

# Human and Nature: Economies of Density and Conservation in the Amazon Rainforest\*

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## Abstract

Conserving tropical forests could impact the material standard of living of local populations. Human adaptation through sectoral or spatial reallocation of economic activity may undermine conservation policy goals. This paper builds and estimates a multi-sector spatial model of rainforest communities using high-resolution georeferenced data from river basins in the Peruvian Amazon and plausibly exogenous variation in the structure of river networks. We find that the agglomeration externality in agricultural production outweighs dispersion forces in access to land, implying that higher concentration leads to higher productivity with less deforestation per farmer. We also find a strong congestion externality with spatial spillovers in natural resource extraction. The estimated agglomeration externality, which is primarily driven by economies of scale in transport technology and agricultural intensification, has large impacts on improving welfare and reducing deforestation but leads to natural resource depletion through general equilibrium effects. Counterfactual simulations demonstrate that well-targeted river infrastructure investments and place-based protection policies are complementary in improving human and ecological well-being. While protecting the rural frontier mitigates natural resource depletion, transport infrastructure that integrates hinterlands can reduce deforestation by generating moderate-sized but dispersed settlements and spreading the agglomeration benefits more evenly across the basin.

**Keywords:** Tropical Forests, Agriculture, Natural resource extraction, Conservation, Externalities, Spatial models

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# 1 Introduction

Tropical forests are home to much of the world's biodiversity and natural resources and have a crucial role in regulating global climate (Lewis et al. 2015; Pimm et al. 2014; Spracklen et al. 2012). Rapid deforestation and loss of biodiversity, caused by human activities, are pressing issues (Benítez-López et al. 2017; Malhi et al. 2008). Meanwhile, many populations in rainforest areas have low living standards and limited access to modern technology, and they rely on forest and environmental income sources (Angelsen et al. 2014).

Policymakers face two fundamental issues. The first involves balancing the inherent trade-off between conserving the rainforest and improving the welfare of local populations. For example, increasing the cost of forest clearing may reduce deforestation, but it may also reduce agricultural income and thus undermine human welfare. The second issue is that the goals of conservation policies may also be undermined as local populations adapt through sectoral or spatial reallocation of economic activity. For example, if the cost of forest clearing is increased, then local populations may shift from agriculture to other extractive activities such as fishing and hunting, which could lead to biodiversity loss. Moreover, if a place-based protection policy prohibits resource extraction in one area, then local populations may move from that area to another to extract resources, and the impact on overall resource depletion is unclear. This paper asks: How to design a policy that offers solutions to these issues?

To answer this question, it is necessary to consider the general equilibrium forces with human-nature interactions across space. Several recent studies in economics investigated the effectiveness of policy interventions such as environmental conditional cash transfers, regulation and taxes, and protected areas (e.g., Assunção et al. 2022; Hsiao 2022; Jayachandran et al. 2017; Sims and Alix-Garcia 2017; Souza-Rodrigues 2019), as well as infrastructure projects (e.g., Asher et al. 2020; Madhok 2022) on deforestation and biodiversity outcomes. However, most prior studies have not considered the general equilibrium contexts. Moreover, a majority of previous studies of tropical forests have focused on the contexts of extensive commercial investments (e.g., logging, soybeans and cattle-ranching in the Brazilian Amazon, and palm oil plantations in Indonesia; see Balboni et al. 2022 for a comprehensive review). However, findings from these contexts cannot be generalized to more underdeveloped areas where deforestation and other resource extractions are primarily practiced by local populations for their livelihood.

In this paper, we build a multi-sector quantitative spatial general equilibrium model that features the concentration and dispersion forces of the population in tropical forests. We estimate the model using fine-resolution georeferenced data from four roadless river basins in the Peruvian Amazon. We identify externality parameters that explain how population density affects productivity in rural sectors by exploiting plausibly exogenous variation in the structure of river networks. We then implement counterfactual experiments to evaluate policy impacts on human welfare, deforestation, and natural resource depletion. The experiments demonstrate that well-targeted place-based protection policies and transport infrastructure are complemen-

tary in welfare and ecological conservation.

The Peruvian Amazon, our study area, is a suitable setting to study fundamental human-nature interactions for two reasons. First, most of the population engages in traditional way of life with limited modern technology and market access in underdeveloped areas without large-scale external investments. These features enable us to attribute resource extraction to small-scale farmers and hunter-gatherers and thus focus on density externalities they caused.<sup>1</sup> Second, river networks constitute almost the only transportation routes in this region. This feature allows us to identify key structural parameters by exploiting the plausibly exogenous variation in the structure of river networks. In particular, our dataset covers major river basins of the Peruvian Amazon (Figure 1) and consists of grid cell-level geographical and remote sensing data, original community-level census from rural communities, and national censuses.

Using this dataset, we start with three stylized facts that motivate the theoretical model. First, we observe both spatial concentration and dispersion of populations and community locations. This fact suggests the presence of both strong agglomeration and congestion forces of economic activities in rainforests. Second, while the land footprint around a community increases with settlement size, *per capita* land footprint decreases. This pattern suggests that as the community population increases, the cost of access to farmland through forest clearing might become higher because of congestion forces around the settlement. Moreover, this negative relationship is convex, which suggests that a mean-preserving increase in the variance of settlement size may increase total deforestation. Third, while agriculture is widely observed in both concentrated and dispersed areas, natural resource extraction tends to occur more in locations surrounded by areas with lower population densities. These observations suggest that the spatial extent over which density externalities operate might vary across sectors.

Motivated by the stylized facts, we build a quantitative spatial model that highlights the rainforest population's trade-off: natural resource and land endowments are richer in sparse areas owing to weak congestion, while dense areas have higher market access and agglomeration benefits. We incorporate two rural sectors and an urban sector. The rural sectors include an agricultural sector (crop production), which is associated with deforestation, and a natural resource extraction sector (fishing, hunting, and forest products), which is linked to biological resource depletion. The model analyzes trade in the products of these three sectors based on comparative advantages across multiple locations (grid cells) in a general equilibrium framework within a river basin. We explicitly incorporate agglomeration and congestion externalities for productivities in the two rural sectors (agriculture and natural resource extractions). The model incorporates the rural-urban linkage to capture rural remoteness, but it primarily focuses on the rural spatial structure and abstracts from the urban form. The balance between the concentration and dispersion forces, including the agglomeration and congestion externalities,

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<sup>1</sup>This empirical setting is also important in that it is closely related to recent concerns and trends of deforestation in the Amazon. Kalamandeen et al. (2018) report that small-scale deforestation has recently increased throughout the Amazon (in Brazil and other countries), raising concerns about the role of small-scale farmers in forest conversion.

determines the spatial distribution of economic activities in equilibrium.

The model is estimated in steps. First, we estimate trade cost and demand parameters without solving the model. Second, we calibrate the productivities that rationalize the observed sectoral populations in all locations by inverting the model, given the parameters obtained in the previous step. The calibrated productivities contain both productivity fundamentals and endogenous terms caused by the density externalities. Third, we implement the GMM to estimate the density externalities, using the inverted productivity composites as data and exploiting plausibly exogenous variation in the structure of river networks. We construct the “river network access” (RNA), which captures the distance-weighted sum of access to other locations via the river network, as an instrumental variable for each location’s population. The main identifying assumption is that the variation in RNA, as an exogenous shifter of market potential, affects productivity only through its effect on employment and thus through externalities that arise, rather than through productivity fundamentals. Section 5 provides a more detailed discussion of the identification.

The estimation reveals three types of sector-specific density externalities. First, we find a strong congestion externality in forest clearing for accessing to agricultural lands. Second, we find a strong agglomeration externality in agricultural production. More importantly, this agglomeration externality outweighs the congestion externality in access to land, implying that higher concentration leads to higher productivity with less deforestation per farmer. Third, we also find a strong congestion externality with spatial spillovers in natural resource extraction.

The estimated density externalities are quantitatively important. For example, the agglomeration externality contributes to substantially improving human welfare and reducing deforestation, at the expense of other natural resource endowments. Without the agglomeration externality, human welfare decreases by about 7–13% and deforestation increases by about 18–56% depending on the basin. On the other hand, without the agglomeration externality, the natural resource depletion also decreases by about 1–3% through general equilibrium effects in the basin. These impacts are primarily due to the sectoral reallocation of workers. Since agricultural productivity is diminished, the economy needs more agricultural employment to satisfy the population’s demand for agricultural goods, given that consumption demands across the agricultural and natural resource goods are complementary.

We investigate mechanisms behind the agglomeration externality, focusing on transaction environment and agricultural intensification. Interpreting the congestion externality in forest clearing or natural resource extraction is straightforward due to its rivalrous nature. However, interpreting the agglomeration externality in agriculture is not straightforward, in part because agglomeration has typically been discussed in urban settings. Using the original community-level census information, we provide supportive evidence that agglomeration is primarily driven by economies of scale in trade costs. The empirical results are consistent with the view that transport modes, transport costs, and transaction costs are endogenous and are affected by the community’s population. This mechanism is also consistent with the model, since the original

model is isomorphic to an alternative model in which a higher origin population leads to lower iceberg trade costs. In addition, using the producer-level agricultural census, we argue that economies of scale in accessing inputs and technologies in the cropping and marketing process are also behind the agglomeration externality, but to a lesser degree.

We implement two types of counterfactual experiments—transport infrastructure investments and protection policies—with the aim of finding a “win-win” policy that simultaneously achieves higher welfare, lower deforestation, and less natural resource depletion. The transport infrastructure investments aim to reduce high trade costs, which primarily stem from the asymmetry of transport costs due to river orientations and the slow speed of river boats. The investments involve having high-quality boats or dredging rivers as proposed in the Amazon Waterway Project. Protection policies aim to answer the following question: In the presence of density externalities, is it beneficial to concentrate the ecological footprint in fewer spots rather than to have many small communities?

The counterfactuals show that well-targeted river infrastructure investments and place-based protection policies are complementary for improving the human-ecological well-being. In particular, the composite intervention that combines the transport infrastructure investments that connects hinterlands to the central area of a basin with protecting the rural frontier simultaneously achieves the win-win outcome.

Figure 2 presents a simplified illustration of this policy outcome that depicts the deforestation impact, abstracting from the sectoral reallocation of workers. The left-hand maps represent a stylized river basin with a fixed number of agricultural populations where each brown area inside the boundaries is the deforested area by each farmer. The right-hand diagrams represent the relationship between the agricultural population of each rural community and the deforested area per farmer, which is negative and convex, consistent with the stylized fact introduced above. First, compare panels (A) and (B). As hinterlands become more integrated by the improvement in river infrastructure (the light blue line) in panel (B), we observe spatial reallocation of farmers from dense areas toward remote areas compared with the benchmark equilibrium in panel (A). In the remote areas, populations enjoy more agglomeration benefits and deforestation *per farmer* decreases. The total deforestation has reduced, since this forest gain in remote areas outweighs the increase in deforestation per farmer in the central area. Next, compare panels (B) and (C). Protecting the rural frontier in panel (C) generates a more compact basin for human settlements, and the population concentrates in a smaller set of communities. Therefore, given the congestion externality, the total deforestation is further reduced. This protection policy also reduces natural resource depletion by increasing the congestion force in resource extractions, which depends on surrounding populations, within the more compact area.

Obviously, this figure abstracts from any other general equilibrium effects. Actual simulations in the four river basins reveal that this composite intervention increases welfare by about 1–2.1%, decreases deforestation by about 1–7%, and decreases natural resource depletion by about 0.5–2.4%. However, neither of these two types of interventions achieves this joint out-

come alone. Section 7 describes the results and mechanisms in more detail.

Careful targeting of treatment locations matters in both types of interventions. With respect to the improvement of transport infrastructure, although it increases welfare, the direction of deforestation impact depends on where the improvement takes place within the spatial structure of river networks. In contrast to the previous case, improving the transport infrastructure only in densely populated areas increases total deforestation in the basin. This comparison implies that policy interventions that spread the agglomeration externalities more evenly across the basin are desirable in terms of reducing deforestation. That is, policies that result in more moderate-sized but dispersed settlements are more preferable to policies that result in a separation in the basin with highly populated areas of agricultural intensification and very small communities with low agricultural productivity in the hinterland. With respect to the protection policies, a comparison between different protected areas, each directly treating the same number of populations, illustrates the policymaker's trade-off in mitigating different types of environmental costs. For example, a resettlement policy that targets the smallest communities reduces deforestation more than the frontier protection discussed above, but it increases natural resource depletion. Moreover, we also discuss unintended consequences of a sector-specific protection policy as well as pathways to external validity in section 7.

**Related literature.** This paper contributes to three strands of literature. First, it adds to a large body of literature on the trade-off between economic development and environmental goals (see Jayachandran 2021; Jayachandran 2022 for review). Specifically, this paper contributes to the debate on the relationship between agriculture and deforestation (e.g., Abman and Carney 2020; Abman et al. 2020; Angelsen 1999; Angelsen 2010; Carreira et al. 2022; Foster et al. 2002; Heß et al. 2021; Szerman et al. 2022). Empirical evidence on whether higher agricultural productivity causes more deforestation is mixed. We introduce a new channel, the agglomeration benefits, through which higher concentration leads to higher productivity and lower deforestation per farmer. Improving agricultural productivity through our channel can reduce deforestation without the strong conditions that other recent papers have used to draw the same conclusions. In particular, agriculture is the most land-intensive sector in our model (unlike Szerman et al. 2022), and we are not imposing any assumption about factor market constraints (unlike Abman et al. 2020). More importantly, we argue that total deforestation as an aggregate outcome in the economy depends on how the agglomeration benefits are spatially spread. This lesson suggests the importance of analyzing the relationship between agriculture and deforestation in a general equilibrium framework. Furthermore, we incorporate distinct types of environmental costs—deforestation and other natural resource extractions such as fishing and hunting—that have often been studied in isolation, in a unified framework. Our counterfactual experiments relate to the policy discussions on preserving rainforests, including protected areas, taxes, and infrastructure (e.g., Alix-Garcia et al. 2013; Alix-Garcia et al. 2015; Araujo et al. 2020; Assunçao et al. 2022; Madhok 2022; Naughton-Treves et al. 2011; Sims and Alix-Garcia 2017;

Souza-Rodrigues 2019). We contribute to them by demonstrating the complementarity between protection policies and transport infrastructure investments, which have often been investigated separately, in reducing the different types of environmental costs. In addition, this paper joins the decades-long discussion on commons (e.g., Dasgupta and Mäler 1995; Hardin 1968; Ostrom 1990; Ryan and Sudarshan 2022). To our knowledge, this paper is the first to investigate spatial competition over common pool resources in rural areas using a quantitative spatial model.

Second, this paper is connected to the literature of economic geography and quantitative spatial models that investigate spatial distribution of economic activities (e.g., Ahlfeldt et al. 2015; Allen et al. 2020; Donaldson and Hornbeck 2016; Fajgelbaum and Redding 2022; Fujita et al. 1999; Nagy 2020; Redding 2016). In particular, this paper contributes to environmental considerations in economic geography. A growing number of studies are examining the impact of exogenous (future) climate change on economic activities and welfare using spatial models at various levels, including country (e.g., Balboni 2019; Rudik et al. 2021), regional and continental (e.g., Conte 2022; Jedwab et al. 2022), and global (e.g., Costinot et al. 2016; Cruz and Rossi-Hansberg 2021; Nath 2022). This paper complements this literature by analyzing new endogenous environmental outcomes in rainforests. Moreover, this paper also contributes to the literature on intra-country agricultural trade in developing countries (e.g., Bergquist et al. 2022; Pellegrina 2022; Rivera-Padilla 2020; Sayre 2022; Sotelo 2020). This paper is distinct from the previous literature in that it applies a quantitative spatial model in a more spatially granular setting in rural areas. In addition, it incorporates extraction of natural resource products, which has contrasting characteristics to agriculture, and features sector-specific density externalities.

Third and relatedly, this paper enriches our understanding of agglomeration economies (see Ahlfeldt and Pietrostefani 2019; Duranton and Puga 2004; Duranton and Puga 2020 for comprehensive review). While agglomeration has typically been discussed in urban settings in the literature, this paper is the first to uncover the presence of agglomeration externality in rainforests. We present the mechanism behind the agglomeration using rich community- and household-level census data, which amplifies this contribution. In this respect, this paper is also related to previous research that study economies of density in agriculture (Boserup 1965; Caunedo et al. 2020; Holmes and Lee 2012; Salehi-Isfahani 1993; Stryker 1976) and contributes to them by deriving general equilibrium implications for human welfare and environmental costs.

**Roadmap.** The remainder of this paper proceeds as follows. Section 2 introduces the empirical setting and data sources. Section 3 presents stylized facts. Section 4 describes the quantitative spatial model. Section 5 calibrates and estimates parameters of the model. Section 6 investigates mechanisms behind the agglomeration externality. Section 7 provides counterfactual experiments. Section 8 concludes the paper and presents directions for future research.

## 2 Empirical Setting and Data

The Peruvian Amazon, our study area, is an almost ideal setting to study fundamental human-nature interactions in rainforests for two reasons. First, in this environment, most of the population engages in traditional ways of life with limited modern technology and little market access in remote areas. This feature allows us to attribute resource extraction to small-scale farmers and hunter-gatherers and focus on the density externalities caused by them. Second, river networks constitute almost the only transportation routes in this region. We take advantage of this feature to identify key structural parameters by exploiting the exogenously given structure of river networks.

This empirical setting is important in that it is also closely related to recent concerns and trends of deforestation in the Amazon. In recent years, small-scale deforestation has increased throughout the Amazon (in Brazil and other countries), raising concerns about the role of small-scale farmers in forest conversion ([Kalamandeen et al. 2018](#)). [Kalamandeen et al. \(2018\)](#) find that the number of small forest loss patches (< 1 ha) increased by more than 30% between 2001-2007 and 2008-2014 in the entire Amazon, while the number of large ones (> 50 ha) declined significantly. In the context of the Peruvian Amazon, government documents tend to blame smallholder farmers who practice shifting cultivation for most of such small-scale deforestation ([Ravikumar et al. 2017](#)). [Potapov et al. \(2014\)](#) estimate that the forest cover lost between 2000 and 2010 in Peru is equivalent to 2.44% of 78.6 million ha of the Peruvian humid tropical forest biome area and that the majority of this forest loss (92%) was due to clearing. Moreover, recent hotspots of forest loss have been shifting from the Brazilian Amazon to Peru and Bolivia ([Kalamandeen et al. 2018](#)). This fact also suggests the importance of research on rainforest conservation outside the Brazilian Amazon, where less is known.

Our study area consists of two administrative departments, Loreto and Ucayali, that cover an area of 4711,99 km<sup>2</sup> or about 85% of the Peruvian Amazon. Iquitos and Pucallpa are the capitals of these departments, respectively. Figure 1 shows our study area. The area covered by our data consists of four major river basins of the Peruvian Amazon (Napo-Amazon, Pastaza, Lower Ucayali, and Upper Ucayali), which together encompass a vast area of 117,680 km<sup>2</sup>, more than double the total area of Costa Rica and close to that of Malawi. We will consider a general equilibrium in the model in each of these major river basins.

The main data and their sources are presented in the following sections. Appendix B provides more detail about the data and introduces additional data.

### 2.1 Grid Cell-Level Geographic Information

Our primary units of empirical analysis are 1 km × 1 km grid cells. We construct grid cells covering the four basins, regardless of the presence of community and human settlements. We use a variety of grid cell-level geographic information.

**Distance matrix.** We select all the grid cells within 5km from a river (with river orders

1–6). We then implement Dijkstra shortest path calculations between all pairs of the selected grid cells. To calculate the shortest path, we take into account total upstream and downstream distances by river travel as well as distance by land travel.<sup>2</sup>

**Forest cover.** We classify Landsat satellite imageries from 1985, 2001, and 2015 as forest, non-forest, and masked (cloud and water), using CLASlite (Asner et al. 2009),<sup>3</sup> and we aggregate them into grid cell-level information. The forest or non-forest area within a grid cell is measured by the number of 30 m × 30 m pixels classified as forest or non-forest. From the multi-period information, we also construct variables of forest loss, forest recovery, and forest disturbance. Forest loss and recovery are measured between 1985 and 2015. The area of forest loss is the area within a grid cell that changed from forest to soil. The area of forest recovery is the area within a grid cell that changed from soil to forest. Forest disturbance is measured between 2001 and 2015. Forest disturbance includes any events that disturbed primary forests, such as the appearance of secondary forests. Secondary forests are forests that re-grow during the fallow phase of the shifting cultivation system after initial clearing of primary forests and cropping.

Our empirical analyses use many other cell-level geographic data and variables, which we list in Appendix B.

## 2.2 Peruvian Amazon Rural Livelihoods and Poverty Project

The Peruvian Amazon Rural Livelihoods and Poverty (PARLAP) project<sup>4</sup> collects key community- and household-level data from the population living in the four major river basins in the Peruvian Amazon. All the surveyed communities are geo-referenced and can be matched with other publicly available census data by unique community-level identifiers. The PARLAP data consist of the following types of data.

**Community Census (CC).** CC is a basin-wide census that collects community-level information from almost all communities in the four river basins (919 communities in total). The field survey team conducted the data collection over the course of 19 months during 2012–2014. In each community, the field team sought out the local authorities and conducted a focus group interview. The CC data include information on community history (foundation, relocation, past shocks), population size, infrastructure (such as transport modes and communication methods), public services, across-community formal and informal networks, commodity prices, initial and current economic activities, and initial and current natural resource endowments. We rely on these data for various purposes throughout this paper. Appendix B describes the data in more detail. Henceforth we refer to these data as the “CC data.”

