Distinguishing Limited Liability from Moral Hazard in a Model of Entrepreneurship

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We present and estimate a model in which the choice between entrepreneur and wage work may be influenced by financial market imperfections. The model allows for limited liability, moral hazard, and a combination of both constraints. The paper uses structural techniques to estimate the model and identify the source of financial market imperfections using data from rural and semiurban households in Thailand. Structural, nonparametric, and reduced-form estimates provide independent evidence that the dominant source of credit market imperfections is moral hazard. We reject the hypothesis that limited liability alone can explain the data.

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