

*Preliminary.*

**Assessing the Benefits of Long-Run Weather Forecasting for the Rural Poor: Farmer Investments and  
Worker Migration in a Dynamic Equilibrium Model**

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The majority of the world's poor reside in rural areas. A key feature of rural populations in low-income countries, most of whom are engaged in small-scale agriculture, is that population density is low even in densely-populated countries. A major consequence is that service delivery to the poor is expensive, especially for services that require monitoring. One of the major issues facing the rural poor is variability in incomes due in large part to fluctuations in rainfall (Rosenzweig and Udry, forthcoming). While research has shown that index-based insurance contracts (Karlan *et al.*, 2016) effectively mitigate the consequences of riskiness, improve farm profitability, and can reduce income risk for the landless (Mobarak and Rosenzweig, 2014), loading costs associated with payment disbursement and weather station construction and maintenance given the number of small farms render such contracts, if priced to incorporate such costs, out of reach for most rural inhabitants.

Technology gives hope, however, that the costs of service or information delivery can be reduced or bypassed relatively cheaply. A key example of exploiting new technology to overcome administrative costs is cell phone technology. Once a network is established, the marginal cost of information delivery is close to zero – the network is like a public good. Jensen (2007), for example, has demonstrated that the delivery of pricing information via cell phones substantially improved market efficiency in the fisheries sector and Suri and Jack (2016) show that the availability of cell-phone based monetary transaction apps enabled households to better cope *ex post* with income variability and facilitated savings.

An alternative means of mitigating the consequences of weather fluctuations in the absence of markets for unsubsidized insurance contracts is to harness technology to directly reduce weather risk. Long-term weather forecasting is an example of a technology-intensive public good that has minimal delivery costs and can mitigate the principle source of income risk for the poor.<sup>1</sup> Like actuarially fair insurance, a perfectly accurate forecast of this year's weather pattern, provided before a farmer makes his or her production decisions for the season, eliminates weather risk. However, a perfect forecast also permits the farmer to make optimal production choices conditional on the realized weather and thus achieve higher profits on average compared with even a perfectly-insured farmer. Similarly, the rural landless can make better choices about migration if informed about future rainfall. Most importantly, a forecast is information that can be delivered via cell phone networks or by broadcast. The returns to enhancing individual-farmer risk reduction by improving the accuracy of inter-annual weather forecasts are thus potentially high, given the small costs of delivery compared with those associated with traditional contractual services (credit, insurance), however well-designed to facilitate coping with the consequences of rainfall realizations.

Long-term rainfall forecast skill has benefitted from recent advances in technology, from improved computational power, from better models that exploit the El Nino southern oscillations (ENSO), and from increases in observational capacity for the key elements feeding weather models – snow cover, polar ice caps (cryosphere), and sea surface temperature (SST) anomalies - via increases in the number and sophistication of satellites and buoys (e.g., Stockdale *et al.*, 2010; Balmaseda *et al.*, 2009). And it is expected that forecast skill will continue to improve in the foreseeable future (National Research Council, Division on Earth and Life Studies, Board on Atmospheric Sciences and Climate,

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<sup>1</sup> Additionally, agricultural scientists have exploited advances in molecular genetics to improve the *ex ante* options available to farmers faced with uninsured weather risk, most prominently by developing drought-tolerant varieties of important crops. These advances benefit all farmers and do not entail extra delivery expenses.

Committee on Assessment of Intra-seasonal to Inter-annual Climate Prediction and Predictability, 2010). Governments are aware of and responding to this opportunity. In India the national Monsoon Mission was launched in 2012 with a budget of \$48 million for five years to support research on improving forecast skill, with a special focus on seasonal weather forecasting.<sup>2</sup> There is nothing new about this; in India the India Meteorological Department (IMD) has been issuing annual forecasts of the monsoon across the subcontinent since 1895, and it is widely reported in the Indian media that farmers' livelihoods depend upon the accuracy of the forecast.<sup>3</sup>

While, as we discuss below, the accuracy of the IMD monsoon forecast is on average marginal, the forecasts are evidently taken very seriously among all sectors of the Indian economy. The NIFTY 50 index is the National Stock Exchange of India's index for the Indian equity market. None of the sectors represented in the index is directly affected by rainfall, as neither farms nor agricultural processing enterprises are included, and only eight percent of the stocks are in the consumer sector. Nevertheless, the index responds significantly to the announcements by the IMD of monsoon rainfall, both the preliminary announcement in April and the final prediction at the end of June. Figure 1 displays the average percent fall in the index the day after the announcement by the IMD of a pessimistic forecast and the average percent rise when the forecast was optimistic for the ten forecasts issued over the period 2013-2017 relative to two major consequential events that also occurred during that time – the UK BREXIT vote and the demonetization of the Indian rupee. While these latter events had major impacts on the equity market, the response to the IMD forecasts was also significant – the index rising 0.8 percent when the forecast was positive and falling 0.6 percent when negative, the 1.4 percent difference (64 percent of the BREXIT decline) being statistically significant at the 0.02 level ( $t=2.87$ ).

Although Figure 1 suggests the importance of both weather outcomes and the existence of direct forecast effects on the overall economy in India, there is as of yet no rigorous assessments of the impact of long-term weather forecasts and improvements in weather forecast skill on the rural poor. In this paper, we use information on the IMD forecasts and rainfall to quantify the effects of the forecasts and forecast skill on the incomes of the rural population using a variety of panel data sets describing farmer and worker behavior. To do that, we need an equilibrium model, as the forecast simultaneously affects all agents in the economy. We also need to recognize the sequential nature of agricultural production and that temporary migration is a major factor in determining the supply of workers. We thus set out a parsimonious dynamic equilibrium model of the local rural economy. The model incorporates a number of realistic features of an agricultural setting. First, the model recognizes the necessity of making (*ex ante*) agricultural investments prior to the resolution of uncertainty (rainfall realizations). Second, the model incorporates two types of *ex ante* investments decisions by farmers that can be influenced by the forecasts: the level of inputs (labor) to employ; and the choice of production technology, characterized by the sensitivity of output to rainfall (riskiness). Third, the model

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<sup>2</sup> The annual budget for the US National Oceanic and Atmospheric Administration, which is responsible for forecasting research (among other responsibilities) in the US, was approximately \$5 billion in 2010.

<sup>3</sup> For example, "Laxman Vishwanath Wadale, a 40-year-old farmer from Maharashtra's Jalna district, spent nearly 25,000 on fertilisers and seeds for his 60-acre plot after the Indian Meteorological Department (IMD) said in June that it stands by its earlier prediction of normal monsoon. Today, like lakhs of farmers, Wadale helplessly stares at parched fields and is furious with the weather office that got it wrong — once again. So far, rainfall has been 22% below normal if you include the torrential rains in the northeast while Punjab and Haryana are being baked in one of the driest summers ever with rainfall 42% below normal" (Ghosal and Kokata 2012).

includes two migration (labor supply) decisions by landless workers, who can choose to migrate *ex ante* out of their home village in response to the forecast but prior to the realization of rainfall and/or *ex post* in response to the realization of weather. An important property of the model is that initial-period investment and migration decisions affect outcomes (farm profits, wages) in later periods because of the dynamic elements of the model and thus incomes (wages) vary within a season due to the interactions of aggregate demand and supply.

There are three novel features of the model. First, the model incorporates both migration (labor supply) and production (labor demand) decisions. Prior studies of rural temporary migration that examine the impacts of interventions that raise the returns to migration have not examined how such interventions affect local farmers' (employer's) decisions. Typically, even in structural models of migration (Morten, 2019; Meghir *et al.*, 2017), the parameters of the income process, while allowed to change due to the specific counter-factual intervention considered, are not the products of optimizing behavior and thus are not invariant to alternative policies. A second novel feature of the model is that it examines both *ex ante* and *ex post* migration and their dynamic interactions. Studies of temporary migration have looked at only one type of migration at a time – either off-season migration, when demand is predictably low, (e.g., Bryan *et al.*, 2014) or *ex post* migration within a growing season that responds to realized weather shocks (Morten, 2019). In our model, within the growing season there is both *ex ante* (anticipatory) and *ex post* migration.

As far as we know, there are no studies of temporary migration in the early stages of the growing season in India. Yet, such anticipatory migration appears to be important and to vary across years. Figure 2 reports the fraction of male rural workers age 19-49 employed in urban areas by month from the 18 villages in the International Crop Research Institute of the Semi-Arid Tropics (ICRISAT) village survey over the period 2010-2014. As can be seen, migration rates sharply increase at the start of the *kharif* growing season, which begins in July and ends in late Fall, and immediately after the final IMD monsoon forecast, with six percent of men migrating out. As seen in Figure 3, monthly data on rural workers away from home, by duration, from the National Social Surveys (NSS) for the same demographic group show a similar pattern across all of India, with out-migration peaking in July, at 10 percent for those away at least one day. Finally, the ICRISAT data, as displayed in Figure 4, also show that the July rates of migration varied substantially across years, peaking at over 11 percent in 2010 and reaching a low of three percent in the middle of the survey period. This intertemporal variation in out-migration could be due to variation in the forecast, which we will test more rigorously.

We believe the dynamic equilibrium model is useful for examining the impact in rural areas of any large-scale program or policy. Besides considering the consequences of forecasts, we also use the model to assess how investments, profits, the two types of migration, and equilibrium wages are affected by variation in the statutory minimum wages associated with the National Rural Employment Guarantee Act (NREGA) of 2005 and, importantly, how changes in minimum wages interact with the forecasts in affecting outcomes. We examine the effects of the minimum wages because over the period in which we look at the forecast effects there was substantial intertemporal variation in nominal statutory minimum wages, with such (nominal) wages changing as much as seven times over the period 2005-2012 in some states, and such variation, as we show, can affect the impacts of forecasts.<sup>4</sup> While

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<sup>4</sup> Variation in the forecasts and in rainfall amounts and their timing are orthogonal to agents' behavior and characteristics, net of fixed effects, so that empirically they allow us to assess the model predictions and evaluate

recent work evaluating NREGA on equilibrium wages has shown that NREGA statutory wage effects depend on rainfall realizations (Santangelo, 2019), no evaluations of NREGA on equilibrium wages (e.g., Berg *et al.*, 2013; Imbert and Papp, 2015) examine both the effects of the IMD forecasts and of rainfall on program wage effects during the period and in the areas studied. Our framework and empirical findings call into question the external validity of these estimates, as we show that the equilibrium wage effects of NREGA statutory minimum wages differ significantly across stages of agricultural production, by the IMD forecast as well as by rainfall.

In section 2 we set out the model. The model delivers predictions for how forecasts affect planting-stage farmer investments and technology choice and the planting-stage migration decisions of workers, and how forecasts and rainfall and their interactions affect farm profits, migration and equilibrium wages in the harvest stage. We also show that increases in the minimum wage blunt the effects of forecasts on both farm decisions and on migration. As a consequence, while increases in minimum wages can never lower the welfare of workers, we show that they can reduce equilibrium wages in the planting stage or in the harvest period (but not both in the same season) when forecasts are pessimistic. In section 3, we begin the empirical work by assessing the skill of the IMD forecasts over the period 1999-2011 using ground-based information on growing-season monthly rainfall at the village level from the ICRISAT survey and from a national survey. We find that overall the forecasts have little skill, but we identify contiguous areas of India in which forecast skill is significant. We explore how skill is related to a variety of agro-climatic attributes, showing that such attributes predict which areas have skill, but not skill variation within the areas with skill.

