costs each time that we entrust scarce resources to a microenterprise program or to any other social program. Cost-effectiveness analysis aims to make the assumptions that back these inevitable judgements more explicit.

The measure of cost here is a lower bound on the total social cost of support for microenterprise programs in the United States. Severens and Kays omit some

microenterprise programs, although they probably include the biggest and most important ones.<sup>137</sup> In addition, given the risk of microenterprise programs, the assumed social opportunity cost is probably too low. All figures are rounded—unrounded cost-per-user is \$2,069.41. The self-reported data may also omit some funds—microenterprise programs surveyed abroad often fail to report all of the subsidized funds that they receive.<sup>138</sup> Finally, Severens and Kays do not define “users,” so the term may encompass far more than the output of microenterprise programs that society cares about.<sup>139</sup>

## Appendix D: RISE, WISE, and Working Capital

This appendix describes three microenterprise programs in table 3 that were not in SEID nor in SELP. The three-year Rivercities of Iowa/Illinois Self-Employment Project (RISE) was run by ISED (see appendix A) and sponsored by state governments.<sup>140</sup> The mission mixed empowerment with development as RISE aimed to help single women on welfare to expand their home-based firms. As in ISED, RISE provided training and assistance with a business plan along with liaison services with sources of finance.

The Women's Initiative for Self-Employment (WISE) served low- and moderate-income women in San Francisco and Oakland.<sup>141</sup> Its empowerment mission was reflected in the 12 weeks of classes required before a client could apply for an individual loan and in that most clients did not already run a business.

Based in Boston, Working Capital piggybacked its loan program on existing groups in community organizations in several places in urban and rural New England.<sup>142</sup> In pursuit of its development mission, Working Capital devolved most responsibility to the group. After a small amount of training, the group made all decisions, including whom to lend to and what new members to admit. The freedom of the group and the belief in their ability and responsibility was meant to have empowerment effects at the community level.

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**Table 1: Effects of UISED on the movement from unemployment to self-employment**

Quantity	Formula	Washington		Massachusetts	
A. Proportion of invited who attended first meeting	Data	0.075		0.042	
B. Prop. at first meeting who applied and qualified	Data	0.469		0.460	
		Treatment	Control	Treatment	Control
C. Prop. of qualified who started a firm in 31-33 months	Data	0.63	0.41	0.58	0.47
D. Prop. of invited who started a firm in 31-33 months	A·B·C	0.0222	0.0144	0.0112	0.0091
E. Change in relative rate of movement to self-employment	(D Trt.-D Ctrl.)/D Ctrl.	0.54		0.23	
F. Absolute change in prop. who move to self-employment	D Treatment-D Control	0.0078		0.0021	
G. Change in absolute number who move per 1,000 invited	1000·F	8		2	

Source: Computed by the author from data in Benus and colleagues, 1995.

**Table 2: Distribution of wages per hour for clients of SELP whose microenterprise is their primary source of earnings**

<b>Wage per hour</b>	<b>% in range</b>	<b>% in or below</b>
\$3.00 or less	28	28
\$3.01 to \$4.99	13	41
\$5.00 to \$6.99	17	58
\$7.00 to \$8.99	9	67
\$9.00 or more	33	100

Source: Clark and Huston, 1993. Wage rates are in 1991 dollars.

**Table 3: Education and demographics for the average person on welfare, the average American, and average users of microenterprise programs**

Trait	AFDC	U.S.	SEID	RISE	SELP	WISE	WCB
<b>Education</b>							
College degree	2	28	24		18	41	
Attended college	24	45	50		57	60	71
High-school diploma	57	75	88	87	82	97	95
<b>Demographics</b>							
Single heads	76	17	68	59			
Female	88	51	85	58	75		
Minority	63	27	54	28	66		

All figures are percentages. Blank cells are missing data. AFDC figures are unweighted frequencies from the 1996 Wave 1 Public Use Tape of the Survey of Income and Program Participation ([ferret.bls.census.gov](http://ferret.bls.census.gov)). U.S. population figures are from United States Bureau of the Census, [Statistical Abstract of the United States, 117<sup>th</sup> edition](#) (Washington, D.C., 1997). SEID is described in the text and in appendix A. SELP is described in the text and in appendix B. RISE (Rivercities of Iowa/Illinois Self-Employment Program), WISE (Women’s Initiative for Self Employment) in San Francisco, and WCB (Working Capital in Boston) are described in appendix D.

**Table 4: Distribution of net worth for a sample of users of microenterprise programs in SELP**

<b>Net worth</b>	<b>% in range</b>	<b>% in range or less</b>
Less than 0	21	21
0	10	31
1 to \$4,999	20	51
\$5,000 to \$9,999	7	58
\$10,000 or more	42	100

Source: Clark and Huston, 1993. Net worth is in 1991 dollars.