**Community/Household Survey (CS/HS).** The PARLAP also surveyed 235 communities from among the 919 communities in the census. This subset of communities was selected by stratified random sampling based on ethnicity, location, initial resource endowments, history, and public

<sup>2</sup>Cadieux et al. (2020) provide a detailed explanation of the Python algorithm used for these calculations.

<sup>3</sup>We are currently working on updating the forest cover data from the Google Earth Engine.

<sup>4</sup>Detailed information about the project can be found at: <https://parlap.geog.mcgill.ca/>.

services. From these 235 surveyed communities, about 4,000 households were surveyed.<sup>5</sup> These survey data were collected between 2014 and 2016. The community survey obtains information on history, school and education, health care, institutions, and natural resource conservation. The household survey contains detailed information on forest clearing, land use and agricultural production, and natural resource extraction. We use these data for some descriptive analyses. Henceforth we refer to these data as the “CS data” and the “HS data.”

Unless otherwise noted, we aggregate variables from these data into the grid cells.

## 2.3 National Censuses

We use the following censuses to complement the dataset.

**Peru Population and Housing Census.** The Instituto Nacional de Estadística e Informática (INEI) in Peru conducted population censuses in 1981, 1993, 2007, and 2017. The census generally contains information on total population size, total number of households, and basic demographic characteristics in the entire country, with variations in the specific content across census years. We primarily use the data from 2007 and 2017.<sup>6</sup> We aggregate variables from these data into the grid cells. Populations in the urban centers (and a few rural communities) not covered by the CC data are extracted from the 2017 census to construct comprehensive population data for the general equilibrium units of the spatial model. Henceforth we call these data the “INEI population census.”

**Peruvian Agricultural Census (CENAGRO).** The INEI collected these data in 1994 and 2012, conducting direct interviews with agricultural producers throughout Peru. We use the data from 2012. These data contain comprehensive farm-level and plot-level information about land use, land tenure, crop choices, irrigation, marketing, livestock practices, credit access, infrastructure and machinery, labor, input use, and demographic characteristics of the producers’ household members. Since a community-level unique identifier is available for each agricultural producer’s location, we can match these data from Loreto and Ucayali departments in the Peruvian Amazon with the others. We primarily use these data to investigate the mechanisms underlying the density externalities in agriculture implied by the structural model.

## 3 Stylized Facts

This section presents stylized facts that motivate the model and counterfactual policy interventions.

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<sup>5</sup>If the surveyed community had more than 20 household, then we surveyed the 20 households selected by the stratified random sampling based on wealth status. Otherwise, we surveyed all households in the community.

<sup>6</sup>In order to construct the long-term panel data, we are currently constructing the data in 1993 by manually matching its community names with the 2007 and 2017 data.

### 3.1 Spatial Distribution of Communities and Populations

#### Fact 1A: Spatial concentration and dispersion of populations and communities.

Figure 3 indicates the concentration and dispersion of populations. The circle dots in the figure represent the centroids of  $1 \text{ km} \times 1 \text{ km}$  populated grid cells in rural locations ( $n = 900$ ). The square symbol in each basin represents the urban center. As shown in the figure legends, the circle dots represent quantiles of population sizes whereby each of the five ranges contains a nearly equal number of locations. It is apparent from the legend that, in all four basins, more than 80% of rural locations have populations smaller than 450. Moreover, about 40% of rural locations are very small, with populations of 150 or less. In contrast, fewer than 50 rural locations (out of 900) have populations larger than 1,000.

Figure A.1 and Figure A.2 illustrate the concentration and dispersion of locations community locations. These maps show the establishment of communities in the Napo and Upper Ucayali basins over decades. Every two decades, newly founded communities appear in both sparse and concentrated areas.

**Implication.** This fact suggests the presence of both strong agglomeration and congestion forces of economic activities in rainforests.

### 3.2 Human Settlements and Forest Cover

It is not feasible to identify the direct cause of deforestation from information on forest loss obtained from satellite imageries. It might nevertheless be useful to investigate the relationship between human settlements and forest cover. We implicitly presume that the deforestation observed around a rural community is primarily caused by the population that settles in the community. Before stating the stylized facts that connect to the model, we first report the overall relevance of the local population for the forest cover in the four basins.

Figure 4 visualizes the significant overlap between community locations, populations, and deforestation in the Upper Ucayali basin. To give a sense of the overall magnitude of this relationship, Table 1 presents summary statistics on forest loss from 1985 to 2015 (in hectares) for each grid cell category according to the presence of settlements. Panel (A) reports summary statistics in all grid cells in the four basins. According to the first row, the average deforested area in cells with a census community (10.434 ha) is significantly higher than in cells without a census community (2.842 ha). However, the areas where people clear forest might not be exactly the same as their residential locations reflected in the census community location. Therefore, other rows in this panel present summary statistics on deforestation in grid cells within 2 km and 5 km of a census community. Importantly, the column of sum in the last two rows indicates that more than 50% of total deforestation in the four basins is observed in areas within 5km of the census communities. Panel (A) reports summary statistics in grid cells within 2km of the census communities in the four basins, given that most communities are located along the

river lines. Among these selected grid cells, the last two rows indicates that almost 60% of total deforestation in the four basins is observed in areas within 5km of the census communities.

Figure 5 shows the cumulative distributions of the percentage of deforested area in each grid cell for cells with and without census communities. This figure implies the same takeaway as in the previous table. The top-left diagram implies that cells with census communities have much higher deforestation. The other diagram imply that the difference in the distribution of deforested area decreases as the buffer size increases. Moreover, these patterns are robust to the period of measuring deforestation. Figure A.3 shows the same relationship, but with deforestation measured between 2001 and 2015.

These patterns stress the importance of small-scale farmers as a cause of deforestation in the study area. This takeaway is indeed consistent with the findings from the existing literature that we introduced at the beginning of section 2. Meanwhile, the positive relationship between human settlements and deforestation is straightforward in theory. We next present a more important fact that motivates the model and policy interventions.

**Fact 2A: The relationship between population and per capita land footprint is negative and convex.**

Figure 6 plots populations and per capita forest loss areas (between 1985 and 2015) or per capita non-forest areas (in 2015) within 2 km buffers from the 2007 INEI population census communities in the Napo-Amazon basin. The total population in the buffer surrounding a community is measured by summing populations from communities whose centroids are inside the buffer. Note that, if we assume that Amazon river basins were fully covered by rainforests at the very beginning (i.e., before any human settlements), then non-forest area could also be a reliable measure of total net deforestation associated with human settlements until today. With the use of either way of measuring the deforestation, the figure is consistent with a negative relationship between population and per capita land footprint.

Furthermore, the negative relationship between population and per capita land footprint is convex. As the lowess lines illustrate, the relationship between population and per capita land footprint is convex. Figure A.4 and Figure A.5 show this relationship for different buffer sizes (1 km, 2 km, 5 km) and for all four basins. These figures illustrate that the convex relationship is robust to different buffer sizes and different basins.

This relationship is correlational, but suppose for simplicity that we take this relationship as structural as a thought experiment. Then, this relationship suggests the following two takeaways toward the modeling, estimation, and policy simulations. First, even without a land market, a congestion force may exist in forest clearing depending on the population size in a residential location. Second, and more importantly, with a strong convexity, a mean-preserving increase in the variance of settlement size might increase total deforestation.<sup>7</sup>

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<sup>7</sup>Figure A.6 shows a clean log linear form of the relationship between population and per capita deforestation with different buffer sizes. This relationship motivates the decision of the functional form of the congestion exter-

Recall Figure 2 that indeed illustrates the second point. We ignore the left-hand maps now and focus on the right-hand diagrams in scenarios (A) and (B), which depicts the convex relationship. We consider these two scenarios for an economy with five communities and a fixed total population of 16. In scenario (A), four communities each have a population of two and a deforested area of 10 hectares per capita. Another community has a population of eight and a per capita deforested area of 3 hectares. In this scenario, the total deforestation in the economy is 104 hectares. In scenario (B), four communities each have a population of three and a deforested area of 6 hectares per capita. Another community has a population of four and a per capita deforested area of 5 hectares. In this scenario, the total deforestation in the economy is 92 hectares and is reduced from the previous scenario.

**Implication.** To summarize, the two takeaways motivate the following investigations. The first takeaway implies the importance of modeling the congestion externality in forest clearing in a land-intensive sector and estimating its magnitude. The second takeaway implies that policy interventions that lead to a change in the variance of settlement size even with the same total population might have an important ecological consequence.

### 3.3 Spatial Distribution of Agriculture and Natural Resource Extraction

We finally focus on sectoral difference in the spatial distribution of economic activities. The two main types of activities in our study area are agriculture and natural resource extractions. Agricultural sector includes food crops (e.g., manioc, farina, plantain) and cash crops (e.g., rice, maize, beans, sugar cane, vegetables, fruits). Natural resource extractions include forest products and wild animal extractions. Natural resource extractions include wildlife extractions and forest products. Wildlife extractions include fishing and game meat (hunting). Forest products consist of non-timber forest products (NTFP) and timber.

Exploiting the HS data for detailed household-level activity choices, we find the following two facts.

**Fact 3A: Agriculture is widely observed in both concentrated and dispersed areas.**

**Fact 3B: Natural resource extraction is observed more in areas with lower surrounding population densities.**

Figure 7 and Figures A.7–A.9 illustrate Facts 3A and 3B. Population density in a smaller buffer of a community becomes close to the population density of the community itself. A smaller population density in a large buffer of a community implies more sparseness of communities and less competition over natural resources. From the figures we observe that spatial distributions of natural resource extractions become more distinct from agricultural activities as the buffer size enlarges ( $x = 5 \text{ km}$ ,  $10 \text{ km}$  compared with  $x = 1 \text{ km}$ ,  $2 \text{ km}$ ).

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nality in the model. Appendix C.1 investigates the relationship between the Market Access and forest cover changes implied by a simple one sector model and it reports consistent facts there.

**Implication.** These observations suggest that the spatial extent over which density externalities operate is heterogeneous across sectors. This takeaway motivates the model that incorporates multiple sectors with distinct types of density externalities.

## 4 Quantitative Spatial Model of Rainforest Communities

We construct a multi-sector spatial general equilibrium model based on comparative advantage and trade across communities in a river basin in Amazonian rainforests. The model is built on Michaels et al. (2011) and incorporates novel sector-specific density externalities and a rural-urban linkage in an environment of missing land market. While the model incorporates the rural-urban linkage to capture rural remoteness, it focuses primarily on the rural spatial structure and abstracts from the urban form.

The model has three purposes. First, the model rationalizes the stylized facts presented in the previous section. Second, we model rainforest populations' fundamental trade-offs between richer resource endowments in sparse areas and higher market access and agglomeration benefits in dense areas. Third, counterfactual experiments based on the model quantify two types of trade-offs from policy planners' perspective. The first trade-off is between rainforest conservation and local populations' welfare. The second type of trade-off is between different aspects of conservation, such as between deforestation and biological resource depletion.

### 4.1 Geography and Population

We consider a general equilibrium in each river basin  $b$ . Each basin consists of a set of rural locations ( $\mathcal{R}_b$ ) and one urban center ( $u_b$ ), indexed by  $o$  (origin) and  $d$  (destination), where  $o, d \in \mathcal{I}_b = \mathcal{R}_b \cup u_b$ .<sup>8</sup> There are three sectors—agricultural production ( $Ag$ ) and natural resource extraction ( $Nr$ ) in the rural locations and an urban sector ( $M$ ) in the urban center. Locations exogenously differ in productivity fundamentals (e.g., soil quality and access to water) in each sector and distance to other locations given the river networks. The total population in each basin is  $\bar{N}_b$  and fixed, while we assume the free mobility of the population within the basin. The total land area (including areas covered by rainforests) in each basin is  $\bar{L}_b$ . The notation of basin  $b$  is omitted for simplicity of exposition hereafter in this section.

Each worker in  $o$  obtains wage  $w_o$  by inelastically supplying one unit of labor and chooses how much of each variety (indexed by  $j$ ) of the rural sectoral goods and of the urban good, all of which are produced in the basin. In particular, a worker solves the following problem:

$$\begin{aligned} & \max_{\{c_{o,Ag}(j), c_{o,Nr}(j), C_{o,M}\}} \left[ \alpha_{Ag} C_{o,Ag}^{\frac{\bar{\sigma}-1}{\bar{\sigma}}} + \alpha_{Nr} C_{o,Nr}^{\frac{\bar{\sigma}-1}{\bar{\sigma}}} + \alpha_M C_{o,M}^{\frac{\bar{\sigma}-1}{\bar{\sigma}}} \right]^{\frac{\bar{\sigma}}{\bar{\sigma}-1}} \\ \text{s.t. } & \int_0^{n_{Ag}} p_{o,Ag}(j) c_{o,Ag}(j) dj + \int_0^{n_{Nr}} p_{o,Nr}(j) c_{o,Nr}(j) dj + P_{o,M} C_{o,M} = w_o \end{aligned}$$

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<sup>8</sup>The urban centers in the four basins are Iquitos in the Napo-Amazon basin, San Lorenzo in the Pastaza basin, Orellana in the Lower Ucayali basin, and Pucallpa in the Upper Ucayali basin, respectively.

where  $C_{o,Ag} \equiv \left[ \int_0^{n_{Ag}} c_{o,Ag}(j)^{\frac{\sigma-1}{\sigma}} dj \right]^{\frac{\sigma}{\sigma-1}}$  and  $C_{o,Nr} \equiv \left[ \int_0^{n_{Nr}} c_{o,Nr}(j)^{\frac{\sigma-1}{\sigma}} dj \right]^{\frac{\sigma}{\sigma-1}}$  are continuums of varieties of the agricultural and natural resource goods.  $C_{o,M}$  represents consumption of the single urban good and  $P_{o,M}$  is its price in  $o$ .  $\sigma$  represents the elasticity of substitution across varieties within each sector and  $\bar{\sigma}$  represents the elasticity of substitution across sectors. Solving this problem yields the following indirect utility:

$$V_o = \frac{w_o}{\left[ \sum_{K=Ag,Nr,M} \alpha_{o,K}^{\bar{\sigma}} P_{o,K}^{1-\bar{\sigma}} \right]^{\frac{1}{1-\bar{\sigma}}}}$$

expenditure shares across varieties within each sector in each location:

$$\tilde{\alpha}_{o,K}(j) = \frac{P_{o,K}^{\sigma} p_{o,K}(j)^{(1-\sigma)}}{\sum_{K'=Ag,Nr,M} P_{o,K'}} \quad K = Ag, Nr \quad (1)$$

and expenditure shares across sectors in each location:

$$\tilde{\alpha}_{o,K} = \frac{\alpha_K^{\bar{\sigma}} P_{o,K}^{(1-\bar{\sigma})}}{\sum_{K'=Ag,Nr,M} \alpha_{K'}^{\bar{\sigma}} P_{o,K'}^{1-\bar{\sigma}}} \quad K = Ag, Nr, M \quad (2)$$

where  $P_{o,Ag} \equiv \left[ \int_0^{n_{Ag}} p_{o,Ag}(j)^{1-\sigma} dj \right]^{\frac{1}{1-\sigma}}$  and  $P_{o,Nr} \equiv \left[ \int_0^{n_{Nr}} p_{o,Nr}(j)^{1-\sigma} dj \right]^{\frac{1}{1-\sigma}}$  are sectoral price indices.

## 4.2 Production with Density Externalities

### Agricultural production with congestion and agglomeration externalities

Agricultural production consists of two steps. The first step is to access land for cultivation by clearing forest. There is no land market. We thus define the production function of "land access" for cropping variety  $j$  as follows:

$$L_o(j) = A_{o,L} N_{o,Ag}^{-\mu_L} \cdot N_{o,L}(j), \quad o \in \mathcal{R} \quad (3)$$

where  $L_o(j)$  is the amount of land cleared for cropping variety  $j$  of the agricultural products and  $N_{o,L}(j)$  represents employment used to access this land.

The first factor of the production function ( $A_{o,L} N_{o,Ag}^{-\mu_L}$ ) represents the productivity composites that depends on productivity fundamentals ( $A_{o,L}$ ) and on total agricultural employment in the location ( $N_{o,Ag}$ ). We assume the common productivity fundamentals  $A_{o,L}$  of land access for cropping different varieties in each location, given that mixed cropping is commonly observed in the shifting cultivation system in tropical forests. Parameter  $\mu_L$  governs the congestion force in forest clearing around the settlement. A positive value for this parameter indicates that as the community population increases, the area of land available to each population becomes

smaller.<sup>9</sup>

The second step is to produce agricultural goods given the accessed land. We define the production function of variety  $j$  of agricultural goods as follows:

$$Q_{o,Ag}(j) = z_{o,Ag}(j) N_{o,Ag}^{\mu_{Ag}} \cdot N_{o,C}(j)^{\gamma} L_o(j)^{(1-\gamma)}, \quad o \in \mathcal{R} \quad (4)$$

where  $N_{o,C}(j)$  represents employment for cropping variety  $j$  on the cleared land. That is, the total agricultural employment in  $o$  is  $N_{o,Ag} = N_{o,L} + N_{o,C} = \int_0^{n_{Ag}} (N_{o,L}(j) + N_{o,C}(j)) dj$ .

The first factor  $(z_{o,Ag}(j) N_{o,Ag}^{\mu_{Ag}})$  represents the productivity. A stochastic factor in the productivity,  $z_{o,Ag}(j)$ , follows the Fréchet distribution such that  $F_{Ag}(z) = \exp(-A_{o,Ag} z^{-\theta})$ , where  $A_{o,Ag}$  represents the absolute advantage and  $\theta$  represents the comparative advantage. Lower  $\theta$  corresponds to higher dispersion of productivity. Productivity in this second step again depends on the total agricultural employment in the location. Parameter  $\mu_{Ag}$  governs the agglomeration force in agricultural production and marketing. A positive value for this parameter indicates that as the community agricultural population increases, agricultural productivity increases.<sup>10</sup>

### Natural resource extraction with congestion externality across space

We define the production function of extracting variety  $j$  of natural resources as follows:

$$Q_{o,Nr}(j) = z_{o,Nr}(j) \left[ \sum_{d \in \mathcal{R}} D_{od}^{-\nu} N_{d,Nr} \right]^{-\mu_{Nr}} \cdot N_{o,Nr}(j), \quad o \in \mathcal{R} \quad (5)$$

where  $N_{o,Nr}(j)$  represents employment for extracting variety  $j$  of natural resource. Note that the amount of  $Q_{o,Nr}(j)$  is natural resource extracted by individuals residing at  $o$  from surrounding areas by search and travel (i.e., not extracted only from  $o$ ). The total employment for natural resource extraction in  $o$  is  $N_{o,Nr} = \int_0^{n_{Nr}} N_{o,Nr}(j) dj$ . In contrast to agricultural production, labor is the only factor for natural resource extraction. In rural locations  $o \in \mathcal{R}$  the total population is thus  $N_o = N_{o,Ag} + N_{o,Nr}$ .

The first factor  $(z_{o,Nr}(j) \left[ \sum_{d \in \mathcal{R}} D_{od}^{-\nu} N_{d,Nr} \right]^{-\mu_{Nr}})$  represents the productivity. A stochastic factor in the productivity,  $z_{o,Nr}(j)$ , also follows the Fréchet distribution such that  $F_{Nr}(z) = \exp(-A_{o,Nr} z^{-\theta})$ , where  $A_{o,Nr}$  represents the absolute advantage and  $\theta$  is the same comparative advantage parameter defined above. Productivity depends on employment of natural resource extraction not only in the own location but also in surrounding locations. Parameter  $\mu_{Nr}$  governs the conges-

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<sup>9</sup>As the community population increases, the cost of access to farmland through forest clearing would become higher. In the absence of a land market, community members negotiate with each other to distribute the land they each use as farmland. The larger the community population, the higher the cost of finding and negotiating areas for forest clearing. For these reasons, we hypothesize that  $\mu_L > 0$ , but the empirical analysis for estimating this parameter does not restrict it to be positive.

<sup>10</sup>We hypothesize that  $\mu_{Ag} > 0$ , but the empirical analysis for estimating this parameter does not restrict it to be positive. There are several possible mechanisms under which the agglomeration externality may exist. Section 6 provides a detailed discussion.

tion force with spatial spillover from the surrounding population in the common pool natural resource extraction. Variable  $D_{od}$  represents the river-equivalent distance between cells  $o$  and  $d$  along the shortest path. Parameter  $\nu$  governs the spatial decay in access to natural resources. The implicit assumption underlying this specification is that people travel longer distances for natural resource extraction than for agriculture.<sup>11</sup>

### Urban good production at the urban center

The urban good contains miscellaneous non-food (manufacturing and service) items, but for simplicity we express it as a single good and define its production function as:

$$Q_{u,M} = A_{u,M} \cdot N_{u,M} \quad (6)$$

where  $N_{u,M}$  ( $= N_u$ ) is employment in the urban center and  $A_{u,M}$  is exogenous productivity.