In section 4, we use ICRISAT panel data and panel data from the national Rural Economic Development Survey (REDS) and the Additional Rural Income Survey (ARIS) to estimate the effects of the forecasts and forecast skill on planting-stage investments and on the planting of risky high-yielding variety crops at the onset of the Indian green revolution. We find that, consistent with the model, a forecast of poor weather lowers planting-stage investments and lowers risk-taking, and the more so the higher the skill level of forecasts in the area. For example, we find using the ICRISAT panel data that a pessimistic forecast lowers planting-stage investments by 15.8 percent overall, but by over 18 percent in the villages located where forecasts have skill, compared with only 4.4 percent in the villages where forecasts have little skill.

We next quantify the gains to farmers in terms of profitability from receiving accurate forecasts. We find that over the period 2009-2014 in the ICRISAT villages benefiting from skilled forecasts if in a bad monsoon rainfall is lower by one-half a standard deviation and in a good monsoon it is higher by one-half a standard deviation profits are increased by 11.5 percent when forecasts are correct. Of course, if the forecasts are incorrect, this is the loss. The net gain from the availability of forecasts stems from the forecasts being correct more than half the time – thus, the greater the forecast skill the greater the gain, even ignoring that increases in forecast skill also amplify farmers' responses, which enhances the net gain.

In the next section we use both the ICRISAT and NSS data and find, again consistent with the model, that a pessimistic forecast increases outmigration in the planting period. In particular, we find

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their effects, with confidence in their internal validity. Variation in statutory minimum wages is less pristine, and empirical identification of their effects should be interpreted with more caution.

using the ICRISAT panel of agricultural workers that a pessimistic forecast increases out-migration by 2.4 percentage points, a 37 percent increase at the sample mean out-migration rate. As implied by the model, the forecast effect on out-migration is also reduced significantly where real statutory minimum wages are higher – when the forecast is pessimistic, a one-standard deviation increase in the minimum wage lowers the positive effect of the forecast on out-migration by 64 percent. While the net effect of a pessimistic forecast on equilibrium planting-stage wages, given its negative effect on worker demand and risk-taking, is theoretically ambiguous, we find that on net a forecast of lower rainfall increases wages in the planting stage, suggesting the out-migration effect dominates. Consistent with the model, however, we also find from both data sets that an increase in the minimum wage when the forecast is pessimistic lowers the equilibrium wage - a one-standard deviation in the real minimum wage decreases the planting-stage equilibrium wage by almost 3.7 percent when the forecast suggests a low-rainfall kharif season.

In section 8, we estimate how the monsoon forecast, rainfall and minimum wages affect harvest-stage migration and harvest-stage equilibrium wages using the ICRISAT panel and its village-level rainfall information. In alignment with the model, we find that out-migration at the harvest stage is lower when rainfall and the minimum wage are higher, but out-migration is higher when the planting-stage forecast was pessimistic. We also find that higher rainfall and a forecast of a poor monsoon raise harvest wages as do higher minimum wages on average. The interactions between rainfall, the forecasts and minimum wages are also significant, however. In accordance with the model, real harvest-stage wages rise less with rainfall in areas where minimum wages are higher and if there was a pessimistic forecast. And the positive effect of a rise in the minimum wage on equilibrium harvest wages is less when the forecast predicted a bad monsoon, with again a higher minimum wage actually lowering the equilibrium harvest wage in a state of the world in which the forecast was pessimistic and incorrect. Section 9 contains our conclusion.

## 2. The Model

Seasonality and risk shape the economic lives of the rural population of India, both landed and landless. We provide a simple model to shape our analysis of decision-making by landowning farmers and landless workers and their interactions in rural labor markets over the course of the agricultural cycle as information about the likelihood of future shocks is revealed and shocks themselves are realized. The decisions at the heart of the model are the magnitudes and riskiness of the planting season investments made by farmers, and the seasonal migration choices of the landless.

a. Environment. We model a single farming season, during which there are two periods, which we call *stages*: planting (1) and harvesting (2). In the empirical work we will allow for the reality that the resources available to a farmer at the start of stage 1 reflect prior decisions, forecasts and realization of shocks, but the model abstracts from these considerations in order to focus on the intra-season allocation across stages and states of nature.

Before stage 1, a forecast  $F \in \{B, G\}$  of the harvest stage state is announced. The harvest stage realized state is  $s \in \{b, g\}$ . Let  $q = \text{prob}(s = b|F = B) = \text{prob}(s = g|F = G)$  be the forecast skill. This simplifying assumption implies that forecast error probabilities are symmetric, but has little consequence in the analysis of the model. Consumption occurs in both the planting and harvest stage, so there are six stages/realized states to consider. Consumption in stage one, which may depend upon the forecast  $F$  is denoted by  $c_{1G}$  and  $c_{1B}$ . Consumption in stage two, which may depend upon both the

forecast  $F$  and the realized state in the harvest stage,  $s$ , is  $c_{sF}$  (so, for example, consumption in the good state of the harvest stage in a season that had been forecast to be bad is  $c_{gB}$ ). We abstract from labor/leisure choices and assume that each individual inelastically supplies one unit of labor in each stage. All agents have constant relative risk aversion preferences:

$$\frac{1}{1-\gamma} [c_{1F}^{1-\gamma} + \text{prob}(S = b|F)c_{bF}^{1-\gamma} + \text{prob}(S = g|F)c_{gF}^{1-\gamma}] \quad (1)$$

**b. Cultivators.** There is a mass 1 of landed cultivators each with a fixed land endowment. Each cultivator works full time on his own plot. Farm output is generated by the cultivator combining his own land and labor with some amount of hired labor ( $x_{1F}$ ) used during the planting stage of the season and hired labor ( $x_{gF}, x_{bF}$ ) used in the good or bad state realized during the harvest stage of the season. The cultivators also choose the riskiness of the portfolio of crops that they plant ( $R_F \in [0,1]$ ). After forecast  $F$ , farm output in state  $s$  of the harvest stage is  $Q_{bF}$ .

$$Q_{bF} = \min(x_{1F}^\beta(1 - R_F), x_{bF})$$

$$Q_{gF} = \min\left(\theta x_{1F}^\beta(1 + R_F), \frac{x_{gF}}{\rho}\right) \quad (2)$$

This is a conventional Cobb Douglas production function with diminishing returns to labor in the planting stage, except that the choice of  $R$  affects gap between output in the good and bad states  $\theta > 1$  represents the additional output that is received in the good state when a farmer takes on additional risk.

Harvest stage production is Leontief in labor use:  $x_{sF} = Q_{sF}$ . We choose units to make the Leontief coefficient equal to unity to reduce notation proliferation. We assume that farmers have no access to insurance, nor to financial savings or borrowing. Therefore, farmers shift resources across stages and states of nature through their decisions regarding the extent and riskiness of their cultivation activities. A farmer wishing to consume more in the planting stage reduces the amount of planting stage labor; a farmer wishing to consume more in the bad state of the harvest stage reduces planting season labor expenditure and reduces the riskiness of the mix of his farming activities.<sup>5</sup> In the absence of a safe asset or credit market, the choice of planting stage labor is the primary tool for moving resources across stages, while the choice of the riskiness of the technology is the first order tool for calibrating risk across harvest stage states of nature. But the absence of complete asset markets implies that these two decisions cannot be separated.

The budget constraints of a farmer after forecast  $F$  in stage 1 and in state  $s$  of stage 2 are:

$$\begin{aligned} c_{1F} &= Y_C - w_{1F}x_{1F} \\ c_{sF} &= Q_{sF}(1 - w_{sF}) \end{aligned} \quad (3)$$

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<sup>5</sup> In this simple model with two states of nature, and only two periods, access to a safe asset would permit each farmer to separate his decisions regarding cultivation and risk-bearing, choosing  $R_F$  to maximize returns and the investment in the safe asset versus cultivation to adjust the extent of risk borne. More generally, this separation property will fail to hold and  $R_F$  depend upon the extent of risk aversion whenever the financial assets available to the farmer fail to span the state space.

At the time the farmer chooses  $x_{1F}$  and  $R_F$ , the forecast is known, as is the planting stage wage ( $w_{1F}$ ). The farmer also knows the forecast skill ( $q$ ) and thus the probability that the good or bad state will be realized in the harvest stage. In addition, the farmer knows the harvest stage wage that will prevail if state  $s$  is realized in the harvest stage ( $w_{gF}, w_{bF}$ ), given the forecast.

Given a forecast ( $F$ ) and the vector of state- and forecast-specific wages  $w_F = (w_{1F}, w_{gF}, w_{bF})$ , a farmer chooses planting stage labor ( $x_{1F}$ ) and the level of risk ( $R_F$ ) to maximize (1) subject to (2) and (3).

**c. Landless workers.** Landless workers have the same preferences as farmers, but they are endowed only with labor. Their only choice in each stage is to work for a wage in the village, or to migrate to the city and work there. Simultaneous with the revelation of the forecast before the planting stage, each landless individual receives an urban wage offer for the planting stage ( $w_{1u}$ ). This offer is drawn from a common distribution  $\mathcal{F}_1(w)$ .<sup>6</sup> After this wage offer is revealed, the worker decides whether to migrate to the urban area or not. We denote the worker's decision to migrate or not in the planting stage after a forecast of  $F$  as  $m_F \in \{0,1\}$ . Similarly, before the harvest stage, simultaneously with the revelation of the realized state for the harvest stage in the village, each landless worker receives another urban wage offer for the harvest stage ( $w_{2u}$ ). After this wage offer is received, the worker again decides whether to work in the urban area (migrate) or to work in the village.

Therefore, the budget constraint of a landless worker is

$$\begin{aligned} c_{1F} &= I(m_F = 1)w_{1u} + (1 - I(m_F = 1))w_{1F} + Y_l \\ c_{sF} &= \max(w_{2u}, w_{sF}) \end{aligned} \quad (4)$$

The urban wage offers for the planting stage are drawn from a uniform distribution

$$w_{1u} \sim \mathcal{F}_1(w) = wf_1, \quad (5)$$

where  $f_1$  is a positive constant. The urban wage offers drawn for the harvest stage are drawn from (uniform) distributions that depend on the planting stage residence of the worker:

$$w_{2u} \sim I(m_F = 1)\mathcal{F}_2(w) + (1 - I(m_F = 1))\mathcal{F}_1(w). \quad (6)$$

We assume that a worker is more likely to attract a better urban wage offer if the worker is resident in the urban area. Therefore, we specify that  $\mathcal{F}_2 = wf_2$ ,  $f_2 < f_1$  so  $\mathcal{F}_2$  first order stochastically dominates  $\mathcal{F}_1$ . Workers maximize (1) subject to (4) – (6).

