The Village Money Market Revealed: Credit Chains and Shadow Banking*

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Abstract

This paper takes advantage of unique, high-frequency panel data to document the existence of active, high volume and relatively sophisticated money markets in villages in Thailand, especially among households in villages in relatively poor regions. Formal and informal transactions are shown to be intimately linked, e.g, households borrow informally, often at high interest, to pay off formal sector loans and borrow to relend. As with traditional markets, loan repayment can be deferred through standard restructuring. But there are also more complicated credit refinancing chains involving multiple parties and short/medium maturities. Intensive but creative matching algorithms are utilized on the Townsend Thai survey data to identify loans, transaction partners, and multiple links in the credit refinancing chain. From risk sharing regressions, we find that borrowers, surprisingly, have higher MPC income coefficients than non-borrowers, seemingly smoothing less well. However, this is not because financial access is detrimental, but rather due to the self-selection into debt of more risk-tolerant individuals, who bear fluctuations without great utility loss. Yet, those engaged in credit refinancing chains have the smoothest consumption of all against income shocks, as risk tolerance is dominated by low transaction and verification costs.

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