## 4.3 Prices and Trade

Let  $p_{od,K}(j)$  be the price of product  $j$  in sector  $K$  produced in  $o$  (origin) to be purchased in  $d$  (destination). We define the iceberg trade cost of sector  $K$  goods, denoted by  $\tau_{od,K}$ , such that it satisfies the following relationships: for  $K \in \{Ag, Nr\}$ ,  $p_{od,K}(j) = \tau_{od,K} p_{oo,K}(j)$ ,  $\tau_{oo,K} = 1$ ,  $\tau_{od,K} > 1$  for  $o \neq d$ , and  $\tau_{od,K} < \tau_{oi,K} \tau_{id,K}$  for  $o \neq i \neq d$ , where  $o \in \mathcal{R}$  and  $i, d \in \mathcal{I}$ . For the urban good,  $P_{d,M} = p_{ud,M} = \tau_{ud,M} p_{uu,M} = P_{u,M}$ , where  $\tau_{ud,M} > 1$  for  $d \in \mathcal{R}$  and  $\tau_{uu,M} = 1$ .

While the above specification of iceberg trade cost is standard in the literature, note that for  $K \in \{Ag, Nr\}$   $\tau_{od,K} = \tau_{do,K}$  does not necessarily hold because of river orientations. That is, trade cost between a pair of locations may be asymmetric. The trade literature often assumes symmetric trade costs, but the asymmetry would especially matter in particular environments such as transports along a river or a high-slope road and during periods before modern transport technologies were adopted. For example, [Chen et al. \(2022\)](#) discuss that exogenously determined asymmetric trade costs play an important role in predicting city locations in ancient Greece where the major transport mode was sailing.<sup>12</sup>

We define  $D_{od}$  as the downstream-river-equivalent kilometers along the lowest-cost route from  $o$  to  $d$  and assume that:

$$D_{od} = D_{od,down} + \lambda_{up} D_{od,up} + \lambda_{land} D_{od,land} \quad (7)$$

where  $D_{od,down}$ ,  $D_{od,up}$ , and  $D_{od,land}$  are the distances (in kilometers) of going downstream and upstream on the river and the distance of land travel.  $\lambda_{up}$  and  $\lambda_{land}$  are the parameters capturing

<sup>11</sup>We hypothesize that  $\mu_{Nr} > 0$  and  $\nu > 0$ , but the empirical analysis for estimating these parameters does not restrict them to be positive.

<sup>12</sup>Trade costs could also be endogenous. See, for example, [Brancaccio et al. \(2020\)](#) and section 6 for more detailed discussion.

the downstream-river-equivalent distance per kilometer of upstream and land travels (i.e., relative travel costs in terms of downstream-river travel). We then parameterize the iceberg trade cost as:

$$\tau_{od,K} = D_{od}^{\delta_K} \quad (8)$$

where  $\delta_K$  is the elasticity of trade cost of sector  $K$  goods with respect to the effective distance.

We assume perfect competition among producers of all the sectors. Under perfect competition, prices are equalized to marginal costs as follows. For the agricultural goods,  $p_{oo,Ag}(j) = \frac{w_o}{z_{o,Ag}(j)A_{o,L}^{(1-\gamma)}N_{o,Ag}^{\tilde{\mu}_{Ag}}\kappa_1}$ , where  $\tilde{\mu}_{Ag} \equiv \mu_{Ag} - \mu_L(1 - \gamma)$  represents the composite of density externalities in agriculture and  $\kappa_1$  contains constant terms.<sup>13</sup> For the natural resource goods,  $p_{oo,Nr}(j) = \frac{w_o}{z_{o,Nr}(j)[\sum_{d \in \mathcal{R}} D_{od}^{-\gamma} N_{d,Nr}]^{-\mu_{Nr}}}$ . For the urban good,  $P_{u,M} = \frac{w_o}{A_{o,M}}$ .

Following Eaton and Kortum (2002), we can derive each destination's expenditure share on goods shipped from each origin. For the rural goods  $K = Ag, Nr$ , the expenditure share across locations within a sector is expressed as:<sup>14</sup>

$$\pi_{od,K} = \frac{\tilde{A}_{o,K}(w_o \tau_{od,K})^{-\theta}}{\sum_{o' \in \mathcal{R}} \tilde{A}_{o',K}(w_{o'} \tau_{o'd,K})^{-\theta}}, \quad o \in \mathcal{R}, d \in \mathcal{I} \quad (9)$$

where  $\tilde{A}_{o,K}$  represents a productivity composite that contains both exogenous and endogenous components of productivity:

$$\begin{aligned} \tilde{A}_{o,Ag} &\equiv A_{o,Ag} A_{o,L}^{(1-\gamma)\theta} N_{o,Ag}^{\tilde{\mu}_{Ag}\theta} \kappa_1^\theta \\ \tilde{A}_{o,Nr} &\equiv A_{o,Nr} [\sum_{d \in \mathcal{R}} D_{od}^{-\gamma} N_{d,Nr}]^{-\mu_{Nr}\theta} \end{aligned} \quad (10)$$

The urban good is only purchased from the urban center  $u$  in all locations.

## 4.4 Spatial Equilibrium

The spatial equilibrium is defined as the following conditions.

1. The labor market for the agricultural production clears in all the rural locations:

$$w_o N_{o,Ag} = \sum_{d \in \mathcal{I}} \pi_{od,Ag} \tilde{\alpha}_{d,Ag} w_d N_d \quad \forall o \in \mathcal{R} \quad (11)$$

2. The labor market for the natural resource extraction clears in all the rural locations:

$$w_o N_{o,Nr} = \sum_{d \in \mathcal{I}} \pi_{od,Nr} \tilde{\alpha}_{d,Nr} w_d N_d \quad \forall o \in \mathcal{R} \quad (12)$$

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<sup>13</sup>Specifically,  $\kappa_1 = \gamma^\gamma (1 - \gamma)^{(1-\gamma)}$ .

<sup>14</sup>=  $\Pr(d \text{ buys a good from } o) = \Pr(o \text{ sells a good at the lowest price to } d) = \text{Fraction of goods that } d \text{ buys from } o$

3. The labor market for the urban good clears in the urban center:

$$w_u N_{u,M} = w_u N_u = \sum_{d \in \mathcal{I}} \tilde{\alpha}_{d,M} w_d N_d \quad (13)$$

4. The overall labor market clears:

$$\bar{N} = \sum_{o \in \mathcal{R}} N_o + N_u = \sum_{o \in \mathcal{R}} \sum_{K \in \{Ag, Nr\}} N_{o,K} + N_{u,M} \quad (14)$$

5. Utility is equalized across populated locations due to free labor mobility:

$$V_o = \frac{w_o}{\left[ \sum_{K=Ag, Nr, M} P_{o,K}^{1-\bar{\sigma}} \right]^{\frac{1}{1-\bar{\sigma}}} } = \bar{U} \quad \forall o \in \tilde{\mathcal{I}} \quad (15)$$

where  $\tilde{\mathcal{I}}$  is the set of all locations that have positive populations.

6. The total deforested area does not exceed the available land area:  $\sum_{o \in \mathcal{R}} L_o \leq \bar{L}$

Solving the model involves solving for endogenous employment shares and wages, given geography, productivity fundamentals, exogenous parameters, and total population in the economy.

## 5 Estimating the Model

Table 2 summarizes the parameters of the model. We estimate the parameters and validate the model in the following sequential steps.

### 5.1 Estimating Parameters without Solving the Model (Step 1)

#### Trade cost parameters

We first calibrate the elasticity of trade cost with respect to the effective downstream-river-equivalent distance for each sector ( $\{\delta_K\}$ ), using price observations in the populated grid cells and the downstream river distance. The CC data collect prices of representative products of agricultural and natural resource sectors in the census communities (see Appendix B.2 for details). We compile the grid cell-level price data by computing average prices of goods in each cell. We then obtain price ratios of these products between all pairs of grid cells that have non-missing price observations. We calibrate  $\delta_K$  by minimizing the squared sum of  $(p_{od,K}^{Max} - D_{od,down}^{\delta_K})$  where  $p_{od,K}^{Max} \equiv \max_j \{p_{d,K}(j)/p_{o,K}(j)\}$  is the maximum price ratio across all the varieties in each sector among location pairs that satisfy  $D_{od,up} = D_{od,land} = 0$ . Although the price ratio should be constant in  $j$  under the model, we need to take the maximum price ratio among the observed prices for the following two reasons. First, this approach mitigates the concern that observed

price gaps of each product might underestimate trade costs, given our limited price information<sup>15</sup> and that price ratios between two locations are bounded above by trade costs between them (Eaton and Kortum 2002). Second, we assume that  $\tau_{od,K}$  is the cost of transport by the most widely available transport mode ("peque-peque," shown in the top-right picture of Figure A.10). However, the observed price ratio may reflect transports by other boat types that are superior (e.g., the bottom two pictures of Figure A.10) even if the location pair consists of actual origin and destination, in which case the trade cost is underestimated. We obtain  $\hat{\delta}_{Ag} = 0.178$ ,  $\hat{\delta}_{Nr} = 0.137$ , and  $\hat{\delta}_M = 0.098$ . These values lie in a standard range of values from the related literature. Values of trade costs that are higher than our estimates nevertheless lead to qualitatively robust subsequent results and just amplify our core findings.

We next calibrate the effective distance parameters in terms of the downstream distance on the river ( $\lambda_{up}$ ,  $\lambda_{land}$ ). We obtain  $\hat{\lambda}_{up} = 1.282$ , using records of travel time by *peque-peque* for several routes in the Peruvian Amazon.<sup>16</sup> We obtain  $\hat{\lambda}_{land} = 36.767$ , using records of transportation costs by land travels. Appendix C.2 provides the detail procedure to estimate these parameters.

Having obtained the lengths of river (downstream and upstream) and land travels in the shortest paths and the relative distance parameters, we compute the effective downstream-river-equivalent distance for all pairs of grid cells. To solve the spatial equilibrium in a later stage, we set  $\tau_{od,K} = \hat{D}_{od}^{\hat{\delta}_K}$ , where  $\hat{D}_{od}$  is calculated by (21) using  $\hat{\lambda}_{up}$  and  $\hat{\lambda}_{land}$ .

## Demand parameters

We estimate elasticity of substitution between varieties within each sector ( $\sigma$ ) and between sectoral composite products ( $\bar{\sigma}$ ), using household-level information on expenditures and unit values (interpreted as buying prices) from the Peru National Household Survey. Appendix C.2 describes the data and provides the detailed procedure for estimating these parameters. We obtain  $\hat{\sigma} = 2.401$  (substitutes since  $\hat{\sigma} > 1$ ) and  $\hat{\bar{\sigma}} = 0.752$  (complements since  $\hat{\bar{\sigma}} < 1$ ).<sup>17</sup>

## Other parameters

We assume that the labor cost share in the agricultural production is  $\hat{\gamma} = 0.6$ , which lies in a standard range of values from the related literature. For example, Sotelo (2020) reports that the average labor cost share in crop production in Peru is 0.55. We assume that the productivity dispersion (the shape parameter) in the rural sectors is  $\hat{\theta} = 7.8$ , drawn from the study by Donaldson

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<sup>15</sup>The price data have the following limitations. First, we do not have multiple periods of price observations. Second, we have a smaller number of products compared with the actual potential number of varieties that people in our study area are producing. Third, we do not observe origins and destinations of these varieties.

<sup>16</sup>The downstream-river-equivalent distance measure specified by (21) implicitly assumes the constant slope everywhere. Future work will construct a more sophisticated measure of the effective distance that takes river orientations with slopes in each travel route into account.

<sup>17</sup>Under alternative specifications (i.e., alternative controls, instruments, and methods for selecting the tuning parameter of LASSO), estimates of  $\sigma$  range around [2.4, 3.3] and those of  $\bar{\sigma}$  range around [0.63, 0.8]. Subsequent results with different values of  $(\sigma, \bar{\sigma})$  are qualitatively robust.

(2018) on agricultural trade in the context of developing economies.<sup>18</sup>

## 5.2 Model Inversion to Recover Productivity Composites (Step 2)

Given the parameters obtained in the previous step, we invert the model to obtain productivity composites of all the sectors and wages ( $\{\tilde{A}_{o,Ag}, o \in \tilde{\mathcal{R}}\}$ ,  $\{\tilde{A}_{o,Nr}, o \in \tilde{\mathcal{R}}\}$ ,  $A_{u,M}$ ,  $\{w_o, o \in \tilde{\mathcal{I}}\}$ ) that rationalize the observable data (sectoral employment share and total population in each location) as a spatial equilibrium. Given that the inverted productivity composites contain both exogenous and endogenous terms, the model inversion is technically equivalent to and easier than simulating the model.

In each basin, we use  $2|\tilde{\mathcal{R}}| + 1 + |\tilde{\mathcal{I}}| (= 3|\tilde{\mathcal{I}}| - 1)$  equations with the observables to solve for  $2|\tilde{\mathcal{R}}| + 1 + |\tilde{\mathcal{I}}|$  unknowns, where  $\tilde{\mathcal{R}}$  is the set of rural locations that have positive populations. We observe sectoral employments in grid cells of rural locations and total populations in the urban centers.<sup>19</sup> The  $2|\tilde{\mathcal{R}}| + 1 + |\tilde{\mathcal{I}}|$  equations involve sectoral labor market clearing in all locations and utility equalization across space, expressed by (11), (12), (13), and (15). The  $2|\tilde{\mathcal{R}}| + 1 + |\tilde{\mathcal{I}}|$  unknowns are the productivity composites and wages.

The model inversion reduces to the nested fixed point problem. The algorithm is described in Appendix C.3. By the construction of the inversion problem, the model perfectly fits the data of sectoral employment.<sup>20</sup> Proving the uniqueness of the solution of this inversion problem follows Michaels et al. (2011).

## 5.3 GMM Estimation of Density Externality Parameters (Step 3)

Using productivity composites obtained in the previous step as data and exploiting exogenous river shape, we employ the GMM to estimate parameters governing the density parameters. We first estimate the parameter governing density externalities in agriculture using both grid cell-level model-driven data and community-level information of forest cover. We then estimate congestion externality in natural resource extraction.

Table 3 summarizes the estimation results of these parameters. Below we describe each step.

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<sup>18</sup>Donaldson (2018) estimates this parameter by a gravity equation using data on quantities of agricultural commodities traded internally in India during 1882-1920. His empirical setting has a similarity to ours because agriculture constituted a significant share in India's economy during this period. Moreover, this parameter value is in the standard range of estimates from developing countries in the literature and is higher than estimates from developed countries. Given that our study area is narrower than the usual context (e.g., a single country), comparative advantage may play a smaller role and the geography exerts a stronger force than in other settings in the literature. However, larger values of  $\theta$  will amplify the main results and will not change the core story of this paper.

<sup>19</sup>See Appendix B.2 for the construction of the sectoral employment shares.

<sup>20</sup>The calibrated productivity composites are correlated with non-targeted data and moments. For example, Table A.1 reports a significant positive correlation between the reported number of species found around a community (from the CC data) and the calibrated productivity of the natural resource sector.

### 5.3.1 Density externalities in agriculture

#### Net density externality in productivity composite in agriculture

The inverted productivity composite of agricultural production is  $\tilde{A}_{o,Ag} \equiv A_{o,Ag} A_{o,L}^{(1-\gamma)\theta} N_{o,Ag}^{\tilde{\mu}_{Ag}\theta} \kappa_1^\theta$ . Taking the logarithm yields the following linear empirical specification:

$$\ln \tilde{A}_{o,Ag} = \tilde{\mu}_{Ag}\theta \ln N_{o,Ag} + X'_o \beta + \phi_B + \epsilon_{o,Ag} \quad (16)$$

where  $\ln N_{o,Ag}$  is the logarithm of agricultural employment at location  $o$ , and  $X_o$  is a vector of exogenous productivity shifters (including the constant).  $\ln N_{o,Ag}$  is likely to be endogenous in this econometric specification, since  $A_{o,Ag}$  and  $A_{o,L}$  (the productivity fundamentals), which include factors unobservable to the econometrician, affect the agricultural population in the theoretical model. That is, demand for agricultural labor would be higher at locations that have higher productivity fundamentals, but unobservable elements captured in  $\epsilon_{o,Ag}$  might remain. To estimate the coefficient of interest,  $\tilde{\mu}_{Ag}\theta$ , we instrument  $\ln N_{o,Ag}$  by  $\ln RNA_o$ .  $RNA_o$  is the "river network access" measure at  $o$  defined by:

$$RNA_o = \sum_{d \in RC} \tau_{od}^\theta \quad (17)$$

where  $RC$  is a set of all river cells in the basin (cells that contain a river) whether or not they have positive populations.<sup>21</sup>

In addition to the fact that river structure is pre-determined and not affected by human settlements, we need the following identifying assumption. After controlling for own-location characteristics,<sup>22</sup> productivity fundamentals are uncorrelated with accessibility to other locations. That is, market opportunity (due to the accessibility to other locations) affects productivity only through its effect on employment (and thus through externalities arisen), rather than through productivity fundamentals. The corresponding moment condition is  $\mathbb{E}[\epsilon_{o,Ag} \ln RNA_o] = 0$ .

Figure 8 provides the intuition behind this identification assumption. This figure represents three similar areas inside a river basin. We focus on the relationship between agricultural population and productivity by comparing the three cells with different colors (pink, red, and brown) that are located next to the bottom-left cells. The ideal experiment to estimate the causal effect of population on productivity is to randomize population size across these three cells, but this experiment is infeasible to implement. We assume that these three cells have the same observable

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<sup>21</sup>For the RNA measure, we use the sector-independent symmetric proximity measure  $\tau_{od} = D_{od}^\delta$  where  $D_{od}$  is the travel distance without taking the river asymmetry into account and  $\delta$  is obtained from price gaps pooling all the sectors.

<sup>22</sup>The geographical controls include a dummy of high river orders (4 and 5), distance to the urban center, distance to the river, squared distance to the river, interaction terms of these two variables with a river cell dummy, elevation, river confluences, flood vulnerability, geology measures, and open water access measures. We provide definitions of these variables in Appendix B.4.

productivity fundamentals (e.g., soil types, distance to the nearest river point, lake size nearby, elevation, climate conditions) that affect labor demand. The only observable difference between these cells in the figure is the RNA measure, that is, the weighted accessibility to other cells that face rivers (whether or not these cells have positive populations). The middle and right maps have one more river cell than the left map, each in a different location. Therefore, the RNA is higher in the red and brown cells than that in the pink cell. Comparing the red cell in the middle map with the brown cell in the right map, the RNA is higher in the brown cell because the additional cell next to the top-right is located closer to the brown cell. This variation in the RNA, stemming from the exogenous river shape in nature, is an exogenous shifter of market potential. That is, the RNA affects the population size because of the trade mechanism. There are still unobservable productivity shifters remaining in the own location. Rivers around a location and water level fluctuations may also affect unobservable soil quality directly. However, there would be no theoretically plausible reason to believe that, after controlling for geographical conditions in the own location, the unobservable productivity shifters are associated with the variation in the RNA measure that can be generated by exogenous river shapes in locations far away from the own location. The comparison between the three panels illustrates this point.

Note that, although the theoretical model is static, the agglomeration effect in the empirical setting could contain the effect of past history of human settlement in a particular location (e.g., accumulation of knowledge). Even if predetermined productivity fundamentals are same, locations with longer histories may attract larger populations today through agglomeration spillovers over time. That is, if early settlements are not correlated with productivity fundamentals, then they would affect current productivity only through their effects on current populations caused by the agglomeration spillovers over time.

Motivated by this conjecture and supported by the subsequent arguments, we also construct, as an instrumental variable, a dummy for whether the community was established in its current location by 1940. Importantly, the primary reason for early settlement was the opportunity to obtain natural resource products. The rubber boom, which began in the late 19th century but collapsed around 1940, had a significant impact on initial settlements ([Barham et al. 1996](#); [Coomes 1995](#)). Moreover, even after the collapse of the wild rubber economy, the primary activity of many communities was initially natural resource extraction and then has shifted towards agriculture over time ([Coomes et al. 2016](#)). Therefore, it would be plausible to assume that the locations of communities established before 1940 were determined primarily by natural resource endowments, not by advantages in agricultural productivity.<sup>23</sup>

The data also support our assumptions and the validity of using these two instrumental variables. First, the left two columns in Table A.2 indicate that these two instruments are uncorrelated both unconditionally and conditionally on the geographic controls. This non-relativity suggests the importance of checking the robustness of the IV estimation results for these two

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<sup>23</sup>For this reason, we do not use this instrument for estimating the density externality in natural resource extraction in section 5.3.2.

instruments, which exploit distinct variations to estimate the same parameter. Second, the right three columns in Table A.2 present the first-stage regression results. The two instruments and their combination significantly predict the current agricultural populations. Third, Table A.3 presents correlations between the instruments and potential productivity fundamentals. In particular, each column presents correlations between the instruments and each of the geographical controls in (16), controlling for the other control variables. We observe a few reasonable significant correlations.<sup>24</sup> In contrast, there is little correlation for relationships that cannot be explained in a theoretically consistent manner. For example, the community existence in 1940 is uncorrelated with all of the three soil variables. The RNA is also uncorrelated with soil conditions other than floodplain soils. Although there is no direct way to prove this claim, these observations suggest that the instruments would be unlikely to be significantly correlated with unobservable productivity shifters.

