Risk and Return in Village Economies

Krislert Samphantharak and Robert M. Townsend*

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Abstract 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.

Keywords: Rate of Return, Aggregate Risk, Idiosyncratic Risk, Household Enterprise, Risk Sharing, Kinship Networks, Village Economy, Asset Pricing, CAPM, Risk Premium, Risk-Adjusted Return, Productivity

JEL Classification: D12, D13, G11, L23, L26, O12, O16, O17

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* Samphantharak: School of Global Policy and Strategy, University of California, San Diego, 9500 Gilman Drive #0519, La Jolla, CA 92093. Email krislert@ucsd.edu. Townsend: Department of Economics, Massachusetts Institute of Technology, 50 Ames Street, E17-230 Cambridge, Massachusetts 02142. Email: rtownsen@mit.edu. We would like to thank Giacomo De Giorgi, Lars Hansen, John Heaton, Ethan Ligon, Juhani Linnainmaa, Albert Park, Michael Peters, Scott Rozelle, Yasuyuki Sawada, Christopher Udry, seminar participants at various conferences and workshops, and anonymous reviewers. Research support from the Eunice Kennedy Shriver National Institute of Child Health and Human Development (NICHD) (grant number R01 HD027638), the research initiative 'Private Enterprise Development in Low-Income Countries' [(PEDL), a programme funded jointly by the Centre for Economic Policy Research (CEPR) and the Department for International Development (DFID), contract reference MRG002_1255], the John Templeton Foundation (grant number 12470), the Consortium on Financial Systems and Poverty at the University of Chicago (funded by Bill & Melinda Gates Foundation under grant number 51935), the Thailand Research Fund (TRF), and the Bank of Thailand are gratefully acknowledged. The views expressed are not necessarily those of CEPR or DFID.