Planting stage migration is anticipatory migration. The worker's decision to migrate in the planting stage has a dynamic component, like the farmers' planting stage decisions, because the distribution from which the harvest stage wage offer is drawn differs depending upon the planting stage residence of the worker. If the worker has chosen to migrate to the city in the planting stage, he draws

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<sup>6</sup> We assume that the distribution of urban wage offers  $\mathcal{F}_1(w)$  (and later,  $\mathcal{F}_2(w)$ ) are independent of the forecast. This simplification permits us to focus on changes in rural wages without a full model of equilibrium in urban labor markets, thus abstracting from the possible indirect effects of rural weather forecasts and realizations on the urban labor market.

an urban harvest stage wage offer from the distribution  $\mathcal{F}_2(w)$ , while if the worker has chosen to remain in the village in the first-stage, his urban harvest stage wage offer is again drawn from  $\mathcal{F}_1(w)$ . Migration to the city during planting has an investment component in that it increases the expected value of the harvest stage urban wage offer. As was the case for the farmer, we assume that the landless worker has no access to financial markets.<sup>7</sup>

Harvest stage migration is *ex post* migration. The worker's decision to migrate in the harvest stage is taken after the state for the harvest stage is realized, and after the worker has received his or her draw from the relevant distribution of urban wages. The harvest stage decision, therefore, is simple: the worker chooses to live in the village if and only if the rural wage for the state realized in the harvest stage is at least as great as that worker's urban wage draw. Given planting stage migration decisions, labor supply in the harvest stage in state  $s$  after forecast  $F$  is

$$1 - M_{sF} = S_{sF} = S_{1F}w_{sF}f_1 + (1 - S_{1F})w_{sF}f_2, \quad (7)$$

where the first term is the supply from village landless workers who did not migrate during the planting stage and the second term is the supply from those village workers who did migrate to the city in the planting stage. Since  $f_1 > f_2$ , the greater the migration out from the village during the planting stage, the lower the village labor supply during any state of the harvest stage at any wage.

d. Equilibrium. An equilibrium is defined conditional on the forecast  $F$  by a vector of wages  $(w_{1F}, w_{gF}, w_{bF}) \equiv w_F$  such that

$$\begin{aligned} S_{1F}(w_F) &= x_{1F}(w_F) \\ S_1\mathcal{F}_1(w_{bF}) + (1 - S_1)\mathcal{F}_2(w_{bF}) &= x_b(x_{1F}(w_F)) \\ S_1\mathcal{F}_1(w_{gF}) + (1 - S_1)\mathcal{F}_2(w_{gF}) &= x_g(x_{1F}(w_F)) \end{aligned} \quad (8)$$

The first equation is the equilibrium condition for the planting season labor market and the second two equations describe equilibrium in the harvest season good and bad states of nature. In Appendix 1, we show how to construct the equilibrium  $w_F$ .

#### Testable Implications of Equilibrium Analysis

The model yields a set of testable implications, and another set that is testable depending on the degree of risk aversion. It also has testable implications regarding the effects of statutory wage floors on wages and migration. To understand these implications and why some of them depend upon the degree of risk aversion, it is useful to consider the three key decisions made in the planting season, after the forecast is revealed and landless individuals receive wage offers in the urban market. The decisions are the choices of cultivators regarding labor demand and the riskiness of their technology choice, and the decisions of the landless regarding migration.

Planting stage labor demand  $x_{1F}$  is determined by the trade-off of current consumption with the expected marginal utility of the consumption to be generated by expanding planting season expenditure

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<sup>7</sup> A fixed cost of migration would generate similar migration decisions. In both cases, the complementarity across stages in migration decisions implies that the planting stage migration decision depends on expectations of wages in the harvest stage.

on labor. The decision regarding the riskiness of a farmer's portfolio ( $R_F$ ) is separable from the planting stage labor demand decision. We show in appendix 1 that it is defined by

$$\min \left\{ 1, \left( \frac{\text{prob}(s = g|F)}{\text{prob}(s = b|F)} \right)^{\frac{1}{\gamma}} \left( \frac{\theta(1 - w_{gF})}{(1 - w_{bF})} \right)^{\frac{1}{\gamma} - 1} \right\} = \frac{1 + R_F}{1 - R_F}. \quad (9)$$

The worker's planting season migration decision has a reservation property such that he migrates if and only if his urban wage offer is greater than equal to the trigger value  $w_{mF}^*(w_F)$ , which depends upon the forecast and the rural wage vector. After forecast  $F$ , given a vector of wages  $w_F = (w_{1F}, w_{gF}, w_{bF})$ , aggregate planting stage labor supply to the village is

$$1 - M_{1F} = S_{1F} = w_{mF}^*(w_F) f_1. \quad (10)$$

We show in appendix 1 that (1) – (8) have the following four testable implications that do not depend on the risk preferences of the agents. First, regardless of the forecast, the concavity of the production function implies that an increase in the planting stage wage reduces the demand for labor ( $\frac{dx_{1F}}{dw_{1F}} < 0$ ). Second, regardless of the forecast, planting stage migration is decreasing in each element of the rural wage vector ( $\frac{dM_F}{dw_{1F}}, \frac{dM_F}{dw_{sF}} < 0$ ). Third, regardless of the forecast, harvest stage migration is less if the good weather state is realized than if the bad weather state is realized ( $M_{gF} < M_{bF}$ ). Fourth, regardless of the forecast, harvest stage wages are higher if the good weather state is realized than if the bad weather state is realized ( $w_{gF} > w_{bF}$ ).

e. Regimes of Risk Aversion and Testable Implications. The four implications would be true in a model with complete markets. However, in our model the neoclassical separation between production and consumption is absent. Some production and migration decisions, therefore, are sensitive to the degree of risk aversion ( $\gamma$ ) and a subset of comparative static results depend upon the value of  $\gamma$ . It is possible, therefore, to distinguish a regime in which the agents are very risk averse ( $\gamma > 1$ ) from one in which the agents are less risk-averse ( $0 < \gamma < 1$ ). Further testable implications follow once the degree of risk aversion can be categorized as belonging to one or the other regime.

We prove in Appendix 1 that if two conditions are met, then we can conclude that  $\gamma < 1$ . These conditions are first, that farm profits are higher in the good weather state of the harvest stage than in the bad weather state (after any forecast) and, second, that planting stage farm labor demand is greater after a forecast of good weather than after a forecast of bad weather ( $x_{1G} > x_{1B}$ ). That is

*Proposition 1: If  $\theta(1 + R_F)(1 - w_{gF}) > (1 - w_{bF})(1 - R_F)$  and  $x_{1G} > x_{1B}$ , then  $\gamma < 1$ .*

The result follows from the nonseparability between consumption and labor demand in the planting season. If farmer profits are higher in the good state than in the bad, then a forecast of good weather increases expected harvest stage income and of course the expected marginal product of labor. The farmer thus has a consumption-smoothing motive to increase consumption in the planting stage, but incomplete financial markets imply that reductions in planting stage investment are necessary to

increase planting stage consumption. If farmer investment in the planting stage increases upon the receipt of a good forecast, the consumption smoothing motive is not too strong, and  $\gamma < 1$ .

We verify (in Tables XX) that these 2 conditions are empirically satisfied and restrict further attention to the case of  $\gamma < 1$ .

We prove in the appendix the following six testable implications of the model when  $\gamma < 1$ . First, planting season migration must be less upon a forecast of good weather than upon a forecast of bad weather:

$$M_{1G} < M_{1B} \quad (11)$$

Second, the riskiness of the cultivation choices of the farmer is greater after a forecast of good weather.

$$R_G > R_B \quad (12)$$

Third, the greater planting stage investment and risk taken after a forecast of good weather implies that the difference in harvest between good and bad weather realizations after a forecast of good weather is greater than that difference after a forecast of bad weather. This implies that the difference in harvest season migration in bad and good weather outcomes after a forecast of good weather is greater than that after a forecast of bad weather:

$$M_{bG} - M_{gG} > M_{bB} - M_{gB} \quad (13)$$

Fourth, there is a greater difference between harvest season wages with good and bad weather realizations after a forecast of good weather than after a forecast of bad weather. This is a consequence of the lower planting stage migration, greater planting stage investments and riskier technology choice after a good forecast:

$$\left( \frac{1 - w_{gG}}{1 - w_{bG}} \right) < \left( \frac{1 - w_{gB}}{1 - w_{bB}} \right) \quad (14)$$

Fifth, the wage in the good state of the harvest stage after a forecast of good weather is greater than the wage in the good state of the harvest stage after a forecast of bad weather:

$$w_{gB} < w_{gG} \quad (15)$$

Sixth, all of these results are strengthened as forecast accuracy ( $q$ ) is improved.

**f. Binding Wage Floor.** The model can be used to assess the consequences of policies that affect local rural labor markets. We consider an employment guarantee scheme that provides a prespecified wage and guaranteed work. How does this influence the dynamic choices of cultivators and workers, and what are the implications for equilibrium wages? While such a program cannot reduce the welfare of workers, we will show that it can reduce their wages in some states of nature and even expected worker income. [In the latter case, the welfare of cultivators can increase with the guaranteed wage. Note the small open village assumption on product markets]

The employment guarantee implies that at the guaranteed wage there might be an excess supply of workers in the community. We assume all of these workers are employed by the institution

running the scheme in an activity that generates no output and that the wages are paid from taxpayers who are outside the modeled population. Equilibrium is now defined conditional on the guaranteed wage ( $w_m$ ) and on the forecast  $F$  by a vector of wages  $(w_{1F}, w_{gF}, w_{bF}) \equiv w_F$  such that  $w_F \geq w_m$  and

$$\begin{aligned} S_{1F}(w_F) &\geq x_{1F}(w_F) \text{ with equality if } w_{1F} > w_m \\ S_1\mathcal{F}_1(w_{bF}) + (1 - S_1)\mathcal{F}_2(w_{bF}) &\geq x_b(x_{1F}(w_F)) \text{ with equality if } w_{bF} > w_m \\ S_1\mathcal{F}_1(w_{gF}) + (1 - S_1)\mathcal{F}_2(w_{gF}) &\geq x_g(x_{1F}(w_F)) \text{ with equality if } w_{gF} > w_m \end{aligned} \quad (16)$$

In appendix 1 we show that regardless of the forecast, an increase in a binding wage floor in any stage/state of production reduces equilibrium wages in at least one other stage/state in which that floor does not bind.

*Proposition 2: Suppose that the equilibrium wage vector is  $(w_{1F}^*, w_{gF}^*, w_{bF}^*) \equiv w_F^*$  such that  $w_F^* \geq w_m$ , and  $w_F^* \neq w_m$ . Then if a small increase in the statutory minimum wage  $w_m$  changes the equilibrium wage vector, it must reduce the equilibrium wage in at least one state of one stage of production.*

For any forecast  $F$ , consider an increase in the minimum wage. If the minimum wage is binding, it must be binding in either the planting stage or in the bad state of the harvest stage (because the wage in the good state of the harvest stage must be no lower than that in the bad state of the harvest stage). Proposition 2 states that if the minimum wage is binding in the planting stage, then an increase in the minimum wage causes equilibrium wages in both the good and the bad states of the harvest stage to decline (unless the minimum wage is also binding in the bad state of the harvest stage, in which case the equilibrium wage in the good state of the harvest stage declines). Similarly, if the minimum wage is binding in the bad state of the harvest stage, then at least one of  $(w_{1F}, w_{gF})$  must decline if the minimum wage is increased.

This result is driven by the complementarity in labor demand between planting and harvest stages (generated by the sequencing of cultivation activities) and by the complementarity in labor supply across planting and harvest stages (caused by the improved distribution of harvest season offers received by early migrants). These joint complementarities imply that a wage increase at one (or several) time or state of nature generates reductions in the demand for labor and increases in the supply of labor that are spread over the entire farming season, causing wages to decline at any other times during the season (or in other states of nature) at which the guarantee is not binding.

It can be the case that the fall in the other two wages is so large that the expected wage over the farming season declines with a rise in the wage floor. We show in the appendix

$$\text{Proposition 3: There exist parameter values such that } \frac{dw_{1F}}{dw_m} + (\text{prob}(s = g|F)) \frac{dw_{gF}}{dw_m} + (1 - \text{prob}(s = b|F)) \frac{dw_{bF}}{dw_m} < 0.$$

### 3. IMD Monsoon Forecasts and Forecast Skill

Each year at about the end of June, the Indian Meteorological Department (IMD) in Pune issues forecasts of the deviation of rainfall from “normal” rainfall for the July-September period (summer monsoon). Rainfall in this period accounts for over 70% of rainfall in the crop year and is critical for *kharij*- season profitability - planting takes place principally in June-August, with harvests taking place in

September-October. IMD was established in 1886 and the first forecast of summer monsoon rainfall was issued on that date based on seasonal snow falls in the Himalayas. Starting in 1895, forecasts have been based on snow cover in the Himalayas, pre-monsoon weather conditions in India, and pre-monsoon weather conditions over the Indian Ocean and Australia using various statistical techniques.<sup>8</sup> Thus, IMD forecasts are based on information that is unlikely to be known by local farmers. There has been no alternative source of monsoon forecasts other than IMD until 2013, when a private weather services company (Skymet) issued its own forecast for a limited set of regions.

