

Villages as Small Open Economies: Disentangling Real and Financial Factors*

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We disentangle the impact of real factors (movement in sectoral relative prices) and financial factors (lower interest rates, more liberal credit/asset ratios) on households running farm/business projects or providing wage labor in diverse, small village economies that are open to trade and capital flows. To do so we proceed in steps: create the village economic SNA and balance of payments accounts from detailed balance sheets and income statements available from a comprehensive, integrated survey; generate stylized facts on factor prices, factor intensities, financial obstacles, and openness; construct a two-sector occupation choice/trade/financially-constrained open economy model around these facts; estimate/calibrate key parameters and initial conditions of the model in diverse regions; simulate and judge model performance against the data; and run some counterfactual exercises, namely, freezing real or financial factors at their initial values and comparing to the baseline simulations, or more radically, making the economies closed with respect to trade, to capital flows, or to both. We find through these counterfactual model-based exercises that the impact of real and financial factors can be heterogeneous and large, generating both gains and losses and non-monotone impact across wealth classes and occupations (even allowing for occupation shifts).

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