Table A.4 reports the IV estimation results and confirms the presence of the agglomeration externality in the agricultural sector. Columns (2) and (3) report that the point estimate  $\tilde{\mu}_{Ag}\theta$  is positive and statistically significant with either the RNA or the historical community existence as an IV. The point estimate is larger with the historical IV. This difference would be because the latter estimate contains more of the agglomeration spillover from the history of human settlements. In our preferred specification that uses the both IVs (column (4)), the point estimate  $\tilde{\mu}_{Ag}\theta$  is 0.501 at the 1% level of statistical significance. Dividing this value by  $\hat{\theta}$ , we obtain the reported point estimate  $\hat{\mu}_{Ag} = 0.064$  (standard error = 0.010) in Table 3. This result confirms the presence of agglomeration externality in the agricultural sector *on net*. That is, this result implies that the agglomeration externality in agricultural production outweighs the congestion externality in land access. Table A.4 also shows that the OLS estimate is larger than the IV estimate in any specification. This observation is consistent with the view that agricultural employment is correlated with agricultural productivity unobservable by econometricians and thus the OLS estimate has an upward bias.

The result is robust to different sample selections and different sets of geographic controls. In particular, this result is not driven by a small number of locations with very large populations or by a specific set of geographical control variables. Columns (5) through (8) report the estimation results by restricting the sample locations to only those with small populations (e.g., < 1,000). While the point estimates are slightly smaller, the statistical significance of the agglomeration externality remains the same. Moreover, Table A.5 presents that the significance (both statistically and economically) of the agglomeration externality is stable across different combinations of the geographical control variables.

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<sup>24</sup>For example, the RNA is higher where the share of river water (the main channel) is higher, possibly because such a thicker river line tends to be located in the central area of a basin. Floodplain soils are formed along whitewater rivers. Moreover, although the RNA cannot predict the locations of early settlements well, it is understandable that early settlements were located closer to river confluence. Note also that we cannot conduct this exercise with theoretically endogenous variables, since they are likely to be affected by the settlement size.

## Decomposition into congestion externality in forest clearing and agglomeration externality in agricultural production

Recall from section 4.3 that  $\tilde{\mu}_{Ag} \equiv \mu_{Ag} - (1-\gamma)\mu_L$ . That is, the overall agglomeration in agriculture based on the estimation in the previous step consists of both congestion externality in forest clearing and agglomeration externality in agricultural production.

To decompose the net density externality into these two components, we first estimate the parameter governing congestion externality in forest clearing, using community-level (not grid cell-level) information. We use community-level information because it is ideal to have the information of deforestation and associated population that caused it. It is not feasible to identify the population that caused each deforestation area with the grid cell-level data. Note also that in the estimation of density externality in forest clearing, we do not use any information from solving the model. This is another reason why we do not have to stick with using the grid cell-level data. In particular, we use the data of community-level working area after clearing forest, constructed by Coomes et al. (2021) and shown in Figure A.11.

The land access function (3) and  $N_{o,L} = (1 - \gamma)N_{o,Ag}$  at the optimal input choice yield the following empirical specification:

$$\ln \frac{L_o}{N_{o,Ag}} = -\mu_L \ln N_{o,Ag} + X'_o \beta + \phi_B + \epsilon_{o,L} \quad (18)$$

To estimate  $\mu_L$ , we follow the same identification strategy as above. The same identifying assumption holds because the residual in (18) is also contained in the residual in (16). Therefore, we use the same IV and the same set of geographical controls. We obtain the point estimate  $\hat{\mu}_L = 0.522$  (standard error = 0.094).

From  $\hat{\mu}_L$ ,  $\hat{\mu}_{Ag}$ , and the relationship  $\tilde{\mu}_{Ag} \equiv \mu_{Ag} - (1 - \gamma)\mu_L$ , we back out the point estimate of the agglomeration externality in agricultural production (given the land cleared for agriculture)  $\hat{\mu}_{Ag} = 0.273$  reported in Table 3.

### 5.3.2 Congestion externality in natural resource extraction

The inverted productivity composite of natural resource extraction is  $\tilde{A}_{o,Nr} \equiv A_{o,Nr} [\sum_d D_{od}^{-\nu} N_{d,Nr}]^{-\mu_{Nr}\theta}$ . By taking the logarithm, we can express the residual variation in  $\ln A_{o,Nr}$  (productivity fundamentals) as follows:

$$\epsilon_{o,Nr} = \ln \tilde{A}_{o,Nr} + \mu_{Nr}\theta \ln \left( \sum_d D_{od}^{-\nu} N_{d,Nr} \right) - X'_o \beta - \phi_B \quad (19)$$

Likewise, employment of natural resource extraction in the own and surrounding locations is likely to be endogenous. We thus estimate the congestion externality parameter ( $\mu_{Nr}$ ) and its spatial decay parameter ( $\nu$ ) by non-linear GMM with the instruments plausibly satisfying the

following moment conditions:

$$\mathbb{E}[\epsilon_{o,Nr} \ln RNA_o] = 0 \quad \text{and} \quad \mathbb{E}[\epsilon_{o,Nr} \ln(\sum_{d|D_{o,d} \leq x} RNA_d)] = 0, \quad x \in \mathcal{X} \quad (20)$$

Panel (B) of Table 3 reports the results of the nonlinear GMM estimation. We select our instruments with  $\mathcal{X} = \{2, 5, 10, 25, 50, 75, 100\}$ . The point estimates and standard errors are based on the two-step estimation using the optimal weight matrix. We construct the optimal weight matrix using the first-step estimates of the parameters that were estimated using the identical matrix as a weight matrix. We get the point estimate of the congestion externality parameter  $\hat{\mu}_{Nr} = 0.335$  (standard error = 0.042) with the spatial decay parameter  $\hat{\nu} = 0.593$  (standard error = 0.075). Given the number of instruments, these parameters are over-identified. We report the result of the overidentifying restrictions  $J$  test. The resulting  $J$ -statistic fails to reject the null hypothesis that the instruments are valid ( $p$ -value = 0.821).<sup>25</sup>

To understand the natural resource competition realistically—that is, to understand the actual distance where spatial spillovers of congestion externality in natural resource extraction are strong—we first approximate the productivity composite by the following:

$$\tilde{A}_{o,Nr} \equiv A_{o,Nr} N_{o,Nr}^{-\mu_{Nr}\theta} \prod_{x \in \mathcal{X}} \left[ \sum_{d|D_{o,d} \leq x} N_{d,Nr} \right]^{-\mu_{Nr,x}\theta}$$

and employ a linear specification to estimate  $\mu_{Nr}$  and  $\{\mu_{Nr,x}\}$  with instruments  $\ln RNA_o$  and  $\ln \sum_{d|D_{o,d} \leq x} RNA_d$  for  $x \in \mathcal{X}$ . Table A.7 reports results with different  $\mathcal{X}$ 's, but they are subsets of  $\mathcal{X}$  used for the main non-linear estimation. There are two noteworthy findings. First, the negative effect of a population engaging in natural resource extraction in the own location becomes weaker both economically and significantly compared with the effects of surrounding populations once we also consider them with wider distance ranges. This empirical pattern is consistent with the presence of congestion externality with spatial spillovers. Interestingly, once we control for surrounding populations with comprehensive distance ranges, the coefficient sign of the own population even becomes positive. This observation is consistent with the view that there is also an agglomeration benefit as we saw in the agricultural sector even though the congestion force outweighs on net. Note also that the OLS estimate of the coefficient of own population is larger than the IV estimate. This observation is consistent with the view that employment of natural resource extraction is correlated with its productivity unobservable by econometrician and thus the OLS estimate has an upward bias. Second, as we increase the number of distances in  $\mathcal{X}$ , the size of point estimate  $\hat{\mu}_{Nr,x_{max}}$  gradually decreases. All of their signs remain the same up to  $x_{max} = 100$ , but this regular pattern diminishes with  $x = 150$ . This empirical pattern implies that the strength of congestion externality has spatial decay. Moreover, this observation

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<sup>25</sup>We are also working on the iterative GMM estimation (Hansen and Lee 2021) and the result will be available soon.

justifies our choice of instruments in the main non-linear estimation, exploiting the variation from surrounding populations up to  $x = 100$ .

## 5.4 Quantifying the Effects of Density Externalities

We investigate the quantitative importance of the estimated density externalities in determining human welfare and environmental costs. The primary outcome variables at each basin level are welfare of the population, total deforestation, and natural resource depletion. The welfare measures is based on the real wage that is equalized across locations in the spatial equilibrium.<sup>26</sup> We proxy the measure of natural resource depletion in each basin by the total expected production amount (not value) of the natural resource extraction sector in the spatial equilibrium, denoted by  $Q(\text{Nr})$ . We also report the counterfactual outcomes of total sectoral employment in the basin, denoted by  $N(\text{Ag})$ ,  $N(\text{Nr})$ , and  $N(\text{Urban})$ .

First, we focus on the agglomeration externality in agriculture. Given the total population in each basin and the calibrated productivity fundamentals, we solve the model by shutting down the agglomeration externality ( $\mu_{\text{Ag}} = 0$ ). Note that we maintain the estimated congestion externalities in forest clearing and natural resource extractions.

Panel (A) of Table 4 indicates that the agglomeration externality has large effects. Without the agglomeration externality, deforestation increases by about 18–56%, but total agricultural production decreases by about 29–35% from the benchmark equilibrium. The human welfare decreases by about 7–13% without the agglomeration. That is, policy interventions that enhance agglomeration benefits achieve the win-win outcome of decreasing deforestation and increasing human welfare. However, the natural resource depletion also decreases by about 1–3% without the agglomeration externality. That is, another trade-off between two types of environmental costs remains—deforestation versus biological natural resource depletion.

Figure 9 and Figure A.12 show spatial distributions of relative values of key outcome variables caused by this counterfactual experiment (in terms of those in the benchmark spatial equilibrium) in the Upper Ucayali and Napo-Amazon river basins.<sup>27</sup> As the upper middle maps indicate, agricultural productivity decreases in all locations with the lack of agglomeration force, since the productivity gains from concentration decline. According to the upper left maps, there is a significant spatial reallocation of the agricultural population: it has increased without the agglomeration externality in more than 80% of rural locations. This spatial reallocation is from concentration into dispersion because the congestion externality in forest clearing dominates. A

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<sup>26</sup>The real wage is equivalent to the indirect utility based on the specified utility function. Note also that the value of indirect utility varies with monotone transformations of the utility function (that result in the same observed endogenous variables). Therefore, while the real wage is uniquely determined, it is possible to construct other welfare measures. Nevertheless, the sign of the welfare effect and the order of its magnitude in different counterfactuals are uniquely identified, although the magnitude of the welfare value varies depending on how the utility function is defined.

<sup>27</sup>To save space, we present maps from the two basins (Upper Ucayali and Napo-Amazon, which have the two largest urban centers) out of the four basins throughout the counterfactual experiments. Maps from the other two basins are available upon request.

sectoral reallocation of workers also occurs: the overall agricultural employment increases (by 6.6% and 2.9%) and the overall employment for natural resource decreases (by 1.8% and 4.4%). This sectoral reallocation reflects general equilibrium effects. Since the agricultural productivity has declined, the economy needs more agricultural employment to satisfy the demand for agricultural goods by the population, given that consumption demands across the agricultural and natural resource goods are complementary.

Next, we focus on the congestion externality in natural resource extraction. Unlike the agglomeration externality, shutting down or reducing the congestion externality is impractical, given the finite nature of natural resource endowments. Therefore, we instead solve the model by increasing the congestion externality in natural resource extractions. In particular, we increase the congestion externality parameter ( $\mu_{Nr}$ ) by 25% from its estimated value. Note that we maintain the estimated agglomeration externality in agriculture and congestion externality in forest clearing as well as the estimated spatial decay parameter in natural resource extractions.

Panel (B) of Table 4 indicates that the increased congestion externality also has large effects. With the increased congestion externality, total natural resource depletion decreases by about 40–50% and human welfare decreases by about 11–30%. A sectoral reallocation of workers also occurs: the overall agricultural employment decreases (by about 2–9%), the overall employment for natural resource increases (by about 9–16%), and the overall employment in the urban center decreases (by about 4–7%). This sectoral reallocation reflects general equilibrium effects and is explained in the same way as in the case of shutting down the agglomeration externality above.

## 6 Mechanisms Underlying the Agglomeration Externality

We investigate mechanisms behind the density externalities that we found in the previous section. Interpretation of the congestion externality in forest clearing or natural resource extractions is straightforward given its rivalrous nature. However, interpreting the agglomeration externality in agriculture is not straightforward, and thus we examine its microfoundation. This is also new to the literature because agglomeration has typically been discussed in an urban setting.

### 6.1 Economies of Scale in Transport and Transaction Costs

One hypothesis is that the cost of transporting products from a community decreases with increases in the community's production and export of the products. This mechanism could be the case if large-scale commercial river boats (e.g., "lancha," shown in the bottom-right picture of Figure A.10) are more likely to stop by communities that export large amounts of their products. The mechanism could also be the case if populations in larger communities cooperate to invest in fast motor boats (e.g., "rapido," shown in the bottom-left picture of Figure A.10). Another simple possibility could be that the average transport cost charged decreases with the amount

of transported products given the same transport mode. In any of the ways, the actual transport costs could be endogenous depending on the exporting community's population. However, the model assumes exogenous river transport costs that depend only on distance and river orientations based on the most widely available transport mode (peque-peque, shown in the top-right picture of Figure A.10).

Nevertheless, the present model with agglomeration externality in agricultural productivity is indeed isomorphic to a model with endogenous transport costs as long as the endogeneity stems from the population of an exporting community; that is, the transport cost depends on an origin-specific endogenous factor. To see this point, consider the following model. Suppose that there is no agglomeration externality in agricultural productivity such that we replace (4) with the following agricultural production function:

$$Q_{o,Ag}(j) = z_{o,Ag}(j) \cdot N_{o,C}(j)^\gamma L_o(j)^{(1-\gamma)}, \quad o \in \mathcal{R}$$

while keeping the same land access function as (3). Suppose also that the trade cost of agricultural products is characterized as:

$$\tilde{\tau}_{od,Ag} = N_{o,Ag}^{-\mu_{Ag}} \tau_{od,Ag}$$

where  $\tau_{od,Ag}$  is the exogenous term of trade cost defined by (8) and  $\mu_{Ag} > 0$  such that the trade cost decreases with the agricultural employment. These assumptions lead to the following expenditure share across locations within the agricultural sector:

$$\pi_{od,Ag} = \frac{A_{o,Ag} N_{o,Ag}^{-(1-\gamma)\mu_{Ag}\theta} \kappa_1^\theta (w_o \tilde{\tau}_{od,Ag})^{-\theta}}{\sum_{o' \in \mathcal{R}} A_{o',Ag} N_{o',Ag}^{-(1-\gamma)\mu_{Ag}\theta} \kappa_1^\theta (w_{o'} \tilde{\tau}_{o'd,Ag})^{-\theta}} = \frac{\tilde{A}_{o,Ag} (w_o \tau_{od,Ag})^{-\theta}}{\sum_{o' \in \mathcal{R}} \tilde{A}_{o',Ag} (w_{o'} \tau_{o'd,Ag})^{-\theta}}, \quad o \in \mathcal{R}, d \in \mathcal{I}$$

same as (9), where  $\tilde{A}_{o,Ag}$  is same as (10). This model thus leads to the same set of spatial equilibrium conditions. Therefore, the inverted productivity composites could contain the endogenous term of trade costs.

The CC data allow us to test this hypothesis. Table 5 reports the results of estimating the scale effect on the availability of different transport modes in a community. First of all, the mean value of *peque-peque* availability is close to one (0.972) and much higher than the availability of the other three transport modes. This observation justifies our decision to calculate the asymmetric trade cost based on *peque-peque*, the most widely available mode. Next, according to columns (2) and (6), a 1% increase in the agricultural employment increases the probability of *lancha* and *rapido* being available in the community by 0.14% and 0.06% at the 1% and 5% levels of statistical significance, respectively.<sup>28</sup>

Table A.8 shows the scale effect on the frequency of these transport modes available. Ac-

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<sup>28</sup>Foster and Gafaro (2017) also report a consistent finding that the economies of scale in transport technology allows small-scale farmers to shift from subsistence to market participation.

cording to column (2), a higher agricultural employment significantly increases the number of days when lancha is available to the community. The mean number of days available per week is 3.429. Lancha is a large commercial boat and is not generally owned by each small-scale community. We thus interpret this value in a way that lancha passes a community about half a week on average. On the other hand, rapido is available almost every day (6.164/7) among communities that have access to it (and the scale effect is insignificant). This observation would be more consistent with the case in which the community owns it as a result of collective investment.

A related mechanism is that other transaction costs decrease as population size increases. According to Table A.9, probabilities that a river trader is available to the community, the community population is contracted to selling a product, or there are contractors living in the community are significantly higher with a higher community population.<sup>29</sup> Although we do not directly observe activities of these intermediaries, a straightforward interpretation is that their presence decreases transaction costs for selling community's products.<sup>30</sup>

## 6.2 Economies of Scale in Agricultural Intensification

Another hypothesis is that there are economies of scale in accessing agricultural inputs. The 2012 CENAGRO allows us to test this hypothesis. Table 6 reports the scale effect on the household-level use of various agricultural infrastructure, technology, and inputs into land and crops in the communities in our study area.

The first important fact from this table is that modern technology is limited in the Peruvian Amazon. We pick all the related variables available in CENAGRO that have non-missing information. All the variables are dummies. The mean value is less than 0.1 for all the variables (i.e., less than 10% of agricultural producers use them) with one exception for boat/canoe/speedboat having about 0.6. Moreover, the mean value is less than 0.01 for 13 items (out of 24).

In this limited environment of available agricultural inputs, we nevertheless observe the scale effect on some technologies and inputs. For example, the effects on some direct inputs into land and crops (insecticides, herbicides, and fungicides) as well as on their complementary equipment (sprayers) have higher point estimates than others at the 1% or 5% level of statistical significance. We also see a significant scale effect on the use of crop processing technology (grain mill). Since grain mills facilitate processing raw grains into marketable products, this result is broadly consistent with the previous finding of the economies of scale in improving trade environment.

The CC data from PARLAP collect detailed information on the form of seed acquisition. The people in the community are asked whether they obtain their seeds or other planting materials from others in the community, from people in other communities, or from a city. They are also asked about the principle form of acquisition if they obtain seeds from other places. Table A.11

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<sup>29</sup>Table A.10 reports product-specific contracts.

<sup>30</sup>Investigating the incidence between traders and community population (e.g., Atkin and Donaldson 2015; Bergquist and Dinerstein 2020) is not feasible with our data. Future work is warranted in this research area.

reports the results. The point estimates reported in panel (A) imply that as the community population increases, people in the community are more likely to obtain crop seeds from others in the community and less likely to obtain them from a city or from other communities,<sup>31</sup> although the statistically significance is not strong. According to panel (B) of the same table, the form of transaction (market or non-market transaction) when people obtain seeds from outside the community does not significantly vary in the community population.<sup>32</sup> To summarize, we find suggestive evidence of the economies of scale in accessing agricultural inputs. Given the very low rate of adopting modernized agricultural technologies and inputs, however, the economies of scale in trading products is revealed to be the primary mechanism underlying agglomeration in the quantitative sense.

## 7 Counterfactual Experiments

Counterfactual experiments investigate environmental protection policies as well as improving infrastructure and technology to design the “win-win policy” that increases both human and ecological well-being. The set of primary outcome variables at each basin level is same as in section 5.4. We define a win-win policy as the policy that achieves the following three outcomes: human welfare is increased, total deforestation is decreased, and total natural resource depletion is decreased.

Note that a counterfactual experiment requires solving the model and obtaining population distributions in a new spatial equilibrium. In the presence of externalities, it is not feasible to prove the uniqueness of the equilibrium. To address this issue, throughout the counterfactual experiments we use the same simulation algorithm, described in Appendix C.4, with the aim of reaching the spatial equilibrium closest to the benchmark equilibrium given the set of populated locations. We have also tried to solve the model with various combinations of initial guesses to search for multiple equilibria, but have not found any equilibria other than those presented in the following results.

### 7.1 Protection Policies

In this section, given the fixed number of total population and estimated density externalities, we ask the following questions: is it beneficial to concentrate the ecological footprint in fewer spots rather than to have many small communities? If so, how do different ways of setting protected areas and encouraging resettlement from the protected locations affect welfare and outcomes? To approach these questions, we implement the following protection policy experiments. We simulate the model to derive endogenous outcomes given the additional condition imposed by each experiment. Note that the model does not incorporate the cost of associated

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<sup>31</sup>Table A.12 reports crop-specific results and that this effect largely stems from maize and plantain.

<sup>32</sup>Market transactions include purchasing and borrowing. Non-market transactions include exchanging, donating, and giving.

resettlements (or a subsidy to compensate for them) in response to policy interventions. Therefore, implementing a cost-benefit analysis of a single policy intervention is beyond the scope of this paper. To interpret and compare policy outcomes meaningfully, we thus conduct multiple policy experiments, each directly treating an equal size of population. We design each policy such that it directly treats 2.5% of rural population in the benchmark equilibrium in each basin for resettlement.

### (A) Protecting the rural frontier

We first present another fact about the spatial distribution of community locations.