What is the skill of the forecasts in predicting July-September rainfall? The IMD has published the history of its forecasts since 1932 along with the actual percentage deviations of rainfall in the relevant period. One could use the entire time series to assess the forecast. However, in addition to the fact that the statistical modeling has changed over time so that forecast skill in earlier periods may no longer be relevant, the forecast regions have changed - geographical forecasting by region was abandoned in the period 1988-1998 - and in many years the forecasts are qualitative (“far from normal,” “slightly below normal”). Starting in 1999, actual percentage deviations were re-introduced. For India as a whole, using the published data from 1999-2010, we find that forecast skill is not very high. However, the forecasts exhibit the symmetry property we have assumed in the model: when the IMD forecast is for below-normal monsoon rainfall or for above-normal monsoon rainfall the likelihood the forecast is correct slightly above 50% in each case.

Forecast skill may, however, vary by region, as India regions differ substantially in rainfall patterns. Indeed, in the period 1999-2003, the forecasts were issued for three regions - Peninsular India, Northwest India and Northeast India. Starting in 2004, the forecasts have been issued for four broad regions of India (see Appendix Map A). To assess area-specific forecast skill, we obtained the correlations between the regional IMD forecasts and village-specific times-series of rainfall in two data sets that contain ground-based (weather station) rainfall data. The first data set is from the ICRISAT Village Dynamics in South Asia (VDSA) surveys from the years 2005-2011 describing farmer behavior in the six villages from the first generation ICRISAT VLS (1975-1984). The villages are located in the states of Maharashtra and Andhra Pradesh. These data contain a module providing daily rainfall for each of the six villages. The second data set we use is from the 2007-8 round of the Rural Economic and Development Surveys (REDS) carried out by the National Council of Economic Research (NCAER). This survey was carried out in 242 villages in the 17 major states of India and includes eight years of monthly rainfall information by village for 212 villages covering the period 1999-2006. For the ICRISAT data (2005-2011) we use the Southern Peninsula and Central forecasts. Table 1 provides the forecasts for the two regions over the period 2009-2014, expressed as the percent of “normal” monsoon rainfall set at 100. For the REDS (1999-2006), we matched up the REDS village rainfall time-series with the appropriate regional forecasts over the time period.

Table 2 provides the correlations between the IMD forecasts and actual July-September rainfall for each of the six ICRISAT villages between 2005 and 2011. As can be seen, for the four Maharashtra villages, skill is relatively high ( $\rho=.267$ ), but for the two Andhra villages the forecast is not even positively correlated with the rainfall realizations. It is not obvious what accounts for the higher skill in the

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<sup>8</sup> Regression techniques were first used in 1909 to predict monsoon rainfall. IMD has changed statistical techniques periodically, more frequently in recent years. Different statistical methods were used for the 1988-2002, 2003-2006, and 2007-2011 forecasts (Long Range Forecasting in India, undated).

Maharashtra villages. It is not because there is less rainfall variability in those villages, as the average rainfall CV is significantly higher than that in the Andhra villages. We investigate in more detail below the correlates of forecast skill below using the REDS data, given its wider geographic coverage.

That there are regional patterns to forecast skill is also exhibited in the REDS data. While the overall correlation between the forecast and actual July-September rainfall in the 1999-2006 period is only .132, the range in village-specific correlations, where the correlations are non-negative, is from .01 to .77. This variation could just be noise. However, there appear to be broad contiguous geographical areas where the skill is substantially higher. Map 1 shows where in India the correlations are highest (darker areas), with the Northeast area exhibiting the highest skill.

Why should forecast skill differ across regions of India? The major reason is that rainfall distribution characteristics vary spatially such that the correlation in rainfall between regions is imperfect and declines by distance. Thus, if there were to be a perfect annual forecast for one area, the forecast skill would mechanically be less high in other areas. To quantitatively assess the distance-correlation rainfall gradient, we obtained the correlations in monthly rainfall across the 36 geocoded REDS villages in Andhra Pradesh and Uttar Pradesh, resulting in 630 unique distance-correlation pairs. Figure 5 provides the Lowess-smoothed relationship between the monthly rainfall correlations and distance, where the base correlation of rainfall within a village was conservatively set at 0.9. As can be seen the drop-off in the rainfall correlation is steep, falling from 0.9 to less than 0.5 when the inter-village distance exceeds only 100 kilometers.

Figure 5 suggests why there may be region-specificity to forecast skill, but it is not informative about where the skill is highest. For example, forecast skill may be highest where rainfall variability is low. Moreover, whatever the reason for the IMD forecast model to be more skilled in particular regions, when we assess whether the response of farmers and laborers to forecasts varies by skill, we need to worry that forecast skill is correlated with other local-area characteristics that might affect decisions. For example, it is possible that forecast skill happens to be correlated with better growing conditions, so that farmers are wealthier where skill is high, or forecast skill is greater where particular crops are more suitable, or skill is greater where there is more abundant credit, which permits greater consumption smoothing and facilitates investment. Indeed, we show in Rosenzweig and Udry (forthcoming) based on the ICRISAT data that the response of planting investments to the forecast depends significantly on individual farm soil characteristics.

The first column of Table 3 reports coefficients and their associated standard errors, robust to heteroscedasticity, for a variety of district level characteristics based on a regression in which the dependent variable is a binary indicator for whether or not the average of village-level correlations between the IMD forecasts and actual *kharif*-season rainfall in a REDS district exceeds zero. This correlation is strictly positive in 39 of the 97 REDS districts with complete rainfall data (out of the 100 REDS districts). The specification includes the mean and coefficient of variation of *kharif* rainfall in the district, the fraction of farmer's in the district growing rice, the fraction of villages proximate to a bank, and four district-level average soil characteristics. The set of district characteristics is jointly statistically significant, with the districts potentially benefiting from skilled forecasts evidently having higher average rainfall, but not greater rainfall variability, greater access to banks, and greater suitability to growing rice.

When we estimate the responses of farmers and laborers to the monsoon forecasts we will focus on villages and districts where the forecasts have skill. In the third column of Table 3 we report the estimates of the correlates of the district characteristics with the district-level average of village skill for the 39 REDS districts where average skill is strictly positive. In these districts, none of the individual district characteristics are statistically significantly associated with forecast skill, with five of the eight coefficients shrinking substantially in absolute value compared with those estimated from the sample of districts including those with no skill. And for this subsample the full set of coefficients is jointly insignificantly different from zero. While these latter results suggest that the degree of forecast skill, where there is skill, is uncorrelated with potentially important direct determinants of agent decisions we can never measure all of the potential area-specific correlates of skill. The existence of unmeasured area factors correlated with forecast skill is a threat to identification that should be kept in mind in assessing the internal validity of our findings on how forecast skill affects the responses to and outcomes from the forecasts. Because we include individual fixed effects in all our specifications for estimating behavioral responses to the IMD forecasts, however, our estimates of the *average* effects of the forecasts are internally valid for India over the period and in the areas from which the estimates are obtained.

### 5. Pinning Down the Location of $\gamma$ : Forecasts, Planting-Stage Investments and Farm Profits

a. Data. In this section we pin down the value of  $\gamma$  relative to one and quantify the gains to farmers from skilled forecasts. We have shown that, given the consumption-smoothing motive of farmers and their inability to borrow, good-weather farm profits will always be higher than bad-weather profits and a favorable forecast will increase planting-stage investments if and only if the farmer's risk aversion (consumption-smoothing motive) is not strong, specifically if  $\gamma < 1$ . The model also implies that whatever the sign of the forecast effect on planting-stage investments, the response will be stronger where forecast skill is higher.

We use two panel data sets. The first is from the expanded ICRISAT Village Dynamics in South Asia (VDSA) surveys from the years 2009-2014 describing the behavior of 3,844 farmers in 20 villages located in six states. A key feature of the data, aside from the availability of daily rainfall for each of the villages, is that, because the data are collected at a high frequency, accurate information is provided on the value of inputs by operation and by date. This enables us to measure *kharif*-season planting-stage investments that are informed by the IMD forecasts (which are issued at the end of June) but made prior to the full realization of rainfall shocks as well as the season-specific profits associated with those investments. These data thus enable us to estimate both response of planting-stage investments to the IMD forecasts as well as the effects of the forecasts and rainfall realizations on farm profits net of farmer fixed effects. Our estimates of the planting-stage investment decisions use an unbalanced panel consisting of 698 farmers appearing in at least two survey years (3,403 observations).

The second panel data set we use is from the 1999 and 2007-8 Rural Economic and Development Surveys (REDS) carried out by the National Council of Economic Research (NCAER). This survey was carried out in 242 villages in the 17 major states of India. Like the ICRISAT survey, this survey elicited information on inputs by season and stage of production in each round so that it is possible to also construct a measure of *kharif* planting-stage investments. While, as noted, the 2007-8 round data also includes monthly rainfall information by village for the years 1999-2006 there is no rainfall information for the year in which profits and inputs were collected in the 2007-8 round, so it is not possible to estimate the effects of rainfall on profits. However, we can use our estimates of forecast skill

variation across the 97 districts represented in the data based on the monthly rainfall time-series to assess the responsiveness of investments at the planting stage to the forecasts by skill.

b. Planting-stage investment responses. The planting-stage specification is:

$$\ln x_{ijt} = \beta_1 F_{jt} + \beta_2 F_{jt} * q_j + F_{jt} * \sum \beta_d Z_{jd} + \lambda_{ij} + \xi_{ijt} ,$$

where  $x_{ijt}$  = the log of the real rupee value of planting-stage investments for farmer  $i$  in area  $j$  at time  $t$ ;  $F_{jt}$  = the forecast at time  $t$  in area  $j$ , measured as a percent of 100 (normal);  $q_j$  = forecast skill in area  $j$  (average correlation between rainfall and the forecast across the REDS sample villages in the district, with  $q_j$  set to zero for district in which the correlation is negative or zero ); the  $Z_{jd}$  = the area specific correlates of skill in table 3;  $\lambda_{ij}$  = farmer fixed effect; and  $\xi_{ijt}$  = iid error.

The first column of Table 4 reports the estimates of equation () based on the REDS panel without the interaction terms containing the skill correlates. As can be seen, at  $q_j = 0$  (no skill) there is no relationship between the forecast and planting-stage investment is not statistically significantly different from zero, but at skill levels above zero the forecast increases planting investments. The point estimate of the skill/forecast interaction coefficient suggests that at the mean correlation across the 39 districts with skill (0.316), a one percentage point increase in the forecast value would increase planting-stage investments by 5.2 percent. Adding the forecast interaction terms with the area variables in columns two and three does not substantially alter the skill/forecast interaction coefficient. And the complete set of area/forecast interaction coefficients are not statistically significant. The results indicating that farmers respond positively to forecasts of good weather in skill areas appears robust to at least a wide variety of climate and soil and credit correlates, and is consistent with  $\gamma < 1$ .

