

The Impact of Regional Isolationism: Disentangling Real and Financial Factors

Archawa Paweenawat

Robert M. Townsend¹

April 22, 2019

Abstract

Recently, there is a pressure for isolation policies both within the United States and among the EU members. The pressure arises due not only to the difference between regions in the U.S. and/or countries in the EU, but also to the difference across their population which affect the gains and losses from economic integration, both real as from trade in a common market and financial as in a monetary financial union. To get a better understanding of this pressure, one would need a model of trade and capital flows that takes into account the difference between individuals in a region and differences across regions. There is also a need for detail data at the individual and aggregated level, which often are not available. In this paper, we use unique long-panel data of households in Thailand, and from these data, we construct the household financial accounts, the village economic accounts, and the village balance of payments account. We also provide stylized facts on factor prices, factor intensities, financial obstacles, and village openness document differences across regions. Finally at the national level it is clear there is co-mingled variation in trade via devaluations and in finance via policies toward off shore bank and within-country financial infrastructure.

We develop a heterogeneous-agent/occupational-choices/trade model with financial frictions carefully built up and calibrated around micro and regional facts, that is, at both the individual level and the aggregate level. Then, we conduct two counterfactual policy experiments. In the first counterfactual experiment, we distinguish the effects of trade from the effects of capital flows. More specifically, we determine what would happen if we allow the prices of goods to change as in baseline scenario while keep borrowing limits and interest rates constant, and vice versa. In the second counterfactual experiment, we determine the effect of isolation policies that impede trade and/or capital flows across regions. We find through these counterfactual experiments that both real and financial factors are at play, that there are differences across regions in impact even when (policy) movements in variables such as interest rates and relative prices, which are exogenous to the regions, are common; impacts can be large, and vary with policy; and impacts are significant heterogeneous with both gains and losses and non-monotone movement across wealth classes and occupations, even allowing for occupation shifts which a priori might have mitigated impact.

¹ Paweenawat, Puey Ungphakorn Institute for Economic Research. Townsend, Massachusetts Institute of Technology. Paweenawat gratefully acknowledges financial support from Thailand Research Fund. Townsend gratefully acknowledges financial support from the Eunice Kennedy Shriver National Institute of Child Health and Human Development (NICHD) under grant R01 HD027638 and the Bill & Melinda Gates Foundation through the Chicago Consortium on Financial Systems and Poverty. The opinions expressed in this paper are those of the authors and should not be attributed to the Puey Ungphakorn Institute for Economic Research or the Bank of Thailand.