**Fact 1B: The formation of new rural communities occurs not only by the rural frontier expanding but also by the interior of the rural frontier filling in**

We define the rural frontier in each river basin as the rural settlement that takes the maximum distance from the urban center (represented by a square in each map of Figure 3). The land beyond the rural frontier is covered by rainforests, and we do not assume human settlements. Figure A.1 and Figure A.2 show the establishment of communities in the Napo-Amazon and Upper Ucayali basins over decades. These maps illustrate that the rural frontier expanded during most of the two-decade intervals. This process is consistent with the explanation provided by the classical model of dynamic city formation (Fujita and Krugman 1995; Fujita et al. 1999), which argues that the agricultural frontier expands as the population grows. In contrast to the assumption in the classical model that areas inside the agricultural frontier are filled with farmers and farmlands, we also observe the formation of new communities as the interior of the rural frontier fills in during most periods. Since our model is static, modeling this complex dynamic process of rural community formation is left for future research. Nevertheless, this fact motivates the question of what happens to the spatial distribution of economic activity and environmental costs when some protection policy controls the expansion of the rural frontier.

We consider a place-based protection policy of controlling the expansion of rural frontier. This experiment chooses rural locations to be treated in order, starting with those farthest from the urban center, until the treated population reaches 2.5% of the total rural population in each basin.

Panel (A) of Table 7 reports the results. In the Upper Ucayali basin, total deforestation has decreased by 2% with a very small decrease in welfare (0.2%). Similar results follow in the other three basins. The intuition behind these results is as follows. In the presence of congestion externality in clearing forest, total deforestation decreases by reducing the number of populated locations while fixing the total population size. The capacity of agricultural production is affected, depending both on the decreased amount of land inputs and the increased productivity gain due to the agglomeration externality in agricultural production. The minimal welfare effect implies that these two forces almost cancel each other out.

This policy has also reduced natural resource depletion (in three of the four basins). In the Upper Ucayali basin, total natural resource depletion has decreased by 0.8%. The intuition is as follows. With the protected areas targeting the rural frontier, the overall scope of natural resource extraction activities is narrowed. The experiment increased the overall population density in the basin as it relocated the population closer to the urban center. This reallocation means that the surrounding populations increase in most of the populated areas. Therefore, the overall productivity of the natural resource sector would be negatively affected because of the congestion externality with spatial spillovers. As a result, the total outputs of the natural resource products decrease (i.e., natural resource depletion is reduced), which is an ecological benefit.

Figure 10 and Figure A.13 show spatial distributions of relative values of key outcome variables caused by this counterfactual experiment (in terms of those in the benchmark spatial equilibrium) where red x marks indicate the treated locations whose residents resettled to other locations. We will discuss these maps later when we compare the counterfactual outcomes between different protection policies.

### **(B) Not allowing new community formation**

We next implement a simple experiment of not allowing new community formation. In this experiment, we simply evaluate economic and environmental outcomes with the same total population but without new community formation. This experiment chooses rural locations to be treated in reverse order of establishment, starting from the most recently established communities, until the treated population reaches 2.5% of the total population in each basin. We then solve the model with the rest of the communities established earlier given the total population.

Panel (B) of Table 7 reports the results. In the Upper Ucayali basin, total deforestation decreases by 3% with a small decrease in welfare (0.1%). Similar results follow in the other three basins. The welfare outcome is almost the same as in the previous experiment. This experiment has also reduced deforestation with a similar mechanism to the previous experiment. Compared with the previous experiment that protects the rural frontier, however, the forest cover gain is larger. After presenting the next experiment, this difference in the forest cover gain will be discussed. Figure 11 and Figure A.14 show spatial distributions of relative values of key outcome variables caused by this counterfactual experiment (in terms of those in the benchmark spatial equilibrium) where red x marks indicate the treated locations whose residents resettled to other locations.

### **(C) Minimum population threshold to form a community**

We also consider a place-based experiment of specifically targeting small communities. This experiment chooses rural locations to be treated in order, starting with the location with the smallest population size, until the treated population reaches 2.5% of the total population in

each basin. We then solve the model with the rest of the locations, keeping the total population in each basin fixed.

Panel (C) of Table 7 reports the results. The welfare outcome is almost the same as in the previous experiment. However, targeting residents of the smallest communities for resettlement leads to a higher gain in preserving forest cover. In all four basins, this policy has the largest negative deforestation impact among the three experiments. This policy has reduced deforestation by 7.3% in the Upper Ucayali basin and 13.1% in the Napo basin. The right five columns in (B) and (C) indicate that the outcomes of sectoral reallocation of the population and sectoral outputs are almost the same as in the previous experiment (except for the Lower Ucayali basin). Therefore, the forest cover benefit relative to the previous experiment arises without sacrificing other objectives. This benefit primarily stems from the agglomeration and congestion externalities. This experiment reduced communities that had both low congestion in accessing land and low agglomeration benefit for agricultural production and caused the population to enjoy more agglomeration externality after resettlement. The resulting increase in productivity due to the agglomeration externality compensated for the increased congestion for land access. Figure 12 and Figure A.15 show spatial distributions of relative values of key outcome variables caused by this counterfactual experiment (in terms of those in the benchmark spatial equilibrium) where red x marks indicate the treated locations whose residents resettled to other locations.

A comparison between policies (A) and (C) illustrates that policymakers face a trade-off in mitigating different types of environmental costs: deforestation and depletion of other natural resources. The protection policy that targets the smallest communities (C) reduces deforestation more than the frontier protection (A), but increases natural resource depletion ( $Q(Nr)$ ). A comparison between the bottom-middle maps of Figure 10 and Figure 12 indicates the primary source of these contrasted outcomes from the two experiments (A) and (C). These two maps report that the productivity of the natural resource sector (relative to its original values) becomes smaller than 0.96 for more than 80% of the remaining locations by protecting the frontier (A), while it becomes larger than 0.97 for all of the remaining locations by this experiment (C).

We of course understand the feasibility and ethical concerns of resettling populations in the smallest communities that already exist. This experiment nevertheless generates an important policy implication. This experiment can indirectly suggest the importance of regulating new community formations to minimize deforestation. For example, one policy idea might be to regulate the formation of new communities with a threshold of minimum settlement size. Indeed, the deforestation impact in the previous experiment (B) of not allowing new community formation is smaller than in this experiment (C) but larger than in the experiment (A) of protecting the frontier (in three of the four basins). This fact reflects that newly formed communities includes more small-scale communities than those locating near the frontier.

## 7.2 Improvement of River Transport Infrastructure

We consider improving the transport infrastructure that aims to reduce high trade costs in the environment of Amazon river networks. The high trade costs primarily stem from the asymmetry of transport costs due to river orientations, the seasonality of transport costs due to water level fluctuations, and the slow speed of river boats. Recall (21) where we defined the downstream-river-equivalent kilometers along the lowest-cost route. With the improved transport infrastructure, the downstream-river-equivalent distance is expressed as follows:

$$D_{od} = D_{od,down} + \lambda_{up} D_{od,up} + \lambda_{land} D_{od,land} + \lambda_{upgraded} D_{od,upgraded} \quad (21)$$

where  $D_{od,upgraded}$  corresponds to the upgraded part of the river transport network.  $D_{od,down}$  and  $D_{od,up}$  correspond to the portions of the river transport network that are not upgraded.

Specifically, we consider the quality improvement of boats and river dredging as the improvement of river infrastructure. In the model, the infrastructure improvement has two elements. The first element is that there is no asymmetric cost in the upgraded part. The second element is that the travel cost of the upgraded part decreases. To capture this effect, we set  $\lambda_{upgraded} = 0.8$ . These two elements are indeed consistent with the trajectory of transportation infrastructure development in the Peruvian Amazon over time.<sup>33</sup> River dredging is a complementary devise for reducing transport costs as it enables larger ships to travel.<sup>34</sup>

Table 8 reports the results of a variety of experiments. Reducing the trade costs increases human welfare in all the cases; however, the effects on environmental costs are heterogeneous across different ways of improving the transport infrastructure.

### Infrastructure investments that make the areas enjoying agglomeration externalities more even across the basin are preferable in terms of reducing deforestation

We first focus on the agricultural sector and the deforestation impact. Figure 13 shows locations of transport infrastructure improvement along river lines according to river orders. Higher river orders mean more splits from the central river.

Panel (A) of Table 8 reports the results of improving the transport infrastructure in a way that hinterlands are connected to the central area of a basin (by targeting river lines with river

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<sup>33</sup>For example, canoes, row and sail boats, and steamers were the primary means of river transportation during 1860-1940. Using historical records on travel time (e.g., Herndon and Gibon 1853; Paz Soldan 1877; Schurz et al. 1925) and the same approach described in Appendix C.2, we estimate that the value of the upstream cost parameter ( $\lambda_{up}$ ) is 2.37 in this historical period. This value is close to double the estimated value  $\hat{\lambda}_{up} = 1.282$  for the modern period. That is, the cost of the asymmetry of river orientations is decreasing over time. Also evident is the increase in speed over time. Meanwhile, the exact speed increase of a next generation boat is ambiguous. Therefore,  $\lambda_{upgraded}$  is set arbitrarily. Smaller values of this parameter amplify the reported results of the counterfactuals.

<sup>34</sup>The Amazon Waterway is an ongoing project (but started after our data collection) that dredges rivers. See, for example, Abizaid et al. (2022) and Lu (2019) for more details. We are currently working on incorporating a potential negative externality of dredging rivers on fish stock, which affects the productivity of the natural resource sector.

order 2). In all basins except Lower Ucayali, total deforestation is decreased by this experiment. Figure 14 and Figure A.16 show spatial distributions of the key outcome variables caused by this counterfactual experiment. As hinterlands become more integrated in the trade network, we observe spatial reallocation of farmers toward remote areas compared with the benchmark equilibrium (the top-left maps). The agglomeration externality in agricultural production amplifies this effect. The top-middle maps show agricultural productivity gains in remote areas. Given the congestion externality in forest clearing, deforestation *per farmer* decreases in remote areas. The reduction of total deforestation in the basin means that this forest gain in remote areas outweighs the forest loss in denser areas.

Panel (B) of Table 8 reports the results of improving the transport infrastructure only in densely populated areas (by targeting river lines with river order 1 in the case of Napo basin). In contrast to the previous case, total deforestation increases. Figure 15 shows spatial distributions of the key outcome variables caused by this counterfactual experiment. The agricultural population is more concentrated in the central area of the basin (the top-left map). Due to the density externalities, agricultural productivity increases and deforestation per farmer decreases in the central areas. On the flip side, this policy also generates much smaller communities with much higher deforestation per farmer in hinterlands. The increase in total deforestation in the basin means that the latter effect dominates. From these two experiments, we learn that the *direction* of deforestation impact depends on where in the spatial structure of river networks the improvement takes place.

Additional experiments help to elucidate the importance of place-based targeting of infrastructure investments to mitigate environmental costs. Panel (C) of Table 8 reports the results of improving the transport infrastructure in a way that combines both of the previous two experiments (i.e., targeting river lines with both river orders 1 and 2 in the Napo basin). The welfare increase is higher than the previous two experiments simply because this experiment treats more river lines. The deforestation impact is between those of the previous experiments, but much closer to the second experiment targeting dense areas. Panel (D) of Table 8 reports the results of just reducing the asymmetry in all river lines. Total deforestation also increases by uniformly improving the transport infrastructure across the basin.

To summarize, policy interventions that make the areas enjoying agglomeration externalities more even across the basin are preferable in terms of reducing deforestation. In other words, policies causing more even distribution of middle-sized communities across the basin are more preferable than those causing a separation in the basin between highly concentrated locations with agricultural intensification and very small communities in hinterlands with low productivity agriculture. This implication is also consistent with the finding in the previous section that the protection policy targeting the smallest communities has reduced deforestation most.

## A sector-specific protection policy leads to an unintended consequence

We next focus on the natural resource extraction. Let us first focus on the experiment of targeting river lines with river order 2 (panel (A) of Table 8; Figure 14; Figure A.16). As hinterlands become more integrated in the trade network, we observe spatial reallocation of this activity toward remote areas from the benchmark equilibrium (the bottom-left maps). The degree of this spatial reallocation is lower than that of agricultural population according to the comparison between the two maps on the left. This difference is due to the different extent of density externalities between agriculture and natural resource extraction. Owing to the congestion externality with spatial spillovers, productivity of the natural resource sector increases in remote areas and decreases in the central dense areas (bottom-middle maps). Although these two opposing forces exist, the net depletion of natural resources increases in remote areas connected by the improved transport infrastructure. The impact on total natural depletion in the basin is ambiguous. It increases by 0.3% in Upper Ucayali, but it decreases in the other three basins.

To combat the natural resource depletion, a sector-specific protection policy such as banning hunting in specific location might be considered. However, the feasibility of such a policy is unrealistic and even more difficult than resettlement policies. It would be more difficult to monitor people's activities than whether areas are inhabited. Therefore, as a more feasible policy, we consider checkposts to monitor traded goods in the improved transport infrastructure. That is, we consider a protection policy of using the improved transport infrastructure only for transporting agricultural and urban goods, but not for transporting natural resource products. The trade cost of natural resource products is thus unchanged in this experiment.

Panel (E) of Table 8 reports the results of this experiment. In contrast to the policy objective of protecting natural resources, it leads to an unintended consequence of increasing extractive activities. In all four basins, the resulting natural resource depletion is higher in this policy (panel E) than in the policy without the sector-specific checkposts (panel A). This unintended consequence is primarily driven by the sectoral reallocation of populations through general equilibrium effects. The overall relative productivity in the natural resource sector (in terms of the amount of output that can be delivered to destinations through trade) is diminished because of the sector-specific restriction in trade. The economy thus needs more employment in this sector to meet the consumption demand by the population, which increases the total depletion of natural resources.

## 7.3 Toward External Validity and the Win-Win Policy

Conceptually, the set of counterfactual experiments derives an implication toward external validity. Counterfactual exercises based on a class of general equilibrium models often derive a conclusion from a single economy (e.g., from one country/region based on economic geography models or from one city based on a quantitative urban model that studies internal city structure). In the context of our study, this practice corresponds to analyzing counterfactuals only

from one of the four basins. However, the conclusions that can be drawn from this practice may not be as conclusive as one might expect. Panel (A) of Table 8 illustrates this point. One might conclude from the Napo basin (or Pastaza and Lower Ucayali) that the improvement of transport infrastructure targeting river order 2 is a win-win policy because it increases welfare and reduces deforestation and natural resource depletion. In contrast, the natural resource depletion is increased in the Upper Ucayali basin even with the same model, the same parameter values, and a similar study area (compared with other rainforest areas outside the Peruvian Amazon). This example illustrates the caveat of deriving conclusions from a single economy.

Therefore, this study states conclusions if and only if primary outcomes from all four basins are qualitatively same. Although it is still not perfect to argue the external validity, this way would improve the credibility of policy implications compared with those derived from a single economy. To achieve the win-win outcome, we consider a composite intervention that combines the protection policy with the improvement of transport infrastructure. Table 9 reports results of the composite counterfactual experiment that contains the following two components. The first component sets protected areas that control the expansion of rural frontier by directly targeting 2.5% of the total rural population in each basin. The second component improves the transport infrastructure in a way that it connects hinterlands to the central area of the basin (by targeting river lines with river order 2). Each component is exactly the same as in a previous experiment. According to the table, this policy is win-win because it increases welfare by about 1–2.1%, decreases deforestation by about 1–7%, and decreases natural resource depletion by about 0.5–2.4%. These outcomes imply that, while limiting the expansion of rural frontier, connecting the given rural frontier with a central area by eco-friendly transport infrastructure is preferable to simultaneously achieve multiple objectives that are seemingly trade-offs.

## 8 Conclusion

This paper investigates the concentration and dispersion forces of economic activity to balance human and ecological well-being in tropical forests. We formalize these forces in a multi-sector spatial model, which we estimate with detailed georeferenced data from major river basins in the Peruvian Amazon and plausibly exogenous variation in Amazon river networks. Counterfactual simulations demonstrate that, in the presence of density externalities, transport infrastructure investments and protection policies can simultaneously achieve higher welfare, lower deforestation, and less natural resource depletion. This paper also emphasizes that such a win-win outcome of welfare and ecosystem conservation can be achieved subject to careful spatial targeting of both types of policy interventions.

Several limitations remain. First, we are not capturing the dynamic process of community formation, policy responses, and the entry of external investments. In other words, the counterfactual spatial distribution of human settlements is being determined from the set of populated locations in the benchmark equilibrium. Second, we are not directly quantifying a collective

value for the preservation of a traditional way of life. In other words, we are not capturing the utility cost of spatial reallocation of the population caused by the counterfactual policy interventions. We believe that this paper has provided a benchmark framework upon which future research can be based to address these agendas.

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# Figures

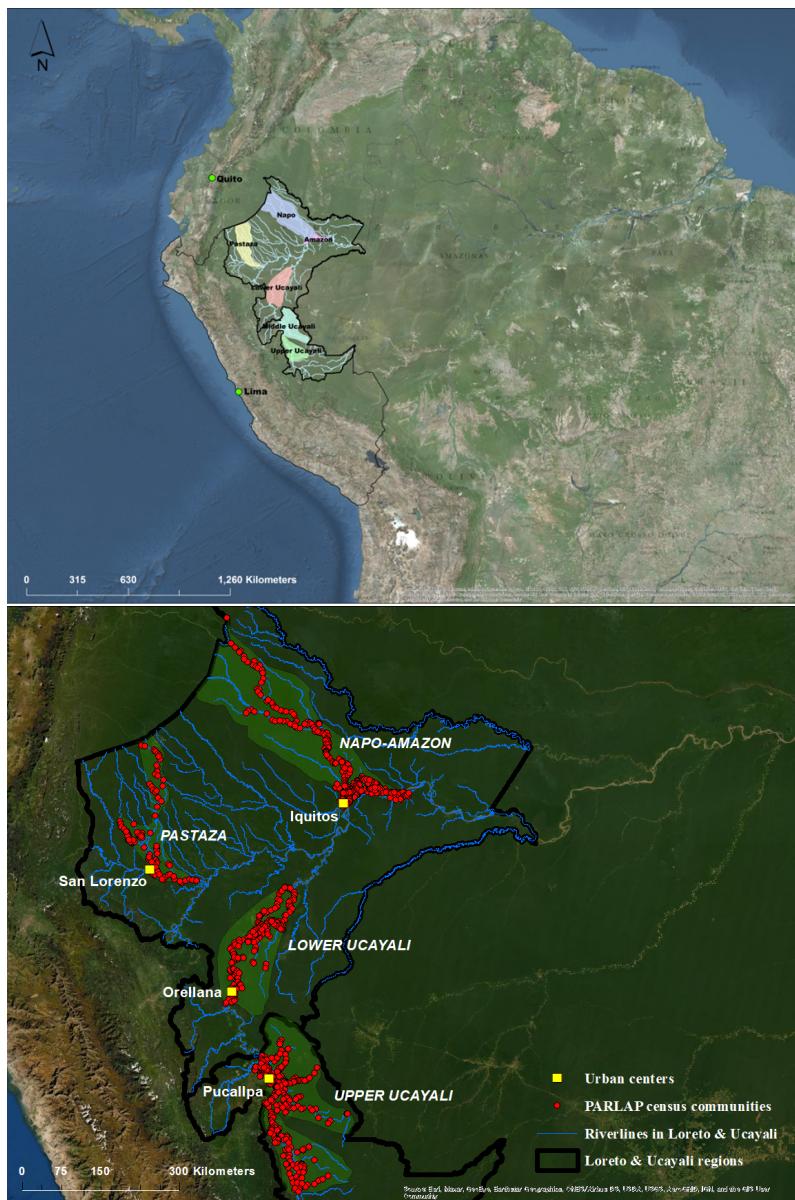
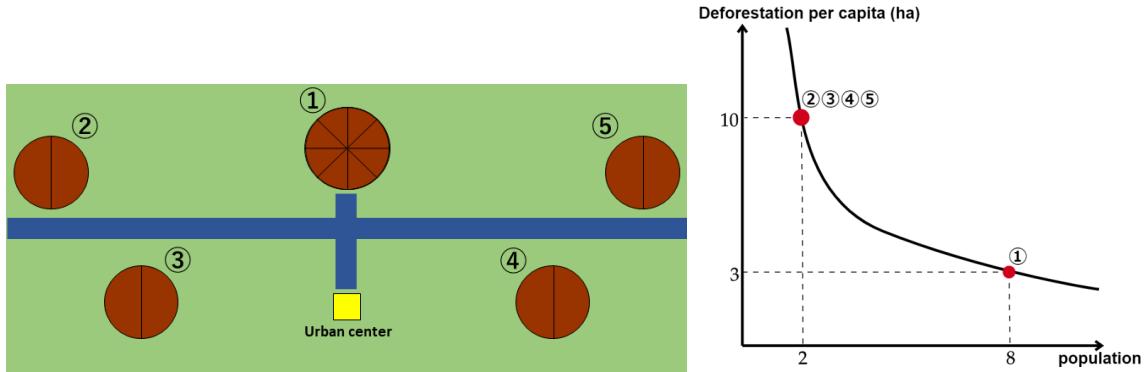
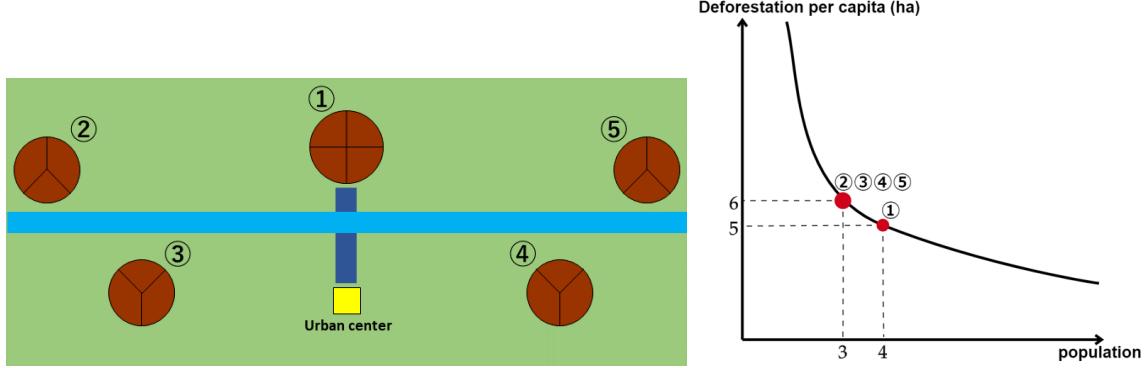