Column one of Table 5 reports the estimate of the effect of the IMD weather forecast on planting-stage investments in the set of ICRISAT villages. Here too, the average response to an increase in the optimism of the forecast is positive. However, the sample contains the villagers in the Andhra Pradesh where the forecast has no skill. In column two therefore we allow the investment forecast response to differ across the farmers in the Andhra villages and the rest of the sample (the  $Z$ 's in equation () are replaced by the Andhra dummy). As can be seen, in the skilled villages the investment response is statistically significantly higher than that in the villages outside of Andhra Pradesh. The point estimates indicate that in the non-Andhra villages for every percentage point increase in the forecast value, planting-stage investment rise by 3.2 percent; in the Andhra villages, investments rise by a statistically insignificant .65 percent. Finally, in columns three and four in Table 5 we replace the linear forecast variable by a dummy variable indicating whether the forecast value was less than 98 (98% of normal rainfall), approximately half the sample-period values. The effects of having this pessimistic forecast is to lower planting-stage investments by 15.8 percent overall, and by over 18 percent in the skill villages, compared with only 4.4 percent in the Andhra villages.

c. Farmer risk-taking: planting HYV seeds. Given the evidence on planting-stage investments indicating that  $\gamma < 1$ , we now proceed to test the additional prediction that farmers who receive a favorable forecast employ a technology  $R$  that is riskier, specifically one that makes output more sensitive to rainfall. We examine the choice of using high-yielding variety (HYV) seeds at the outset of the green revolution, using the Additional Rural Income Survey (ARIS) of NCAER. HYV seeds at the time were substantially more sensitive to rainfall (and fertilizer) than were traditional varieties of the same

crops (Foster and Rosenzweig, 1996). Thus, use of HYV seeds at the time unambiguously made the farmer more vulnerable to weather risk. This survey collected information on HYV plantings for 2,600 farmers in 250 villages across 100 districts over the three-year period 1968-70 just at the start of the introduction of HYV's.

At the time of the ARIS, the IMD issued monsoon forecasts for only a subset of areas (56 of the 100 districts represented in the sample). The forecasts were qualitative – “normal”, “below normal”, “much below normal”, “above normal”. We created a forecast index, coding the most pessimistic forecast as -2, the next pessimistic level as -1, normal as 0. We use the last two years of the panel, so that all farmers had the opportunity to use the technology for at least one year. In the first of the two years, 45 percent of the farmers in the areas where there was a forecast received the most pessimistic forecast, in other areas the forecast was for normal rainfall. In the third year all farmers in forecast areas received a forecast of “below normal” rainfall. Thus, there was variation over the two years in the rainfall forecast for almost half of the sample.

The first column of Table 7 reports the estimates of the IMD forecast on the amount of HYV acreage planted from the two-year panel for farmers in all areas, where we coded the forecast index as zero (for normal) in the areas without a forecast. The second column reports the estimates for the restricted sample of farmers residing in forecast areas. As can be seen the estimates are similar, due to the fact that identification comes only from the change in the forecast, which only occurs in forecast areas. Both indicate that a more favorable forecast increases  $R$  significantly. The point estimates indicate that change in the forecast from below normal (-1) to normal increases a farmer's planting of HYV acreage by 1.3 acres, which is an increase of 64 percent.

d. Rainfall, rainfall forecasts and farm profits. Another test of whether  $\gamma < 1$ , as indicated by the planting-stage investment and risk estimates, is whether profits respond positively to rainfall. We use the ICRISAT panel of farmers in the non-Andhra villages where the forecast has skill and farmers evidently respond. The number of farmers with at least two observations in these villages is 557. Our measure of profits is the real value of agricultural output minus the value of all agricultural inputs, including the value of family labor and other owned input services.<sup>9</sup> As before when we assessed forecast skill, we use the total amount of rainfall in the *kharif* period as our measure of rainfall. The first column of Table 8 reports the estimates of seasonal rainfall on profits in a quadratic specification. For all values of *kharif* rainfall observed in the data, the effect of rainfall on profits is positive and statistically significant. Thus, all sets of estimates are consistent with  $\gamma < 1$ .

Given the forecasts and realized rainfall over the period we can quantify the average gains to farmers from having correct forecasts (at the sample skill level) over the sample period – the

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<sup>9</sup> Our model suggests that the value of output should be discounted by  $r$ , the return on risk-free assets between the time of input application and the time of harvest. Appendix table A shows the nominal annual interest rates of formal and informal savings accounts held by the ICRISAT households. 85% of the households have positive savings balances. The average nominal interest rate (weighted by value of deposit) is 10.4%. Average annual inflation over the span of the ICRISAT survey was 10.6%. Therefore, we set  $r=1$  and do not discount output when we calculate profits.

profitability of forecasts. The key advantage that the forecast provides is that it allows farmers to exploit the gains from higher rainfall and to minimize the losses from lower rainfall. We have seen that indeed farmers invest more and take more risk when there is an optimistic forecast. We should therefore observe that when there is a good forecast, increases in rainfall increase profits more than when there is a bad forecast, and symmetrically, when rainfall declines, the loss in profits is less when there was a pessimistic forecast compared with a forecast of normal weather.

To test whether we in fact observe significant gains from the forecasts, we add in the second column of Table 8 interactions between the two rainfall variables and the dummy variable indicating whether the forecast value was less than 98. The squared rainfall/forecast interaction term is highly statistically significant, and is negative – when the forecast is bad, the positive effect of rainfall is attenuated, as farmers invest less and more conservatively. To quantify the gains, we computed the derivatives of the rainfall effects on profits at mean rainfall when there is a forecast of good weather and when there is a forecast of bad weather. These derivatives and their associated standard errors are also reported in the second column of the table. The estimates indicate that when the forecast is good, on average profits increase by 37 rupees for every millimeter increase in realized rain, and when the forecast is bad, the rate of profit decrease when rainfall declines by one millimeter is only 29 rupees. The difference across the two forecast effects of 8 rupees per millimeter of rain is statistically significant and is the net gain from having correct forecasts, at the level of skill and thus investment/risk-taking responsiveness in the sample. This suggests that if in a bad monsoon rainfall is lower by one-half a standard deviation and in a good monsoon it is higher by one-half a standard deviation profits are increased by 11.5 percent when forecasts are correct. Of course, if the forecasts are incorrect, this is the loss. The net gain is from the forecasts being correct more than half the time – thus, the greater the forecast skill the greater the gain, even ignoring that increases in forecast skill also amplify farmers' responses, as we have seen, and thus also increase the net gain.

## **6. Forecasts, Minimum Wages and Planting-Stage Worker Out-migration**

Our estimates from the sample of farmers indicated that forecasts affect farmer investments and risk-taking, the more so the greater is forecast skill, and farmers benefit from greater forecast skill in the form of higher profits. The effects of forecasts on worker wages, however, depends also on what happens to worker supply, on worker migration responses. Our estimates of farmer behavior, consistent with the model, indicate that a pessimistic forecast decreases worker demand in the planting period, which should lower planting-stage wages in equilibrium. However, the model also suggests that pessimistic forecasts increase out-migration, and thus lower supply. The net effect on worker wages in the planting stage is theoretically ambiguous. In this section we estimate the forecast response of worker out-migration immediately after the rainfall forecast. Specifically, we estimate the probability that a male worker leaves the village for work in July and August. We use two data sets, a panel of workers from the 2010-2014 rounds of the ICRISAT data in the villages outside of Andhra Pradesh and a panel of districts from four rounds (62, 63, 64, 66) of the National Social Survey (NSS), covering the periods 2005-2007 and 2009. During this period, we need to take into account the NREGA (real) guaranteed minimum wages that were in effect. The model implies that where the wages are higher, out-migration is lower and that higher minimum wages blunt the effects of the forecast on out-migration. Thus, we merged in each data the state-and year-specific real statutory minimum wages associated with the NREGA program.

We first obtain estimates from a panel of males aged 19-49 from the 2010-2014 rounds of the ICRISAT data in the villages outside of Andhra Pradesh. The specification we estimate is:

$$s_{ijt} = \alpha_1 F_{jt} + \alpha_2 \omega_{jt} + \alpha_3 F_{jt} * \omega_{jt} + \lambda_{ij} + \xi_{ijt},$$

where  $s_{ijt} = 1$  if a male worker  $i$  aged 19-49 residing in area  $j$  is located outside the village in year  $t$  in the months of July and August;  $F_{jt} = 1$  if the forecast value is below 98 (low rainfall);  $\omega_{jt}$  = the real statutory minimum wage associated with NREGA in area  $j$  at time  $t$ ;  $\lambda_{ij}$  = worker fixed effect; and  $\xi_{ijt}$  = iid error. The model predicts that  $\alpha_1 < 0$  and  $\alpha_3 < 0$ .

The first column of Table 9 reports the estimates from a specification that omits the interaction between the minimum wage and the forecast. The estimates indicate that, consistent with the model, an optimistic forecast decreases out-migration, by 2.4 percentage points, a 37 percent decrease at the sample mean out-migration rate (6.4 percent). On average across the period a higher minimum wage also lowered out-migration. However, while the minimum wage effect is statistically different from zero, it is small – a one standard deviation increase in the wage decreases out-migration by only 0.8 percentage points. However, as is seen in the second column of Table 7 in which the interaction between the forecast and the minimum wage is also included, the inhibiting minimum wage effect on out-migration is significantly higher in absolute value when there is a pessimistic forecast, consistent with the model. The estimates indicate that when the forecast is not pessimistic, there is no significant effect of a rise in the minimum wage on out-migration, but when the forecast is pessimistic a one standard deviation increase in the real minimum wage decreases out-migration by 1.5 percentage points (23 percent). The forecast effect on out-migration is also reduced significantly – when the forecast is pessimistic, a one-standard deviation increase in the minimum wage lowers the positive effect of the forecast on out-migration by 64 percent.

As noted, the limited geographic coverage of the ICRISAT survey prevents examining how forecast skill affects forecast responsiveness. The NSS has national coverage and thus we can exploit the geographic variation across India in forecast skill that we obtained using the REDS data. Selected rounds of the NSS contain information on temporary migration in Schedule 1.0, which ascertains the number of days away from home in the last month. Because the NSS collects information in very month of the year, we can look at July/August planting-stage out-migration using the rounds administered in August and September. We use data on male agricultural workers in rural areas who are residing in the districts common with those in the REDS data set. We thus merge the estimates of skill obtained from the REDS data with the NSS worker data to assess if forecast skill matters for migration decisions.

There are two main limitations of the NSS for our analysis. The first is that the NSS is not a panel of individuals or households. It is panel of administrative units that is larger than villages but smaller than districts. We thus need to control for both time-invariant worker characteristics and the agroclimatic characteristics of the villages. The second limitation of the NSS data is that there is no rainfall information. We thus merge TRMM satellite data on rainfall over the relevant periods to the NSS data at the village level. Comparisons of the time-series of the village-matched TRMM data with the REDS and ICRISAT ground-based rainfall indicate that the satellite matching is not very accurate. We only use the first two moments of the TRMM rainfall data as village-level control variables. The distribution moments of the TRMM and ground-based rainfall time-series are substantially more correlated at the village-level than are the year-to-year values.

The specification we use for estimation is:

$$s_{ijt} = \alpha_1 F_{jt} + \alpha_2 F_{jt} * q_j + \alpha_3 \omega_{jt} + \alpha_4 F_{jt} * \omega_{jt} + \alpha_5 F_{jt} * \omega_{jt} * q_j + \mu_j + \xi_{ijt}$$

where  $s_{ijt} = 1$  if a male agricultural worker  $i$  aged 14-49 residing in area  $j$  is located outside the village in year  $t$  in the months of July and August;  $F_{jt}$  = the forecast at time  $t$  in area  $j$ , measured as whether the forecast value is below 98 (low rainfall);  $\omega_{jt}$  = the real statutory minimum wage associated with NREGA in area  $j$  at time  $t$ ;  $q_j$  = forecast skill in area  $j$  (average correlation between rainfall and the forecast across the REDS sample villages in the district, set to zero if  $< 0$ );  $\omega_{jt}$  = area fixed effect; and  $\xi_{ijt}$  = iid error. We also include in the specification as controls the worker's schooling, age and age squared, the household's landholdings, and the mean and standard deviation of rainfall in the worker's village. The model predicts that  $\alpha_2 < 0$  and  $\alpha_5 < 0$ .

