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Heterogeneity and Risk Sharing in Village Economies*

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ABSTRACT

We show how to use panel data on household consumption to directly estimate households' risk preferences. Specifically, we measure heterogeneity in risk aversion among households in Thai villages using a full risk-sharing model, which we then test allowing for this heterogeneity. There is substantial, statistically significant heterogeneity in estimated risk preferences. Full insurance cannot be rejected. As the risk sharing, as-if-complete-markets theory might predict, estimated risk preferences are unrelated to wealth or other characteristics. The heterogeneity matters for policy: Although the average household would benefit from eliminating village-level risk, less-risk-averse households who are paid to absorb that risk would be worse off by several percent of household consumption.

Keywords: Risk preferences; Heterogeneity; Complete markets; Insurance

JEL classification: D12, D14, D53, D81, D91, G11, O16

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