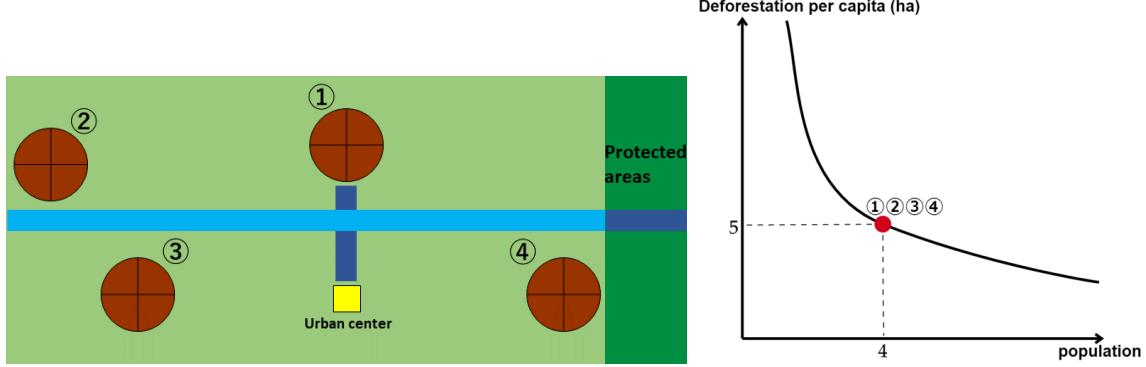
Figure 1: Study Area



(A) Benchmark (Deforestation = 104 ha)



(B) Transport infrastructure investments that integrate hinterlands (Deforestation = 92 ha)



(C) Transport infrastructure + Protecting the rural frontier (Deforestation = 80 ha)

Figure 2: Intuitive Illustration of the Deforestation Impacts of Counterfactual Policies

*Notes:* These figures illustrate the deforestation outcome in a simple river basin with a fixed number of total population (= 16) under three different scenarios. For simplicity, these figures focus on the agricultural sector and abstract from sectoral reallocation of the population through general equilibrium effects. There are 16 agricultural populations. In the left maps, brown areas represent deforested areas for agricultural land around each community. Each area inside borders represents the deforested area by each farmer. A dark blue line represents rivers. A light blue line represents rivers with upgraded transport infrastructure. The right diagrams plot the agricultural population in each community and the size of deforested area per farmer. ①-⑤ represent community identifiers and correspond between the left maps and the right diagrams.

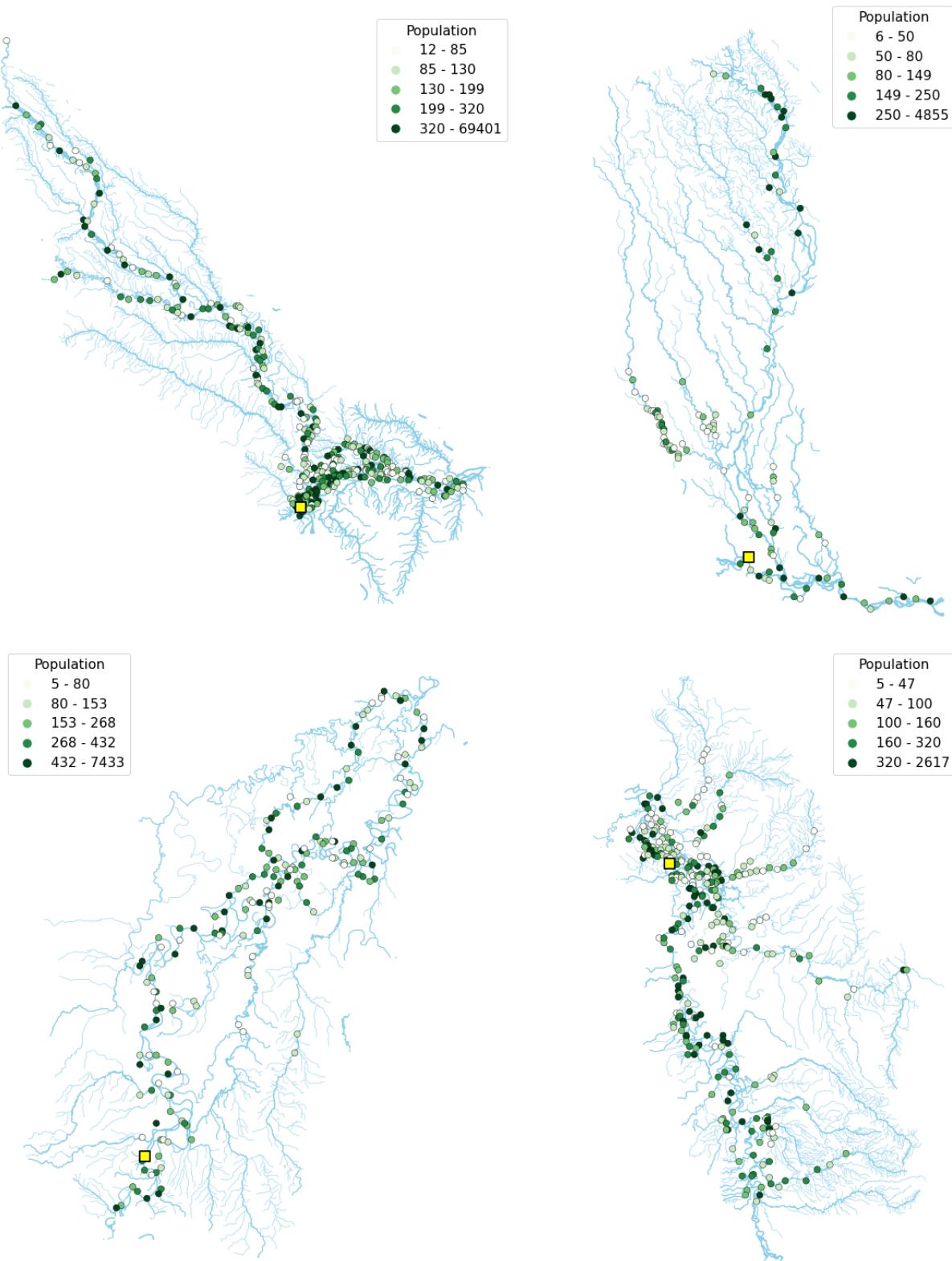


Figure 3: Population in Rural Locations

*Notes:* Each map shows population in rural locations in each basin (upper-left = Napo-Amazon; upper-right = Pastaza; bottom-left = Lower Ucayali; bottom-right = Upper Ucayali) of the study area. Light-blue squares represent the urban centers.

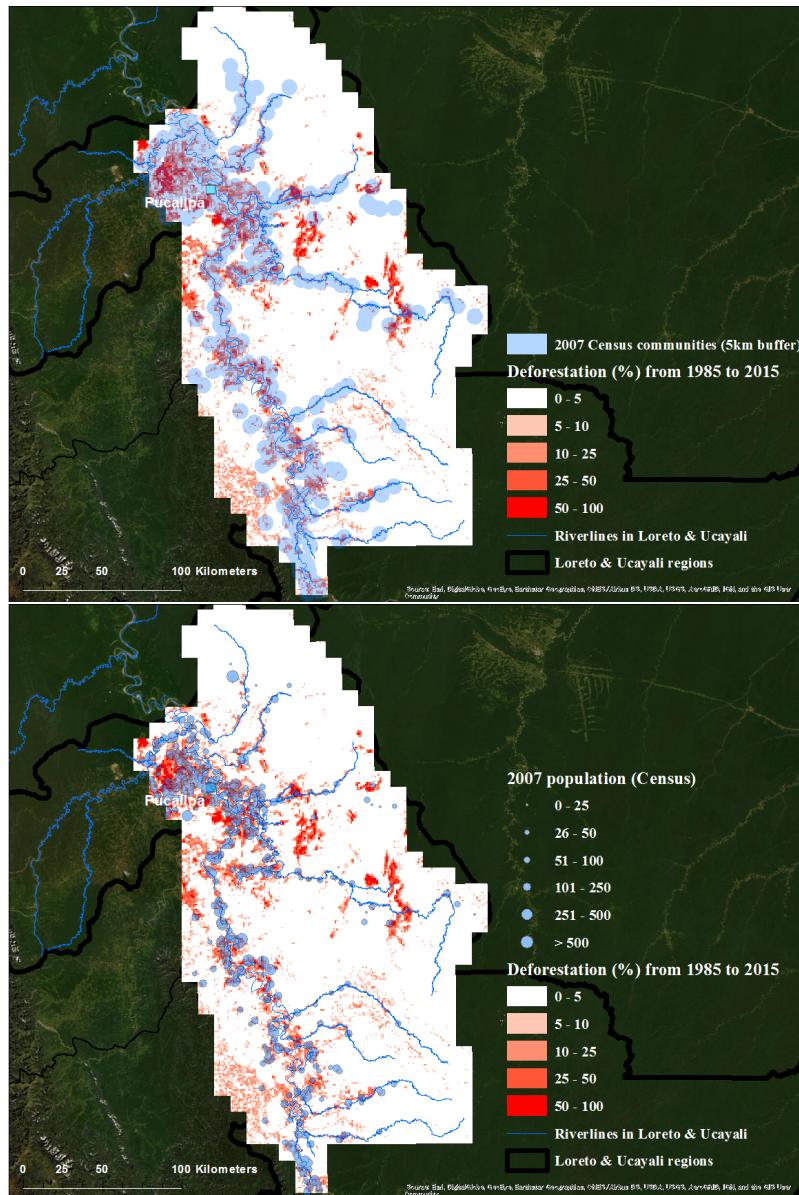


Figure 4: Communities, Populations, and Deforestation

Notes: The maps show the Upper-Ucayali basin. The forest loss measure represents a percentage of the deforested area inside each grid cell.

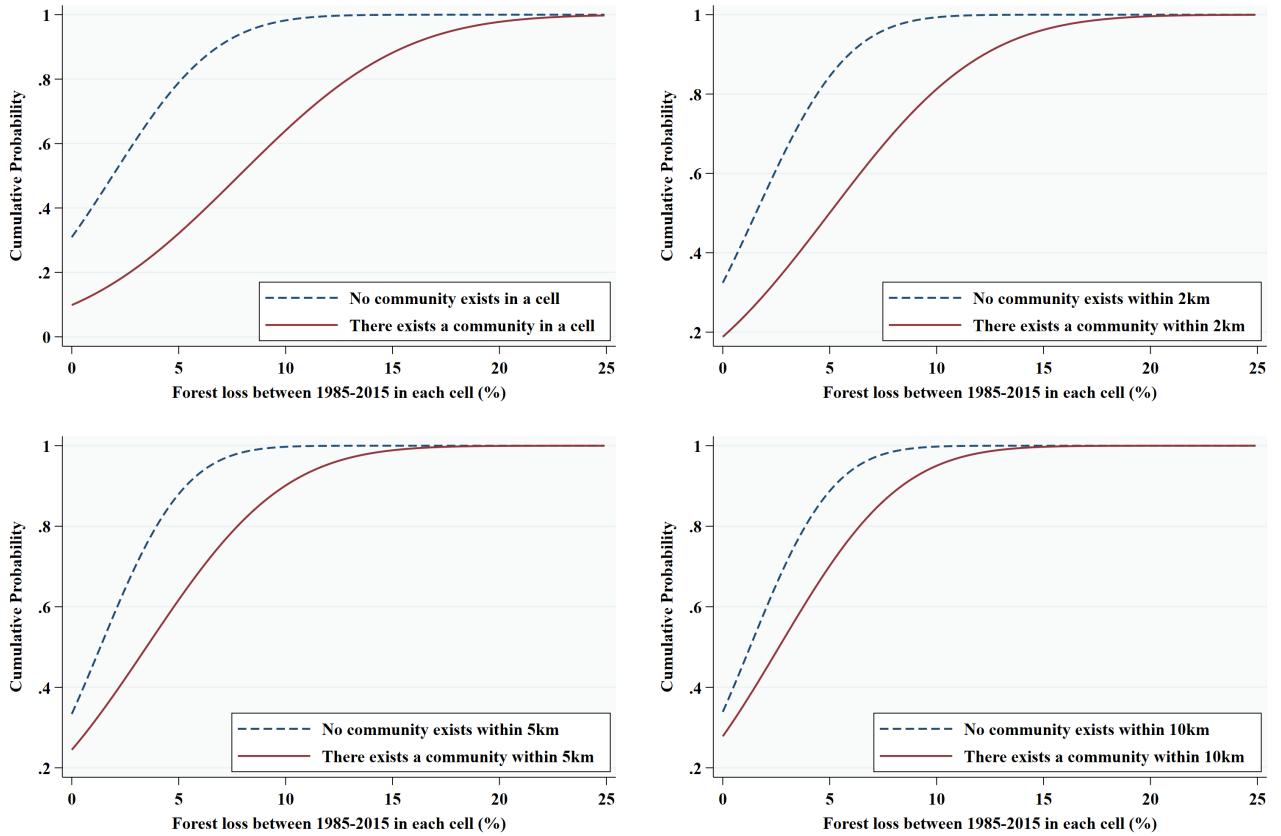


Figure 5: Communities and Deforestation (1985-2015)

Notes: The unit of analysis is a  $1\text{km} \times 1\text{km}$  grid cell in the four river basins. The forest loss measure represents a percentage of the deforested area inside each grid cell. The information of community locations is from the Peru Population and Housing Census in 2007.

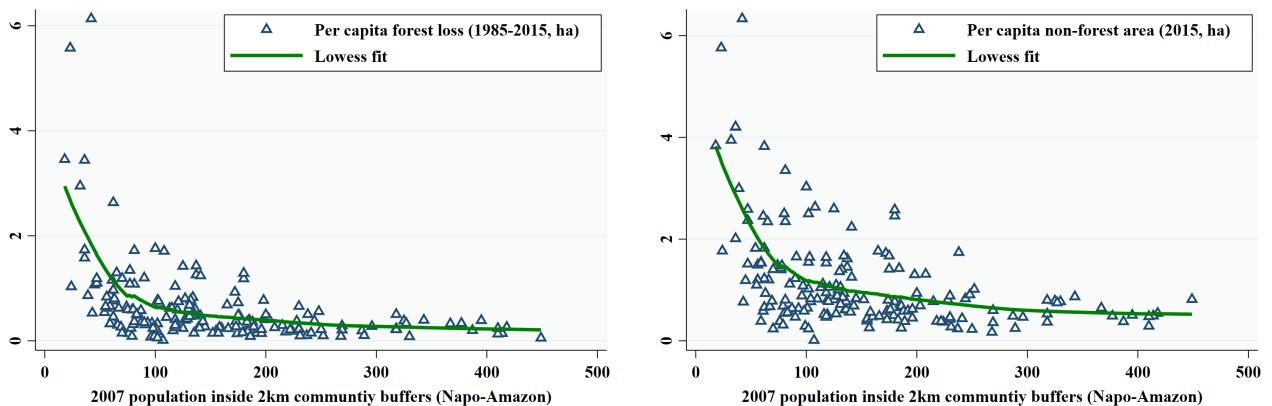


Figure 6: Populations and Per Capita Land Footprint

Notes: The population information is from the Peru Population and Housing Census in 2007. The total population in the 2km buffer surrounding a community is measured by summing populations from communities whose centroid are inside the buffer.

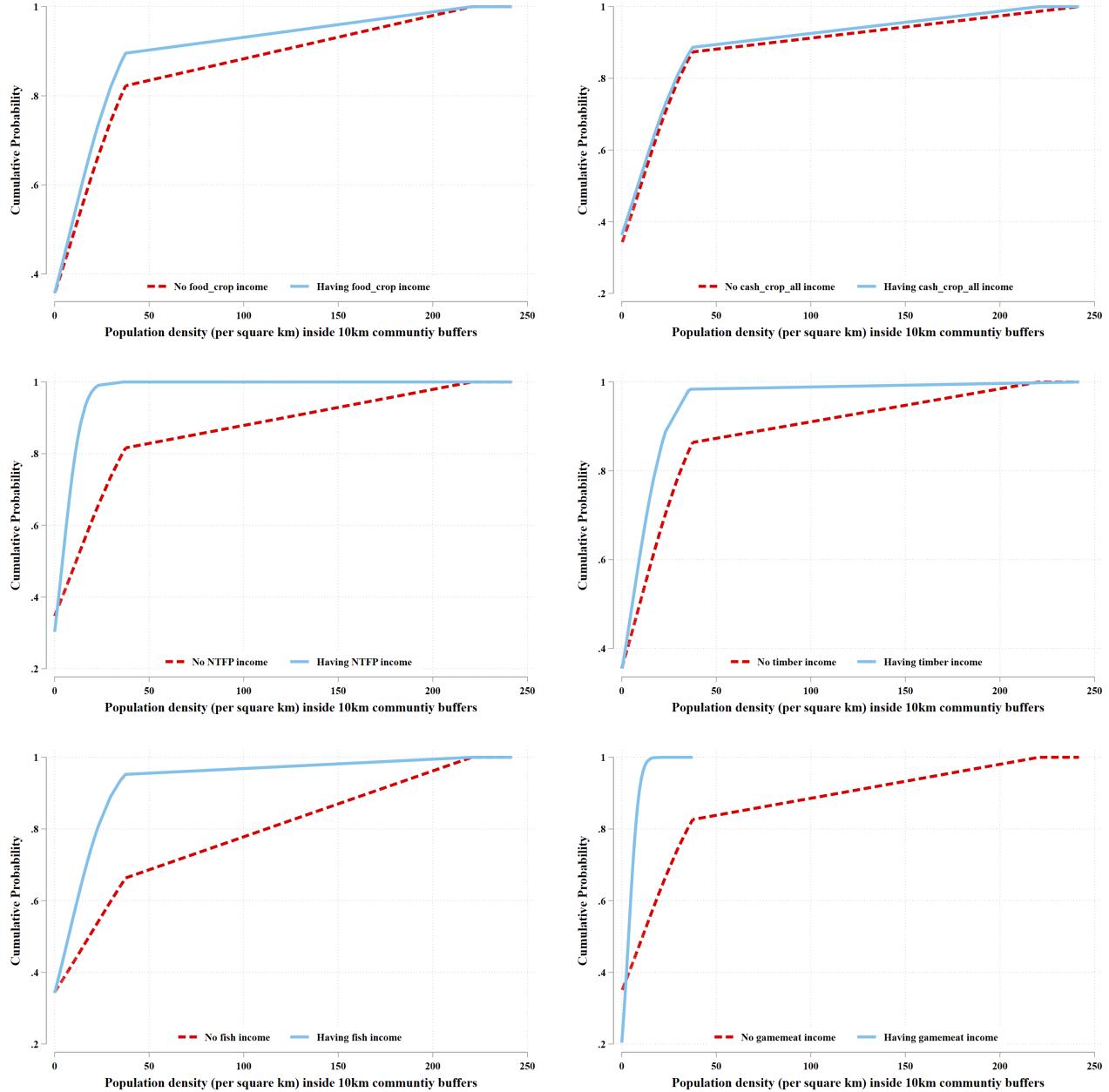


Figure 7: Population Density (10km buffer) and Distribution of Activities (Household-level)—Agriculture vs. Forest Products vs. Wildlife Extractions

*Notes:* The population information is from the PARLAP community census. We divide the total population in the  $x\text{km}$  buffer by the area of buffer ( $x^2\pi$ ) to calculate the population density in the  $x\text{km}$  buffer. The total population in the  $x\text{km}$  buffer surrounding a community is measured by summing populations from communities whose centroid are inside the buffer.