The first column of Table 10 reports the estimates of the determinants of planting-stage out-migration omitting the interaction variables. The estimates show that a forecast of bad weather, just as in the ICRISAT sample, significantly increases out-migration in the planting stage, the more so the greater the skill of the forecast. At the sample mean skill for districts with skill (.224) the point estimates indicate that a bad forecast increases planting-stage migration by 20 percentage points, a 54 percent reduction in out-migration. On average the effect of the minimum wage over the period was not statistically significantly different from zero. However, as seen in column two of the table, a higher minimum wage significantly reduces out-migration in the planting stage when the forecast predicts low monsoon rainfall (only) when the forecast has skill, again consistent with the model. The point estimates indicate that at the mean skill, an increase in the minimum wage by one standard deviation reduces out-migration by 23.5 percentage points (64 percent) when the forecast indicates low monsoon rainfall.

## 7. Forecasts, Minimum Wages and Equilibrium Planting-stage Wages

The estimates of the effects of a bad forecast on planting-stage farmer investments suggests that such forecasts reduce the demand for labor in the planting stage and thus would lower equilibrium wages. However, also consistent with the model, forecasts of low rainfall evidently induce greater out-migration in the planting stage, which would raise planting-stage wages. The net effect on equilibrium planting-stage wages resulting from a pessimistic forecast is thus an empirical question. In this section we estimate the effects of the forecast on equilibrium wages in the planting stage. Given our theoretically-consistent finding that a higher minimum wage inhibits the migration response to forecasts, we also test whether higher minimum wages lower equilibrium wages in the planting stage when rain shortfalls are forecast. We again use the sample of male workers from the ICRISAT panel survey residing outside of Andhra Pradesh and the sample of men in the NSS data.

The first column of Table 11 reports the worker fixed-effects estimates of the effects of a bad forecast on the log of agricultural wages in the planting stage for the ICRISAT sample of male workers aged 19-49 along with the estimate of the effect of the statutory minimum wage. The estimates indicate that on net a bad forecast raises wages in the planting stage – the migration/supply response evidently dominates such that wages are 5.7 percent higher when there is a pessimistic forecast. And, on average, higher minimum wages are associated with higher equilibrium planting stage wages. However, as the estimates in the second column of Table 11 indicate, the net effect of a rise in the minimum wage on the equilibrium wage in the planting stage when there is a bad forecast is negative. A one-standard

deviation in the real minimum wage decreases the planting-stage equilibrium wage by almost 3.7 percent when the forecast suggests a low-rainfall *kharif* season.

The estimates from the NSS data for equilibrium planting-stage wages are somewhat different from those from the ICRISAT data in areas where the forecast has skill. In the second-column of Table 12, which contains estimates from the full specification, the forecast of bad weather and its interaction with the real minimum wage are both statistically different from zero. The point estimates indicate that at the mean real minimum wage and average skill in the skill areas, a pessimistic forecast lowers equilibrium planting-stage wages, but only by 2.1 percent. However, as also found in the ICRISAT survey data, a rise in the minimum wage when the forecast is bad lowers the equilibrium planting-stage wage. The point estimates indicate that a one-standard-deviation increase in the minimum wage would lower the equilibrium wage in the planting stage by 4.7 percent, a result similar in magnitude to that obtained from the ICRISAT data.

### 8. Forecasts, Rainfall, Minimum Wages and Equilibrium Harvest-stage Outcomes

Planting-stage migration decisions are made prior to the realization of rainfall based on expectations of subsequent rainfall, which are evidently influenced by the IMD forecast. Harvest-stage migration in contrast occurs after the realization of rainfall and thus is not only affected by the planting-stage forecast (due to its effects on planting-stage migration and the planting decisions of farmers) but also by the realizations of rainfall. Harvest-stage equilibrium wages are also affected by both rainfall outcomes and the forecast. Higher rainfall increases output and thus raises labor demand, and in equilibrium, despite higher rainfall lowering out-migration, raises equilibrium wages. However, the key insights of the model are that the effects of any determinant of harvest-stage migration and wages are affected by the rainfall forecast – rainfall as well as minimum wages interact with the forecast. In particular, when the forecast of rainfall was pessimistic, the effects of changes in rainfall and the minimum wage on out-migration and wages are attenuated compared with states of the world in which the forecast is optimistic. And, as we have shown, it is theoretically possible that when there is a bad forecast but normal rainfall a higher minimum wage can lower harvest-stage equilibrium wages.

In this section we test the implications of the model for the determination of harvest-stage out-migration and equilibrium wages. Because rainfall is a key determinant of harvest-stage outcomes, we obtain estimates from the ICRISAT panel of workers, making use of the village-level daily rainfall information contained in the survey. We again focus on the workers in the villages outside of Andhra Pradesh, where the IMD forecast has skill. The equation we estimate is:

$$y_{ijt} = \pi_1 F_{jt} + \pi_2 \omega_{jt} + \pi_3 r_{jt} + \pi_4 F_{jt} * \omega_{jt} + \pi_5 F_{jt} * r_{jt} + \lambda_{ij} + \xi_{ijt},$$

where  $y_{ijt} = 1$  if a male worker  $i$  aged 19-49 residing in area  $j$  is in located outside the village in year  $t$  in the months of September and October or the log of the real daily wage in those months;  $F_{jt} = 1$  if the forecast at time  $t$  in area  $j$  is below 98 (low rainfall);  $\omega_{jt}$  = the real statutory minimum wage associated with NREGA in area  $j$  at time  $t$ ;  $r_{jt}$  = rainfall in the months of July through September;  $\lambda_{ij}$  = worker fixed effect; and  $\xi_{ijt}$  = iid error. The model predicts that for migration  $\pi_1 > 0$ ,  $\pi_2$  and  $\pi_3 < 0$ ,  $\pi_4$  and  $\pi_5 > 0$ . For equilibrium wages, the signs are opposite to those for migration:  $\pi_1 < 0$ ,  $\pi_2$  and  $\pi_3 > 0$ ,  $\pi_4$  and  $\pi_5 < 0$ .

The first column of Table 13 reports the coefficients for the rainfall, forecast and minimum wage variables omitting the interaction terms in the equation determining harvest-stage out-migration. Consistent with the model, migration at the harvest stage is lower when rainfall and the minimum wage are higher but out-migration is higher when the planting-stage forecast was pessimistic. All coefficients are statistically significant. In the second column the interaction terms are added. All three interaction coefficients are statistically significant from zero. Consistent with the model, the positive effect of a bad forecast on out-migration is significantly decreased at higher values of the statutory minimum wage. The point estimates indicate that at the sample mean values of rainfall and the real minimum wage, a bad forecast increases harvest-stage migration by a statistically significant 35.6 percent; but when the minimum wage is one standard deviation higher, the same forecast only reduces out-migration in the harvest stage by a statistically insignificant 5.3 percent. On the other hand, a rise in the minimum wage of one standard deviation at the sample means when there is a forecast of good weather reduces harvest-stage out-migration at sample mean rainfall by only 5.4 percent but reduces harvest-stage out-migration by 24.6 percent if there was a pessimistic forecast. The only coefficient that deviates from the model predictions is that for the interaction between the forecast and rainfall, which suggests that rainfall has a stronger negative effect on harvest-stage out-migration when the forecast was for reduced rainfall.

In contrast to the results for out-migration, all of the estimated coefficients of the log wage equation conform to the predictions of the model. The estimates are reported in Table 14. In the first column, as predicted, higher rainfall and a forecast of a poor monsoon raise harvest wages as do higher minimum wages on average. As seen in column two, all of the interactions coefficients are statistically significant. In accordance with the model, real harvest-stage wages rise less with rainfall if there was a pessimistic forecast and in areas where minimum wages are higher. And the positive effect of a rise in the minimum wage on equilibrium harvest wages is less when the forecast predicted a bad monsoon.

Indeed, the point estimates in the second column of the table indicate that a rise in the minimum wage can reduce the harvest equilibrium wage when the forecast is pessimistic as suggested by the model. In particular, when the forecast predicts a normal or better monsoon, at average kharif rainfall levels, a one standard deviation increase in the minimum wage pushes up equilibrium harvest-stage wages by a statistically significant 10.9 percent. However, when the forecast was for a bad monsoon, the same rise in the minimum wage under the same (normal) realized rainfall conditions lowers harvest wages by a statistically significant 5.5 percent. As indicated by the model, this occurs when actual rainfall is normal and the minimum wage is binding in the planting stage but not the harvest stage. The binding minimum wage together with the (incorrect) pessimistic forecast reduce farmer investments and increase the supply of local workers, both of which lower the harvest wage in equilibrium when the minimum wage is not binding in that stage. Note that the estimates suggest that if realized rainfall is at its sample low and the forecast is pessimistic (and thus correct), a rise in the minimum wage still raises equilibrium wages, by a marginally statistically significant 2.8 percent. The perverse effect of the minimum wage on equilibrium wages is thus due to an inaccurate forecast; increasing forecast skill would thus reduce the incidence of cases in which workers in the harvest stage are harmed by increases in the minimum wage (combined with guaranteed employment).

## 9. Conclusion

In this paper we have set out a parsimonious dynamic equilibrium model of rural economies in low-income countries that incorporates a number of their fundamental properties: the importance of agriculture and its sequential decision-making, the role of temporary migration, the salience of weather risk, and the necessity of decision making by both laborers and farmers prior to the resolution of uncertainty. We used the model as a framework to assess empirically, based on panel data from India, the effects of long-range weather forecasting in the presence of variable weather outcomes and a guaranteed-employment minimum-wage scheme on the input and technology choices of farmers, the migration decisions of laborers, farm profits and equilibrium wages in the planting stage and at harvest.

We first showed, using ground-level times-series data on monthly rainfall at a fine geographical resolution across India, that the monsoon forecasts issued by the India Meteorological Department in recent years exhibited skill only in a few contiguous regions in India. Our empirical results, examining investments and migration decision as well as profits and wages, indicated that only in areas in which the forecasts were skillful, did the forecast significantly affect outcomes. Moreover, within the skill areas, the higher the skill level of the forecasts, the greater its effects. Where the forecast effects were salient, we found that they were aligned with the predictions of the model: favorable rainfall forecasts lead to a higher level and riskier planting-stage investments by farmers, lower rates of planting-stage out-migration migration, and lower equilibrium wages in the planting stage. We showed that the forecasts in particular raised farm profits on average by allowing farmers to allocate resources *ex ante* to exploit rainfall conditions.

The effects of weather forecasts on equilibrium wages in the harvest stage were more complex, depending on both rainfall outcomes, the level of minimum wages, and whether the forecast was pessimistic or optimistic. For example, harvest stage out-migration and wages were more sensitive to rainfall outcomes when the rainfall forecast was favorable compared to when it was unfavorable. And, in areas with higher minimum wages, responses to weather outcomes and to the forecast were less strong, with average equilibrium wages actually lower in high minimum-wage areas if the forecast was pessimistic.

Our results suggest that expected improvements in long-run weather forecasting skill will have beneficial effects for rural populations, while avoiding the administrative costs of delivering traditional contract-based services to the poor that rely on personal interventions. The results also suggest that any evaluations of interventions in rural areas in India need to take into account the forecasts in place as well as realized weather outcomes to maximize external validity. Finally, our model ignored networking among rural agents. The integration of dynamic equilibrium elements incorporating forecasts and production decisions in network models would appear to be a fruitful agenda for future research.

