Response to Referee 1

1. The referee states that we claim that nonconvexities are inconsistent with the evidence. First, this isn't our claim. That's the claim in the existing empirical literature. Second, the example the referee provides of a paper that does find "an S-shaped curve in the response to an asset transfer" indicates that the referee failed to understand our paper and was confused between assumptions and outcomes. We do not claim that the outcome of an S-shape curve is inconsistent with the evidence, we claim that assuming an S-shaped production function is inconsistent with the evidence. We obtain S-shaped dynamics without relying on non-convexities.

   The referee also mentions a paper that indicates some poor households behave as if they are risk-loving in some specific circumstances. This is a petty argument against our paper, as the large consensus, based on a lot of evidence, is that the poor are by and large very risk-averse. We discuss the evidence in the paper.

   The referee also mentions that the evidence is consistent with microfinance facilitating exit from a poverty trap for existing entrepreneurs. That is correct and fully consistent with our paper! Our model predicts corner solutions - the poor who are very risk-averse choose zero investment and the wealthier individuals choose to borrow and invest as they are less risk-averse.

   The referee also claims that in some cases investments are lumpy. However, this indicates the failure of the referee to understand the claim in the existing empirical literature. We do not claim that there are no businesses that require significant fixed costs. The claim is that the existence of business opportunities that do not require significant fixed costs is sufficient to conclude that the evidence is inconsistent with technology-based poverty traps.

2. The referee feels that the setting of the experiment isn't tied to the setting of microcredit. This is true, but the experiment is just designed to test if human beings in the real world behave as the model predicts. The model isn't specific to microfinance, it is applied to explain the failure of microfinance. The claim that Czech households are better off than a typical microfinance borrower is true, but if individuals who are better off are sufficiently risk-averse to make choices consistent with our model then that seems to strongly indicate that poorer households who are more risk-averse would choose the corner of no investment.

3. This comment of the referee is correct, but the referee only suggest some discussion.

4. Yes, this prediction holds.

Summary – there is nothing in this report to justify rejection.