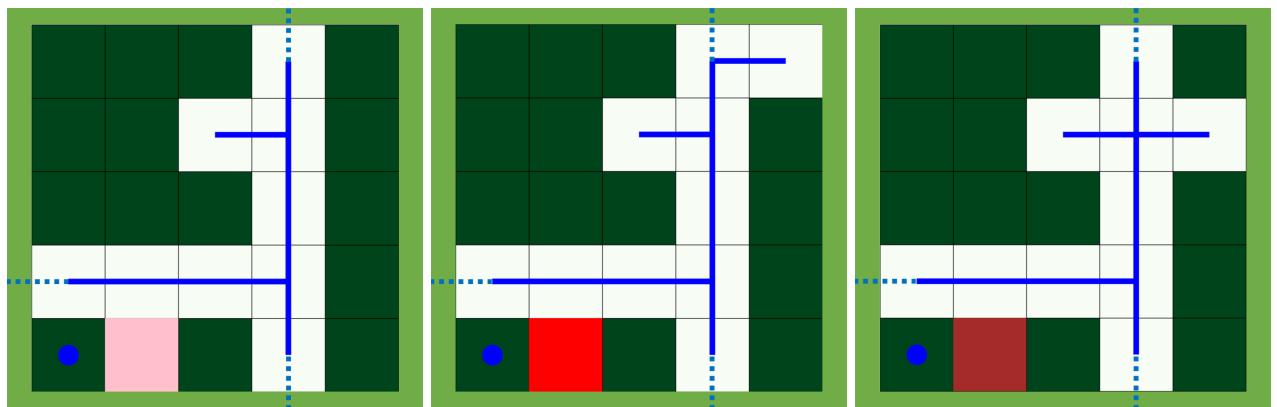
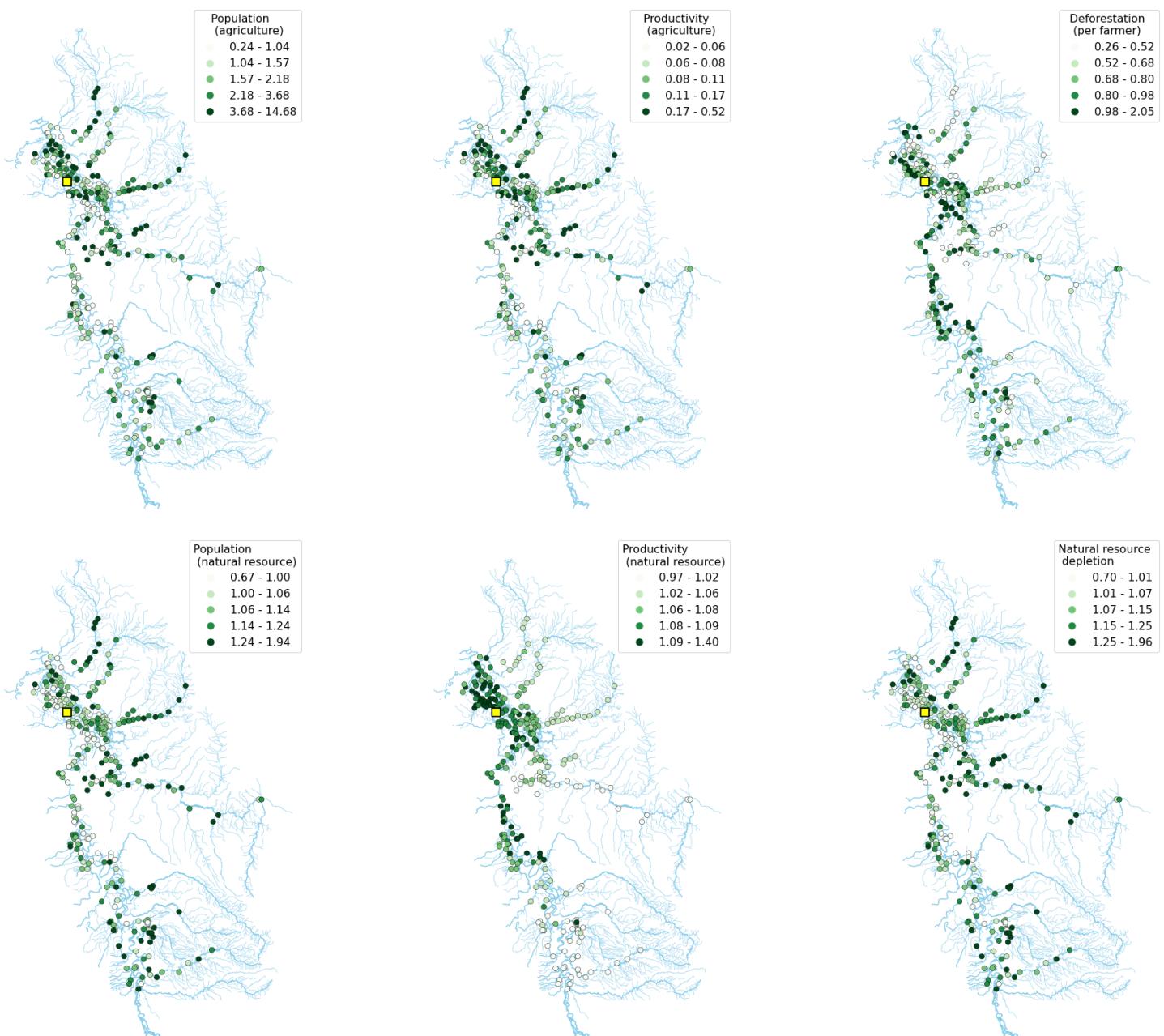


Figure 8: Intuition of Identifying the Density Externalities

*Notes:* This figure shows three similar areas inside a river basin and illustrates a comparison of the River Network Access (RNA) measures between pink (in the left), red (in the middle), and brown (in the right) cells as a plausibly exogenous variation to identify the density externalities. The blue lines indicate rivers and the white cells indicate river cells (cells that face rivers). The RNA measure captures the weighted sum of the accessibility to other river cells (the white cells in this figure) whether or not these cells have positive populations. The middle and right maps have one more river cell than the left map, each in a different location. Therefore, RNA is higher in the red and brown cells than that in the pink cell. Comparing the red cell in the middle map with the brown cell in the right map, RNA is higher in the brown cell because the additional cell next to the top-right is located closer to the brown cell.



**Figure 9: Counterfactual Outcomes without the Agglomeration Externality (Upper Ucayali)**

**Notes:** These maps present the counterfactual outcomes of shutting down the agglomeration externality in agriculture. Values shown in the legend of the circle dots are relative values in the counterfactual scenarios in terms of those in the benchmark spatial equilibrium in rural locations. The yellow square represents the urban center.

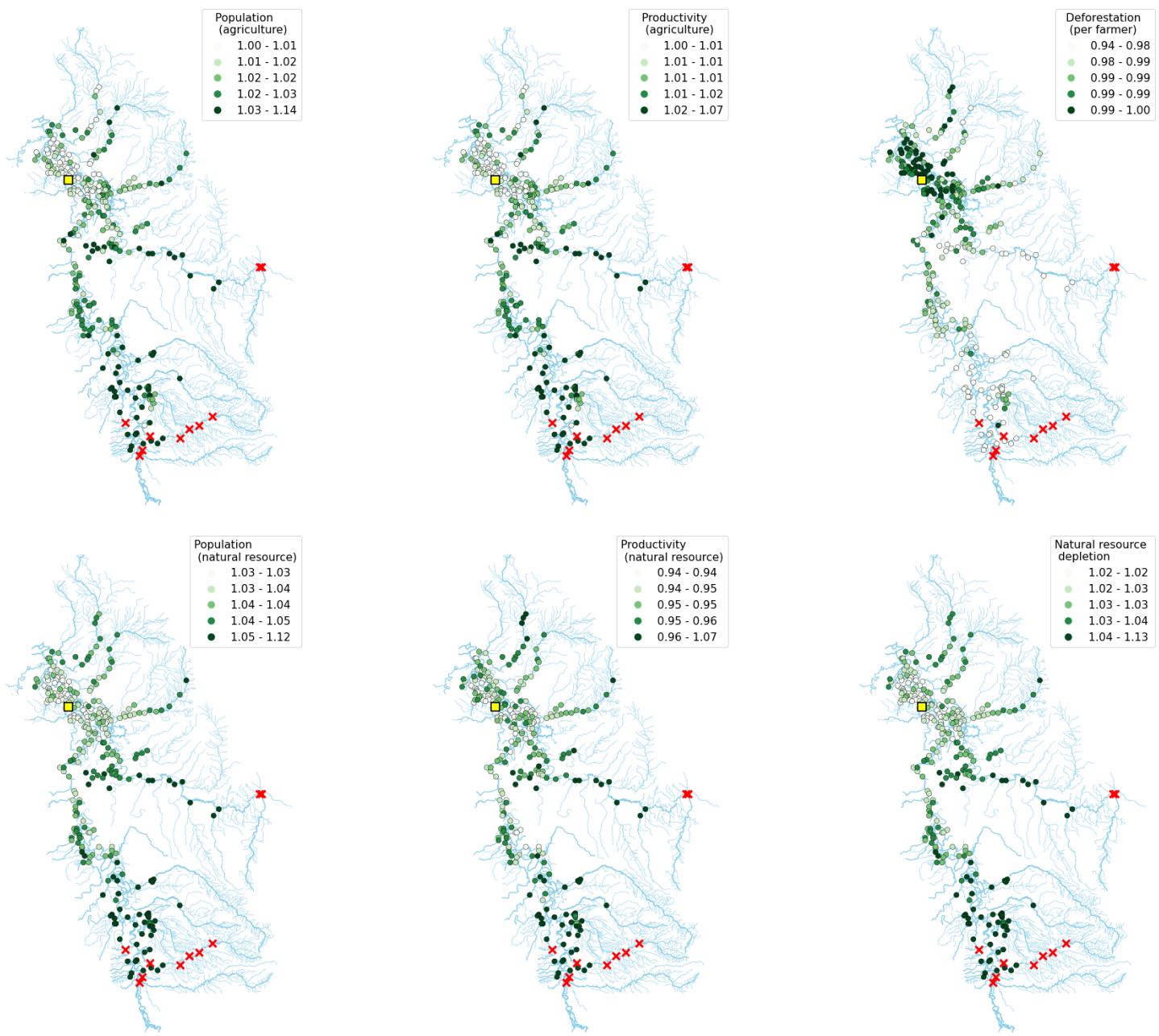


Figure 10: Counterfactual Outcomes of Protecting the Rural Frontier (Upper Ucayali)

*Notes:* These maps present the counterfactual outcomes of a place-based protection policy of controlling the expansion of rural frontier. This experiment chooses rural locations to be treated in order, starting with those farthest from the urban center, until the treated population reaches 2.5% of the total rural population in each basin. The red x marks indicate the treated locations. Values shown in the legend of the circle dots are relative values in the counterfactual scenarios in terms of those in the benchmark spatial equilibrium in rural locations. The yellow square represents the urban center.

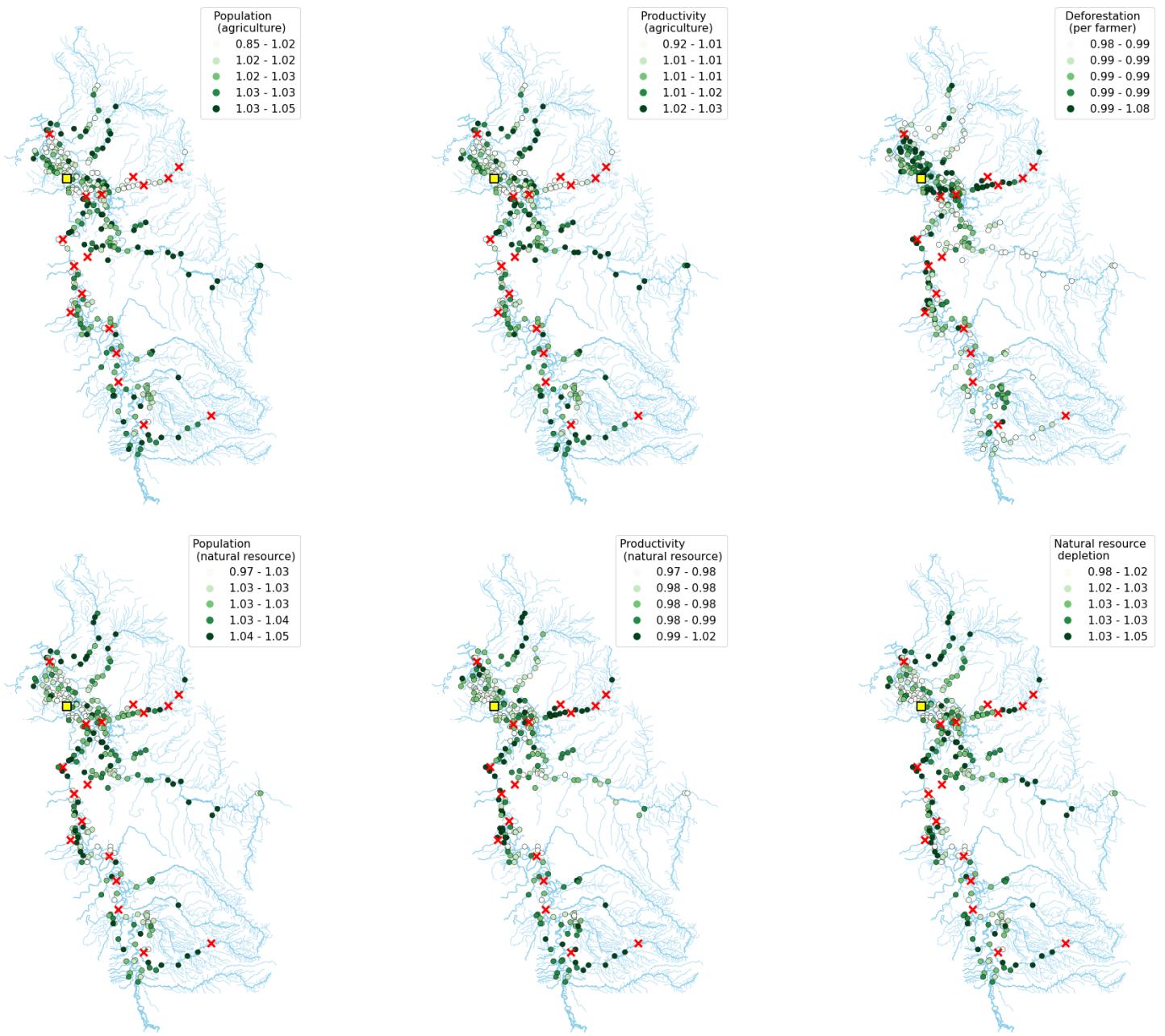


Figure 11: Counterfactual Outcomes without New Community Formation (Upper Ucayali)

*Notes:* These maps present the counterfactual outcomes of not allowing new community formation. This experiment chooses rural locations to be treated in order, starting with newly established communities, until the treated population reaches 2.5% of the total population in each basin. The red x marks indicate the treated locations. Values shown in the legend of the circle dots are relative values in the counterfactual scenarios in terms of those in the benchmark spatial equilibrium in rural locations. The yellow square represents the urban center.

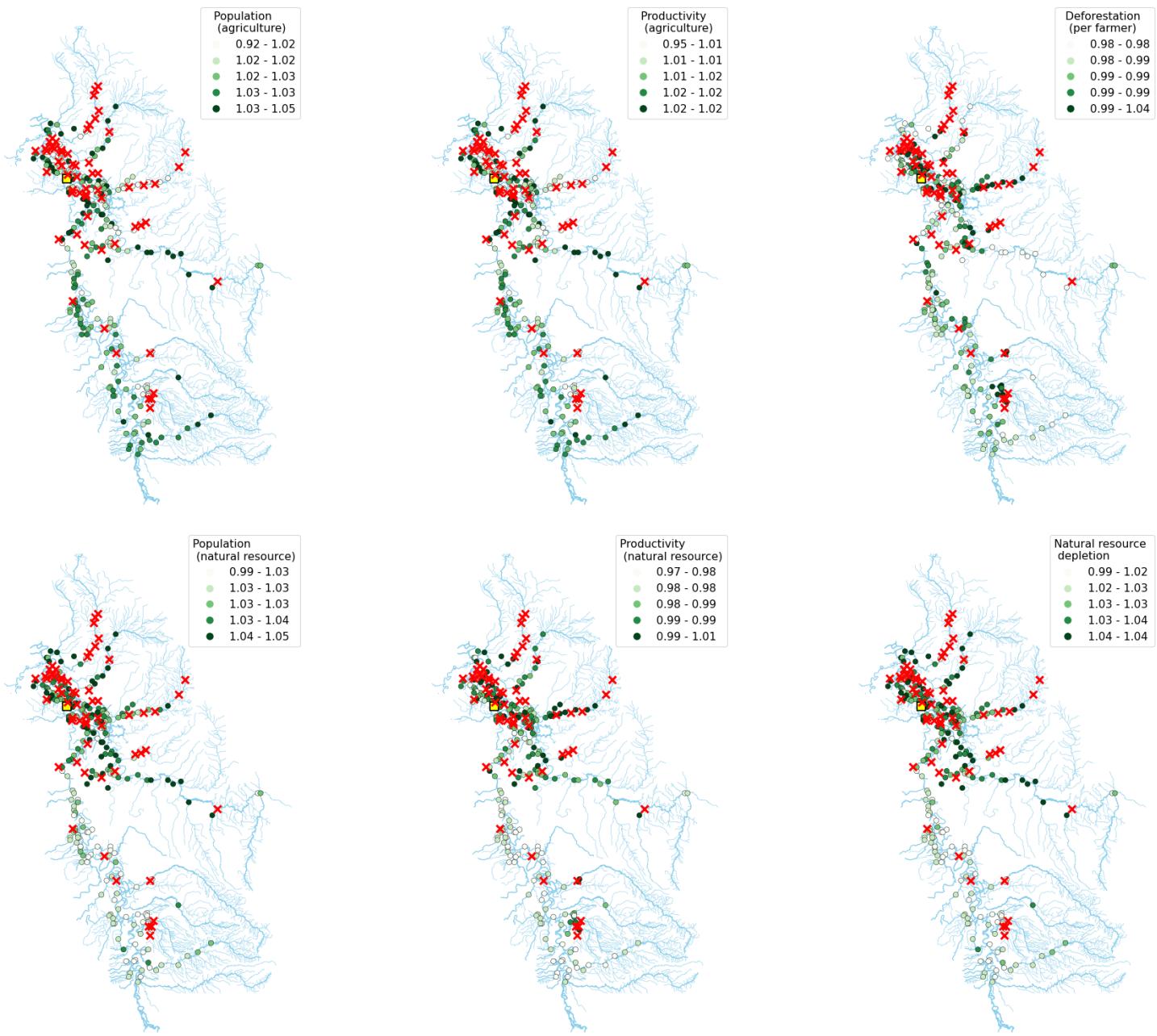
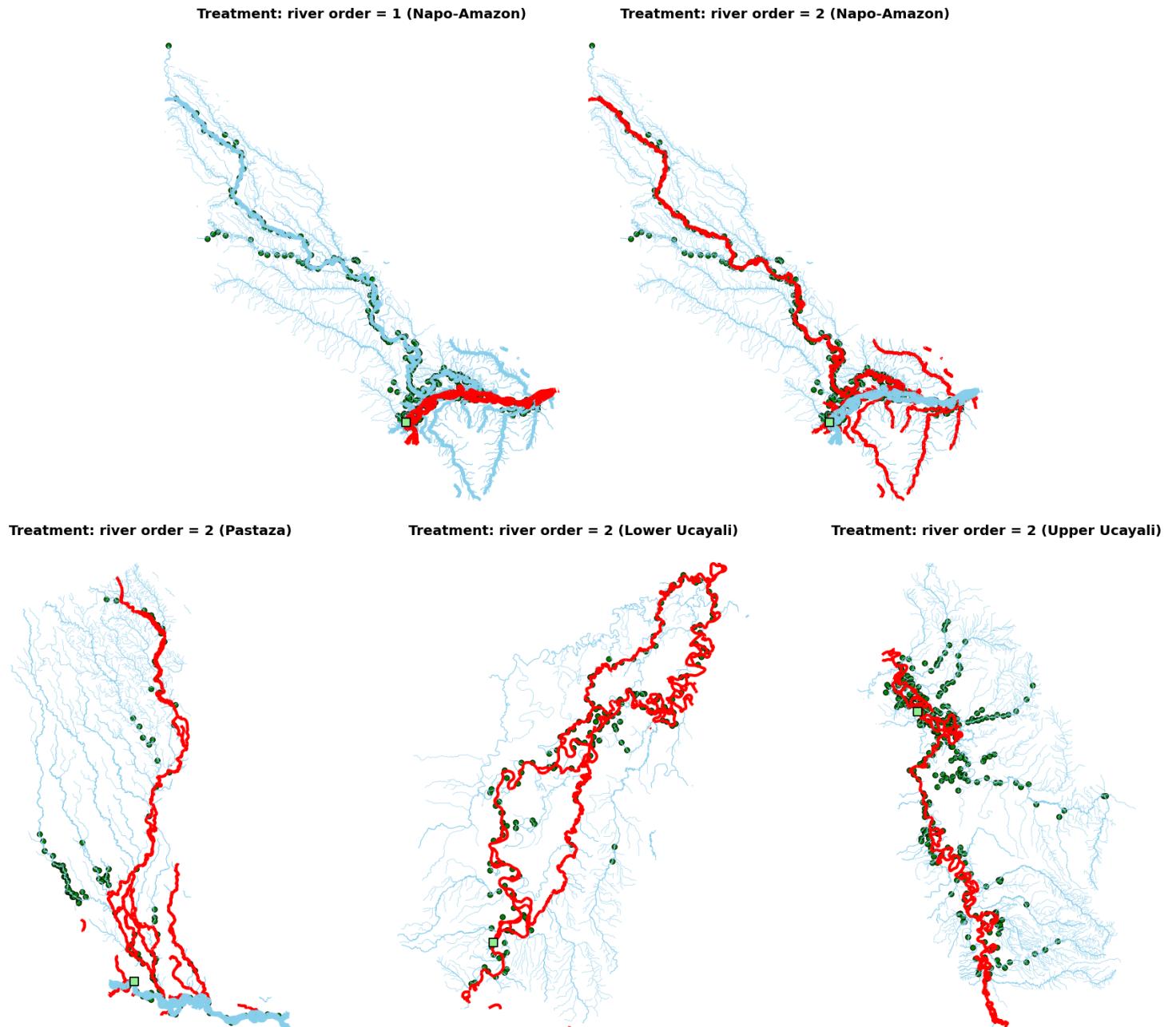


Figure 12: Counterfactual Outcomes without Small Communities (Upper Ucayali)

*Notes:* These maps present the counterfactual outcomes of a place-based protection policy that targets the smallest communities. This experiment chooses rural locations to be treated in order, starting with the location with the smallest population size, until the treated population reaches 2.5% of the total population in each basin. The red x marks indicate the treated locations. Values shown in the legend of the circle dots are relative values in the counterfactual scenarios in terms of those in the benchmark spatial equilibrium in rural locations. The yellow square represents the urban center.