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## Appendix

### Preliminaries: Demand for Labor and Technology Choice

#### 1. Symmetry

The model with if  $F = G$  with  $q = q_0$  is indistinguishable from that with  $F = B$  and  $q_1 = 1 - q_0$ . Therefore the equilibrium wage vector  $\mathbf{w}_G = \mathbf{w}_B$  if  $q = 0.5$ .

#### 2. Choice of Technology is separable

The farmer chooses the level of risk knowing the forecast and wage vector. Consider  $F = G$ ; the argument is entirely symmetrical for  $F = B$ . The first order conditions with respect to labor demand and technology choice are:

	$\beta x_{1G}^{\beta-1} [(1-q)(1-w_{bG})(1-R_G)c_{bG}^{-\gamma} + q(1+R_G)(1-w_{gG})\theta c_{gG}^{-\gamma}] - w_{1G}c_{1G}^{-\gamma} = 0$	(17)
	$q(1-w_{gG})\theta c_{gG}^{-\gamma} - (1-q)(1-w_{bG})c_{bG}^{-\gamma} \leq 0; R_G \geq 0$	(18)

(2) holding with complementary slackness.

So

	$\frac{c_{bG}}{c_{gG}} \leq \left( \frac{(1-w_{bG})(1-q)}{(1-w_{gG})q\theta} \right)^{\frac{1}{\gamma}}$	(19)
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and from the budget constraints we have

	$\frac{c_{bG}}{c_{gG}} = \frac{(1-w_{bG})(1-R_G)}{(1-w_{gG})\theta(1+R_G)}$	(20)
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(3) and (4) imply

	$R_G = \max \left\{ 0, \frac{1 - \left[ \left( \frac{1-w_{bG}}{\theta(1-w_{gG})} \right)^{\frac{1}{\gamma}-1} \left( \frac{(1-q)}{q} \right)^{\frac{1}{\gamma}} \right]}{1 + \left[ \left( \frac{1-w_{bG}}{\theta(1-w_{gG})} \right)^{\frac{1}{\gamma}-1} \left( \frac{(1-q)}{q} \right)^{\frac{1}{\gamma}} \right]} \right\}$	(21)
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Parallel calculations provide the analogous result for  $R_B$ .

#### 3. Labor Demand

From (1) and (2)

$\beta x_{1G}^{\beta-1} \left[ (1-q)(1-w_{bG})(1-R_G) \frac{(1-w_{gG})q\theta}{(1-w_{bG})(1-q)} + q(1+R_G)(1-w_{gG})\theta \right]$ $= w_{1G} \left( \frac{c_{1G}}{c_{gG}} \right)^{-\gamma}$	(22)
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From the budget constraints we have

$2\beta x_{1G}^{\beta-1} q(1-w_{gG})\theta = w_{1G} \left( \frac{Y - w_1 x_{1G}}{\theta x_{1G}^\beta (1+R_G)(1-w_{gG})} \right)^{-\gamma}$	(23)
--	------

Therefore

$x_{1G}^{\beta-1-\beta\gamma} - \frac{(Y - w_1 x_{1G})^{-\gamma} w_{1G} (1+R_G)^\gamma (1-w_{gG})^{\gamma-1} \theta^{\gamma-1}}{2\beta q} = 0$	(24)
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implicitly defines  $x$ . Define the LHS of (14) as  $G_x$ . Noting that

$\frac{\partial G_x}{\partial x} = (\beta - 1 - \beta\gamma) x_{1G}^{\beta-2-\beta\gamma} - \frac{\gamma w_1 c_{1G}^{-\gamma-1} w_{1G} (1+R_G)^\gamma (1-w_{gG})^{\gamma-1} \theta^{\gamma-1}}{2\beta q} < 0$	(25)
$\frac{\partial G_x}{\partial w_{1G}} = \frac{-\gamma c_{1G}^{-\gamma-1} x_{1G} w_{1G} (1+R_G)^\gamma (1-w_{gG})^{\gamma-1} \theta^{\gamma-1} - c_{1G}^{-\gamma} (1+R_G)^\gamma (1-w_{gG})^{\gamma-1} \theta^{\gamma-1}}{2\beta q}$ $< 0$	

We have

$$\frac{dx_{1G}}{dw_{1G}} < 0.$$

#### 4. Migration and wages

There will be a cutoff planting stage reservation wage  $w_{uF}^*$  such that a worker migrates for the planting stage if and only if he draws an urban wage for the planting stage greater than that reservation wage ( $w_{1u} \geq w_{uF}^*$ ).

$w_{uF}^*$  is defined as the urban wage offer that equalizes a worker's expected utility from migrating in the planting stage with the expected utility from working in the village in the planting stage given a forecast of  $F$ .

Consider  $F=G$ .  $w_{uG}^*$  is defined by

$ \begin{aligned} W: & v(w_{uG}^*) + q[w_{gG}f_2v(w_{gG}) + (1 - w_{gG}f_2)E(v(w_u) w_u > w_{gG})] \\ & + (1 - q)[w_{bG}f_2v(w_{bG}) + (1 - w_{bG}f_2)E_2(v(w_u) w_u > w_{bG})] \\ & - \{v(w_{1G}) \\ & + q[w_{gG}f_1v(w_{gG}) + (1 - w_{gG}f_1)E_1(v(w_u) w_u > w_{gG})] \\ & + (1 - q)[w_{bG}f_1v(w_{bG}) + (1 - w_{bG}f_1)E_1(v(w_u) w_u > w_{bG})]\} \\ & = 0 \end{aligned} $	(26)
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The LHS of (10), which we denote as  $W$ , is monotonically increasing in  $w_{uG}^*$ , so a simple application of the IFT shows that (10) defines the trigger urban wage as a function of the rural wage vector  $w_G$ :  $w_{uG}^*(w_{1G}, w_{gG}, w_{bG})$ . It is immediately apparent that  $\frac{dw_{uG}^*}{dw_{1G}} > 0$ . The effects of the harvest stage wages on the trigger urban wage are positive as well.  $\frac{dw_{uG}^*}{dw_{gG}} > 0$  if  $\frac{\partial LHS}{\partial w_{gG}} > 0$ . Differentiating (10):

$$\begin{aligned}
\frac{dW}{dw_{gG}} &= q \left[ (f_2 - f_1)v(w_{gG}) + w_{gG}(f_2 - f_1)v'(w_{gG}) - f_2E_2(v(w_u)|w_u > w_{gG}) \right. \\
& \quad + (1 - w_{gG}f_2) \frac{dE_2(v(w_u)|w_u > w_{gG})}{dw_{gG}} + f_1E_1(v(w_u)|w_u > w_{gG}) \\
& \quad \left. - (1 - w_{gG}f_1) \frac{dE_1(v(w_u)|w_u > w_{gG})}{dw_{gG}} \right] \\
&> q \left[ (f_1 - f_2) \left( E_2(v(w_u)|w_u > w_{gG}) - v(w_{gG}) \right) \right. \\
& \quad + w_{gG}(f_2 - f_1) \left( v'(w_{gG}) - \frac{dE_2(v(w_u)|w_u > w_{gG})}{dw_{gG}} \right) \\
& \quad \left. + \left( \frac{dE_2(v(w_u)|w_u > w_{gG})}{dw_{gG}} - \frac{dE_1(v(w_u)|w_u > w_{gG})}{dw_{gG}} \right) \right] > 0
\end{aligned}$$

Where the first inequality is a consequence of  $E_2(v(w_u)|w_u > w_{gG}) - E_1(v(w_u)|w_u > w_{gG}) > 0$ . The second inequality then follows from  $f_1 > f_2$  and the boundary condition that  $v'(w_{gG}) = \frac{dE_2(v(w_u)|w_u > w_{gG})}{dw_{gG}}$ . Therefore,  $\frac{dw_{uG}^*}{dw_{gG}} > 0$ .

A parallel calculation shows  $\frac{dw_{uG}^*}{dw_{bG}} > 0$ , and three similar calculations show  $\frac{dw_{uB}^*}{dw_{1B}}, \frac{dw_{uB}^*}{dw_{gB}}, \frac{dw_{uB}^*}{dw_{bB}} > 0$ .

The trigger urban wage offer is less than the growing stage rural wage:

$ \begin{aligned} & v(w_{1G}) - v(w_{uG}^*) \\ & > q \left[ E_2(v(w_u) w_u > w_{gG}) - E_1(v(w_u) w_u > w_{gG}) \right. \\ & \quad \left. + \{w_{gG}(f_1 - f_2) (E_1(v(w_u) w_u > w_{gG}) - v(w_{gG}))\} \right] \\ & + (1 - q) \left[ E_2(v(w_u) w_u > w_{bG}) - E_1(v(w_u) w_u > w_{bG}) \right. \\ & \quad \left. + \{w_{bG}(f_1 - f_2) (E_1(v(w_u) w_u > w_{bG}) - v(w_{bG}))\} \right] > 0 \end{aligned} $	(27)
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Analogous reasoning holds for  $F = B$ .

Therefore, migration in the planting stage  $M_{1F} = (1 - w_{uF}^*(w_{1F}, w_{gF}, w_{bF}, F)f_1)$ , with  $\frac{dM_{1F}}{dw_{1F}}, \frac{dM_F}{dw_{sF}} < 0$ .

Migration in state  $s$  of the harvest stage is  $M_{sF} = 1 - (S_1f_1 + (1 - S_1)f_2)w_{sF}$ . The supply of labor in stage 1 is  $S_1 = w_{uF}^*(w_{1F}, w_{gF}, w_{bF}, F)f_1$ . In the harvest stage, the supply of labor is

$S_{sF} = (S_1f_1 + (1 - S_1)f_2)w_{sF}$	$(28)$
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is.

### 5. Harvest Stage Equilibrium in the Rural Labor Market

For either forecast, for harvest stage wages less than 1 ( $w_{sF} < 1$ ), labor demand in the bad state of the harvest stage is less than labor demand in the good state:

$$Q_{bF} = x_{1F}^\beta(1 - R_F) < x_{1F}^\beta\theta(1 + R_F) = Q_{gF}$$

Equilibrium requires that harvest stage labor supply in the good state be larger than harvest stage labor supply in the bad state ( $S_{gF} > S_{bF}$ ). Therefore,  $w_{gF} = \frac{S_{gF}}{(S_1f_1 + (1 - S_1)f_2)} > \frac{S_{bF}}{(S_1f_1 + (1 - S_1)f_2)} = w_{bF}$ . In addition,  $S_{gF} > S_{bF}$  requires that harvest stage migration is less in the good state than in the bad state of the harvest period ( $M_{gF} < M_{bF}$ ).

#### Distinguishing the Degree of Risk Aversion

Using (1), (5) and the budget constraints, we find

$X: x_{1G}^{\beta-1-\beta\gamma} - \frac{(Y - w_1x_{1G})^{-\gamma}w_{1G}(1 + R_G(w_{gG}, w_{bG}))^\gamma(1 - w_{gG})^{\gamma-1}\theta^{\gamma-1}}{2\beta q} = 0$	$(29)$
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which implicitly defines  $x_{1G}$  as a function of the wage vector. We denote the LHS of (12) as  $X$ . Implicit differentiation yields after some manipulation

$\frac{dx_{1G}}{dq} = A \left( 1 - \left( \frac{(1-q)}{q} \frac{1 - w_{bG}}{\theta(1 - w_{gG})} \right)^{\frac{1}{\gamma}-1} \right)$	$(30)$
---	--------

where

$$A = \frac{x_{1G}^{\beta-1-\beta\gamma}}{2\beta q^2 \left[ (\beta - 1 - \beta\gamma)x_{1G}^{\beta-2-\beta\gamma} - \frac{\gamma w_1 c_{1G}^{-\gamma-1} w_{1G} (1 + R_G)^\gamma (1 - w_{gG})^{\gamma-1} \theta^{\gamma-1}}{2\beta q} \right]} \times \frac{1}{1 + \left[ \left( \frac{1 - w_{bG}}{\theta(1 - w_{gG})} \right)^{\frac{1}{\gamma}-1} \left( \frac{(1-q)}{q} \right)^{\frac{1}{\gamma}} \right]} > 0$$

Define profit in state  $s$  of the harvest stage as  $Q_{sF}(1 - w_{sF}) = \pi_{sF}$ .

