

Risk-taking over the Life Cycle: Aggregate and Distributive Implications of Entrepreneurial Risk*

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January 2021

Abstract

We study the risk-taking behavior of entrepreneurs over the life cycle in the presence of limited idiosyncratic insurance. The model quantitatively accounts for the levels of aggregate and idiosyncratic risk premium, the patterns of inequality, and the life-cycle profiles observed in the data. A reform that relaxes the risk constraints leads to a reduction in the idiosyncratic risk premium and an investment boom. Consistent with a Kuznets curve, inequality increases in the short-run and declines in the long-run. The initial generation of entrepreneurs benefits from better insurance, but future generations of entrepreneurs are worse-off after the reform.

*We would like to thank Antonio Antunes, Francisco Buera, Pedro Brinca (discussant), Sylvain Catherine (discussant), David Lagakos, Juan Passadore, and seminar participants at Barcelona GSE Summer Forum, Econometric Society Meeting, FGV-EPGE, LACEA-LAMES, Lubramacro, SED, UFABC, WFA, and Yale for their helpful comments and suggestions.

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