Risk and Return in Village Economies

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This paper provides a theory-based empirical framework for understanding the risk and return on productive capital assets and their allocation across activities in an economy characterized by idiosyncratic and aggregate risk and thin formal markets for real and financial assets. We apply our framework to households running business enterprises in Thai villages with extensive networks, taking advantage of panel data: income, assets, consumption, gifts, and loans. We decompose risk and estimate the risk premia faced by households, distinguishing aggregate risk from idiosyncratic, potentially diversifiable risk. This distinction matters for estimating measures of underlying productivity and has important policy implications.

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This paper provides a theoretical framework for understanding the allocation, risk, and return on productive real capital assets across activities and sectors in an economy characterized by idiosyncratic and aggregate risk and thin formal markets for real and financial assets. We apply our framework to households running farm