*Proposition 1: If  $\pi_{gF} > \pi_{bF}$  and  $x_G > x_B$ , then  $\gamma < 1$ .*

Proof:  $\pi_{gF} > \pi_{bF}$  implies  $\frac{\theta(1+R_G)}{1-R_G} > \frac{1-w_{bG}}{1-w_{gG}}$ . Substitute (5) and use  $\gamma > 0$  to find

	$\frac{1-q(1-w_{bG})}{\theta q(1-w_{gG})} \leq 1.$	(31)
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The symmetry of the model noted in section A.1 implies that  $\frac{dx_{1G}}{dq} = -\frac{dx_{1B}}{dq}$ . Therefore, the observation that  $x_{1G} > x_{1B}$  implies  $\frac{dx_{1G}}{dq} > 0$ . (14) then requires that  $\gamma < 1$ . ■

### Harvest Stage Equilibrium with $\gamma < 1$

We can reduce the problem of solving for the equilibrium wage vector to two dimensions when  $\gamma < 1$  by noting that harvest season relative wages (from (15) and (5)) are:

$$\left(\frac{w_{gF}}{w_{bF}}\right)^\gamma \left(\frac{1-w_{gF}}{1-w_{bF}}\right)^{1-\gamma} = \theta \left(\frac{q}{(1-q)}\right)^{J_F} \quad (32)$$

for  $J_G = 1$  and  $J_B = -1$ . (16) implicitly defines  $w_{bF}$  as a function of  $w_{gF}$ . To calculate an equilibrium:

1. For every  $w_{gF}$ , calculate the consistent  $w_{bF}$  from harvest season relative wage equilibrium (19). Note that for  $\gamma \leq 1$ ,  $w_{bF}(w_{gF})$  is monotonic and  $\frac{dw_{bF}}{dw_{gF}} > 0$ .
2. So the problem is to find  $(w_{1F}, w_{gF})$  such that  $\mathbf{w}_F = (w_{1F}, w_{gF}, w_{bF}(w_{gF}))$  solves the 2 equations:

$$\begin{aligned} S_{1F}(\mathbf{w}_F) &= x_F(\mathbf{w}_F) \\ w_{gF}(S_{1F}(\mathbf{w}_F)f_1 + (1 - S_{1F}(\mathbf{w}_F))f_2) &= \theta(1 + R_F(\mathbf{w}_F))(x_F(\mathbf{w}_F))^\beta \end{aligned}$$

### Testable Implications of the Model when $\gamma < 1$

1. Planting stage labor market equilibrium requires

	$(1 - M_{1G}) = S_{1G} = x_{1G} > x_{1B} = S_{1B} = (1 - M_{1B})$	(33)
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2. Equation (5) and its analogue for  $F = B$  together imply that if

$$\left(\frac{1-w_{bG}}{\theta(1-w_{gG})}\right)^{\frac{1}{\gamma}-1} \left(\frac{q}{1-q}\right)^{\frac{1}{\gamma}} \geq \left(\frac{1-w_{bB}}{\theta(1-w_{gB})}\right)^{\frac{1}{\gamma}-1} \left(\frac{1-q}{q}\right)^{\frac{1}{\gamma}}$$

then  $R_G \geq R_B$ . Simplifying this inequality shows that  $R_G \geq R_B$  if

	$\left(\frac{q}{1-q}\right)^{\frac{2}{1-\gamma}} \geq \frac{1-w_{bB}}{\theta(1-w_{gB})} \frac{\theta(1-w_{gG})}{1-w_{bG}}$	(34)
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That is, as long as the relative net harvests in the bad and good states of the harvest stage after a forecast of bad weather are not much larger than relative net harvests in the bad and good states of the harvest stage after a forecast of good weather, then  $R_G \geq R_B$ . The equilibrium wage relations (16) for  $F = B$  and  $F = G$  and  $\gamma < 1$  together imply

	$\frac{\frac{1 - w_{bB}}{(1 - w_{gB})}}{\frac{1 - w_{bG}}{(1 - w_{gG})}} < \left(\frac{1 - q}{q}\right)^{\frac{2}{1-\gamma}} < 1 < \left(\frac{q}{1 - q}\right)^{\frac{2}{1-\gamma}}.$	(35)
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Therefore, (18) is satisfied and  $R_G \geq R_B$ .

3.  $R_G \geq R_B$  implies  $\frac{Q_{gG}}{Q_{bG}} \geq \frac{Q_{gB}}{Q_{bB}}$ .  $R_G \geq R_B$  and  $x_{1G} > x_{1B}$  together imply  $Q_{gG} - Q_{bG} > Q_{gB} - Q_{bB}$ .

The greater planting stage labor input and higher risk taken after  $F = G$  implies that the difference in output is greater after a forecast of good weather. Therefore, the difference in migration in the harvest stage must be greater after a forecast of good.

	$M_{bG} - M_{gG} > M_{bB} - M_{gB}$	(36)
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4. The implication that there is a greater difference between harvest season wages with good and bad weather realizations after a forecast of good weather than after a forecast of bad weather is demonstrated in (19).
5.  $x_{1G} > x_{1B}$  and  $R_{1G} > R_{1B}$  imply for the harvest stage labor markets to clear that

$$w_{gG}(x_{1G}f_1 + (1 - x_{1G})f_2) = x_{1G}^\beta \theta(1 + R_{1G}) > x_{1B}^\beta \theta(1 + R_{1B}) = w_{gB}(x_{1B}f_1 + (1 - x_{1B})f_2) > w_{gB}(x_{1G}f_1 + (1 - x_{1G})f_2)$$

because  $f_2 < f_1$ . Therefore,  $w_{gG} > w_{gB}$ .

### Wage Floors

A statutory wage floor at a fixed level  $w_m$  generated by an employment guarantee scheme implies that an equilibrium must have  $(w_{1F}, w_{gF}, w_{bF}) \equiv \mathbf{w}_F$  such that  $\mathbf{w}_F \geq w_m$ , with labor market clearing conditions defined in text equation (16). We consider the effect of a change in the level of the statutory wage floor on equilibrium rural wages.

We now show

*Proposition 2: Suppose that the equilibrium wage vector is  $(w_{1F}^*, w_{gF}^*, w_{bF}^*) \equiv \mathbf{w}_F^*$  such that  $\mathbf{w}_F^* \geq w_m$ , and  $\mathbf{w}_F^* \neq w_m$ . Then if a small increase in the statutory minimum wage  $w_m$  changes the equilibrium wage vector, it must reduce the equilibrium wage in at least one state of one stage of production.*

*Proof:* The proposition rules out the trivial case in which  $\mathbf{w}_F^* = w_m$ : given forecast  $F$ , the wage floor is binding in each state of each stage of production. Rural labor demand is less than rural labor supply in each state and stage, and the excess supply is employed in the employment guarantee scheme. An increase in  $w_m$  obviously increases all rural wages.

Similarly, the proposition rules out the trivial case of  $\mathbf{w}_F^* \gg w_m$ , where the wage floor is never binding.

We need not consider any case in which  $w_{gF}^* = w_m < w_{bF}^*$  because the good state harvest stage labor market equilibrium requires

$$w_{gF}^*(S_{1F}(\mathbf{w}_F^*)f_1 + (1 - S_{1F}(\mathbf{w}_F^*))f_2) \geq \theta(1 + R_F(\mathbf{w}_F^*))(x_F(\mathbf{w}_F^*))^\beta,$$

but the bad state harvest stage labor market equilibrium is

$$w_{bF}^*(S_{1F}(\mathbf{w}_F^*)f_1 + (1 - S_{1F}(\mathbf{w}_F^*))f_2) = (1 - R_F(\mathbf{w}_F^*))(x_F(\mathbf{w}_F^*))^\beta,$$

which requires  $w_{gF}^* \geq w_{bF}^*$ .

Therefore, for any forecast  $F$ , there are 2 cases to consider:

- A. The planting stage rural labor equilibrium holds with equality:  $EQ_{1F}(\mathbf{w}_F^*) = S_{1F}(\mathbf{w}_F^*) - x_F(\mathbf{w}_F^*) = 0$ . We have shown that  $S_{1F}(\mathbf{w}_F)$  is monotonically increasing in each of its three wage arguments, and that  $x_F(\mathbf{w}_F)$  is monotonically decreasing in each of its arguments. Therefore,  $EQ_{1F}(\mathbf{w}_F)$  is monotonically decreasing in each wage. Therefore at least one wage must decline if  $w_m$  increases.
- B. The planting stage rural labor equilibrium does not hold with equality ( $w_{gF} = w_m$ ) but the rural labor market equilibrium in the good state does hold with equality:

$w_{gF}^*(S_{1F}(\mathbf{w}_F^*)f_1 + (1 - S_{1F}(\mathbf{w}_F^*))f_2) = \theta(1 + R_F(\mathbf{w}_F^*))(x_F(\mathbf{w}_F^*))^\beta$	(37)
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There are two subcases to consider. Either the rural labor market equilibrium in the bad state does or does not hold with equality.

- i. If the rural labor market equilibrium in the bad state of the harvest stage holds with equality, then (16) can be used to define  $w_{bF}^*(w_{gF})$  with  $\frac{dw_{bF}^*}{dw_{gF}} > 0$ . The implicit function theorem yields

$$\begin{aligned} \frac{dw_{gF}}{dw_m} = & - \left[ w_{gF} \left( \left( \frac{\partial M_{1F}}{\partial w_m} \right) (f_2 - f_1) \right) - \beta \theta (1 + R_F) \frac{\partial x_1}{\partial w_m} x_1^{\beta-1} \right] \\ & \times \left[ ((1 - M_{1F})f_1 + (M_{1F})f_2) + w_{gF} \left( \frac{\partial M_{1F}}{\partial w_{gF}} + \frac{\partial M_{1F}}{\partial w_{bF}} \frac{dw_{bF}}{dw_{gF}} \right) (f_2 - f_1) \right. \\ & \left. - \beta \theta (1 + R_F) \left( \frac{\partial x_1}{\partial w_{gF}} + \frac{\partial x_1}{\partial w_{bF}} \frac{dw_{bF}}{dw_{gF}} \right) x_1^{\beta-1} \right]^{-1} < 0. \end{aligned}$$

$x_{1F}$  and  $M_{1F}$  are declining in each of their three arguments.  $f_2 < f_1$ , so the supply of labor in the village increases with both  $w_m$  and with  $w_{gF}$ . Labor demand in the village declines with both wages. Hence harvest stage wages in both the good and bad weather states are lower in the presence of higher binding wage floors in the planting stage.

- ii. The rural labor market equilibrium in the bad state of the harvest stage does not hold with equality ( $w_{bF} = w_{1F} = w_m$ ). (21) then defines  $w_{gF}^*(w_m)$ , with the planting stage wage and the wage in the bad state of the harvest period both equal to  $w_m$ .  $f_2 < f_1$ , so the LHS of (21) is monotonically increasing in  $w_{gF}$  and  $w_m$ . The RHS of (21) is monotonically declining in  $w_{gF}$  and  $w_m$ , so  $\frac{dw_{gF}^*(w_m)}{dw_m} < 0$ .