**Figure 13: River Orders and Counterfactual Experiments of Improving Transport Infrastructure**

*Notes:* The light blue lines indicate the river lines without the improvement of transport infrastructure. The red lines indicate the river lines where the transport infrastructure is upgraded. The yellow square represents the urban center.

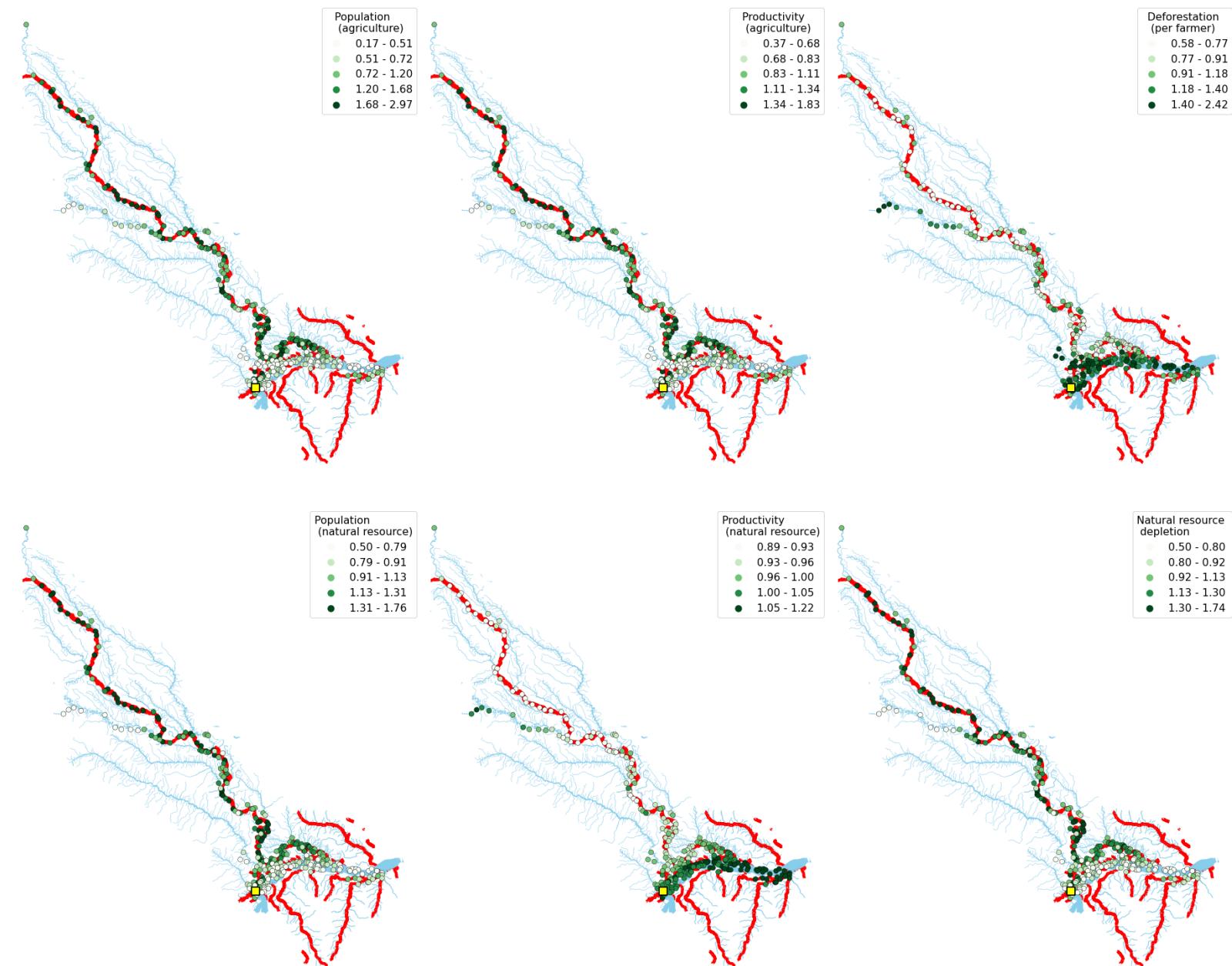


Figure 14: Counterfactual Outcomes with Improved Transport Infrastructure along River Order 2 (Napo-Amazon)

*Notes:* These maps present the counterfactual outcomes of improving the transport infrastructure in a way that hinterlands are connected to the central area of the basin. Values shown in the legend of the circle dots are relative values in the counterfactual scenarios in terms of those in the benchmark spatial equilibrium in rural locations. The light blue lines indicate the river lines without the improvement of transport infrastructure. The red lines indicate the river lines where the transport infrastructure is upgraded. The yellow square represents the urban center.

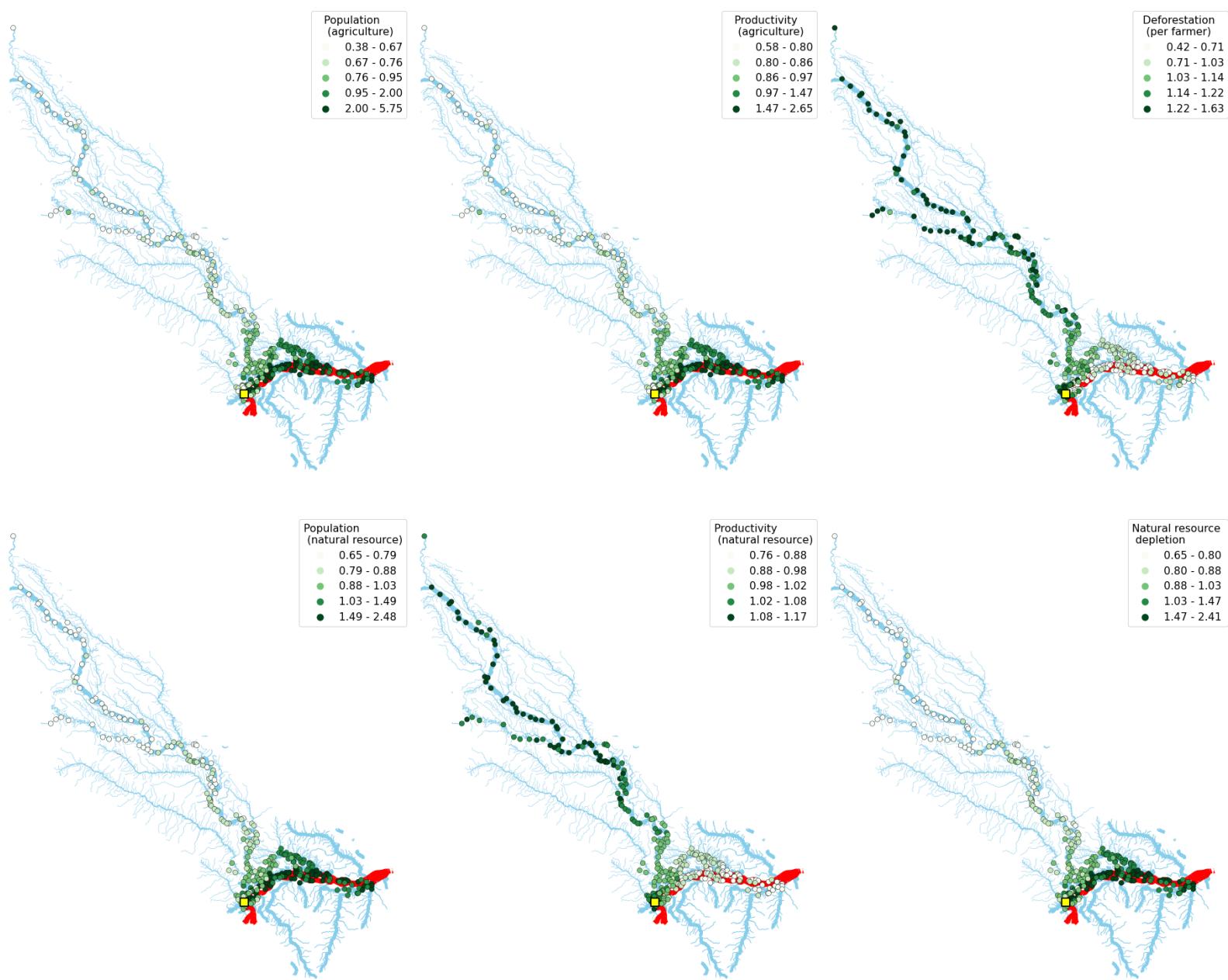


Figure 15: Counterfactual Outcomes with Improved Transport Infrastructure along River Order 1 (Napo-Amazon)

*Notes:* These maps present the counterfactual outcomes of concentrating the transport infrastructure investments in the central area of the basin. Values shown in the legend of the circle dots are relative values in the counterfactual scenarios in terms of those in the benchmark spatial equilibrium in rural locations. The light blue lines indicate the river lines without the improvement of transport infrastructure. The red lines indicate the river lines where the transport infrastructure is upgraded. The yellow square represents the urban center.

# Tables

Table 1: Human Settlements and Deforestation

	Sum	N	Mean	Std. Dev.	Min	Max
<b>(A) All grid cells in the four basins</b>						
1.1. No community exists in a cell	424160.7	149259	2.842	7.601	0	101.97
1.2. There exists a community in a cell	13606.38	1304	10.434	10.8	0	96.93
2.1. No community exists within 2km	302599.5	131962	2.293	6.883	0	101.97
2.2. There exists a community within 2km	135167.6	18601	7.267	10.865	0	101.79
3.1. No community exists within 5km	205061.6	106244	1.93	6.217	0	101.97
3.2. There exists a community within 5km	232705.5	44319	5.251	9.963	0	101.79
<b>(B) Grid cells within 2km from a river line</b>						
1.1. No community exists in a cell	301283.9	102075	2.952	7.533	0	101.97
1.2. There exists a community in a cell	12243.42	1232	9.938	10.007	0	88.11
2.1. No community exists within 2km	197397	86501	2.282	6.772	0	101.97
2.2. There exists a community within 2km	116130.3	16806	6.91	10.078	0	101.79
3.1. No community exists within 5km	126734.8	67652	1.877	6.134	0	101.97
3.2. There exists a community within 5km	186792.6	35786	5.22	9.417	0	101.79

*Notes:* This table presents summary statistics on forest loss from 1985 to 2015 for each grid cell category according to the presence of settlements. The unit of analysis is a 1km × 1km grid cell in the four river basins. The unit of measurement for forest loss measure is the hectare. The information of community locations is from the Peru Population and Housing Census in 2007.

Table 2: Summary of Model Parameters

Parameter	Description	Estimation strategy
$\delta_{Ag}, \delta_{Nr}, \delta_M$	Elasticity of trade cost	Commodity prices from the CC
$\lambda_{up}, \lambda_{land}$	Relative distance in terms of downstream river	Travel time and transport costs survey
$\alpha_{Ag}, \alpha_{Nr}, \alpha_M$	Utility weights	Normalized to = 1
$\sigma$	Within-sector elasticity of substitution	Expenditure information from ENAHO
$\bar{\sigma}$	Across-sector elasticity of substitution	Expenditure information from ENAHO
$\gamma$	Labor share in agricultural production function	From the literature (e.g., Sotelo 2020)
$\theta$	Trade elasticity	From the literature (Donaldson 2018)
$\mu_L$	Congestion in forest clearing	Linear IV using the community-level data
$\mu_{Ag}$	Agglomeration in agricultural production	Model inversion and linear IV
$\mu_{Nr}$	Congestion in natural resource extraction	Model inversion and non-linear GMM
$v$	Spatial decay in natural resource access	Model inversion and non-linear GMM

*Notes:* See section 4 for the model and section 5 for the structural estimation.

Table 3: Density Externalities in Agriculture and Natural Resource Extraction

Parameter	Point estimate	Standard error	Description
<b>(A) Agriculture</b>			
$\tilde{\mu}_{Ag}$	0.064	0.010	$= \mu_{Ag} - (1 - \gamma)\mu_L$
$\mu_L$	0.522	0.094	Congestion in forest clearing
$\mu_{Ag}$	0.273		Agglomeration in agricultural production
<b>(B) Natural resource extraction</b>			
$\mu_{Nr}$	0.335	0.042	Congestion in natural resource extraction
$\nu$	0.593	0.075	Spatial decay of congestion externality
	Hansen $J$ stat = 2.905		
	$J$ test $p$ -value = 0.821		

Notes: Estimates of density externalities in agriculture (panel A) are based on the linear specification using  $\ln RNA_o$  as an instrument. Estimates of parameters governing congestion externality in natural resource extraction (panel B) are based on the non-linear GMM using  $\ln RNA_o$  and  $\{\ln \sum_{d|D_{o,d} \leq x} RNA_d\}$  for  $x \in \mathcal{X} = \{2, 5, 10, 25, 50, 75, 100\}$  as instruments.

Table 4: Quantifying the Effects of Density Externalities

Basin	Welfare	Deforestation	Q (Ag)	Q (Nr)	N (Ag)	N (Nr)	N (Urban)
<b>(A) Without the Agglomeration Externality in Agriculture (<math>\mu_{Ag} \rightarrow 0</math>)</b>							
Napo	0.888	1.555	0.654	0.991	1.029	0.956	1.011
Pastaza	0.911	1.241	0.688	0.992	1.044	0.974	0.988
LowerUcayali	0.873	1.214	0.718	0.968	1.051	0.959	0.987
UpperUcayali	0.929	1.177	0.709	0.987	1.066	0.982	0.985
<b>(B) Higher Congestion Externality in Natural Resource Extractions (<math>\mu_{Nr} \uparrow</math> by 25%)</b>							
Napo	0.770	1.131	0.927	0.497	0.925	1.138	0.955
Pastaza	0.757	1.035	0.909	0.585	0.930	1.087	0.938
LowerUcayali	0.704	1.015	0.901	0.536	0.914	1.088	0.926
UpperUcayali	0.889	0.996	0.980	0.586	0.976	1.156	0.975

Notes: Values shown in the table are relative values in the counterfactual scenarios in terms of those in the benchmark spatial equilibrium.

Table 5: Community Population and Availability of Transport Modes

	Availability of Transport Modes in a Community							
	Lancha		Colectivo		Rapido		Peque-peque	
	(1) OLS	(2) IV	(3) OLS	(4) IV	(5) OLS	(6) IV	(7) OLS	(8) IV
$\log(N_{o,Ag})$	0.0469*** (0.0111)	0.144*** (0.0430)	0.0478** (0.0115)	0.0280 (0.0383)	0.0522*** (0.0108)	0.0566* (0.0292)	-0.00528 (0.00576)	0.00418 (0.0156)
Basin FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Geographic controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Mean (Dep. var.)	0.492	0.492	0.386	0.386	0.110	0.110	0.972	0.972
SD (Dep. var.)	0.500	0.500	0.487	0.487	0.314	0.314	0.164	0.164
First stage F-stat		24.84462		24.84462		24.84462		24.84462
Observations	906	906	906	906	906	906	906	906

Notes: Robust standard errors in parentheses. The unit of analysis is a community in the PARLAP Community Census (CC) in 2014. We use  $\log(RNA_o)$  and the initial community existence in 1940 as instruments for  $\log(N_{o,Ag})$ . Geographical controls include a dummy of high river orders (4 and 5), distance to the urban center, distance to the river, squared distance to the river, interaction terms of these two variables with a river cell dummy, elevation, river confluence, flood vulnerability, geology measures, and open water access measures for a grid cell where each census community belongs.

\*  $p < 0.1$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$ .

Table 6: Community Population and Modern Technology Use

<b>(A) Basic infrastructure</b>						
	(1)	(2)	(3)	(4)	(5)	(6)
	Irrigation	Certified seed	Crops have been certified organic	Electricity for agricultural work	Animals for agricultural work	Tractors for agricultural work
$\log(N_{o,Ag})$	-0.00329*	-0.000857	0.0000692	-0.000688	0.00315	0.000476
	(0.00180)	(0.00430)	(0.000584)	(0.000863)	(0.00206)	(0.000811)
Mean (Dep. var.)	0.013	0.064	0.001	0.003	0.010	0.002
SD (Dep. var.)	0.112	0.245	0.037	0.054	0.098	0.044
First stage F-stat	1649.082	1649.082	1649.082	1649.082	1649.082	1649.082
Observations	25827	25827	25827	25827	25827	25827
<b>(B) Inputs into land and crops</b>						
	(1)	(2)	(3)	(4)	(5)	(6)
	Guano/manure/compost	Chemical fertilizers	Insecticides	Herbicides	Fungicides	Biologic control
$\log(N_{o,Ag})$	0.000807	0.00265**	0.0228***	0.0314***	0.0118***	-0.00239
	(0.00111)	(0.00115)	(0.00353)	(0.00371)	(0.00219)	(0.00239)
Mean (Dep. var.)	0.005	0.004	0.040	0.051	0.012	0.020
SD (Dep. var.)	0.069	0.063	0.197	0.221	0.111	0.140
First stage F-stat	1649.082	1649.082	1649.082	1649.082	1649.082	1649.082
Observations	25827	25827	25827	25827	25827	25827
<b>(C) Animal, electrical, or mechanical energy</b>						
	(1)	(2)	(3)	(4)	(5)	(6)
	Iron plow of animal traction	Wooden plow of animal traction	Harvester	Foot plow	Motorized sprayer	Manual sprayer
$\log(N_{o,Ag})$	-0.000796	-0.000223	-0.000229	-0.000806	0.00197**	0.0214***
	(0.000523)	(0.000311)	(0.000282)	(0.000556)	(0.000815)	(0.00401)
Mean (Dep. var.)	0.001	0.000	0.001	0.001	0.002	0.062
SD (Dep. var.)	0.035	0.022	0.025	0.035	0.043	0.241
First stage F-stat	1649.082	1649.082	1649.082	1649.082	1649.082	1649.082
Observations	25827	25827	25827	25827	25827	25827
<b>(D) Electrical or mechanical energy</b>						
	(1)	(2)	(3)	(4)	(5)	(6)
	Grain mill	Grass chopper	Thresher	Electric generator	Wheel tractor	Boat/canue/speedboat
$\log(N_{o,Ag})$	0.00696***	0.000462	-0.00102	-0.0103***	0.000932	-0.0187**
	(0.00194)	(0.000448)	(0.000674)	(0.00323)	(0.000590)	(0.00746)
Mean (Dep. var.)	0.013	0.001	0.004	0.036	0.001	0.618
SD (Dep. var.)	0.111	0.025	0.061	0.186	0.030	0.486
First stage F-stat	1649.082	1649.082	1649.082	1649.082	1649.082	1649.082
Observations	25827	25827	25827	25827	25827	25827
Basin FE	Yes	Yes	Yes	Yes	Yes	Yes
Geographic controls	Yes	Yes	Yes	Yes	Yes	Yes

Notes: Robust standard errors in parentheses. The unit of analysis is a household in the 2012 Peruvian Agricultural Census. We use  $\log(RNA_o)$  and the initial community existence in 1940 as instruments for  $\log(N_{o,Ag})$ . Geographical controls include a dummy of high river orders (4 and 5), distance to the urban center, distance to the river, squared distance to the river, interaction terms of these two variables with a river cell dummy, elevation, river confluence, flood vulnerability, geology measures, and open water access measures for a grid cell where each census community belongs.

\*  $p < 0.1$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$ .

Table 7: Counterfactual Experiments of Protection Policies

Basin	Welfare	Deforestation	Q (Ag)	Q (Nr)	N (Ag)	N (Nr)	N (Urban)
<b>(A) Protecting the rural frontier</b>							
Napo	0.998	0.948	0.999	0.997	1.002	1.003	0.996
Pastaza	0.999	0.975	0.999	1.001	1.001	1.000	0.998
LowerUcayali	0.997	0.967	0.999	0.997	0.999	1.001	0.996
UpperUcayali	0.998	0.980	1.000	0.992	1.001	1.004	0.999
<b>(B) Not allowing new community formation</b>							
Napo	0.998	0.915	1.008	1.002	1.002	1.002	0.997
Pastaza	0.997	0.951	1.004	1.000	0.999	1.003	0.997
LowerUcayali	0.997	0.979	0.996	0.994	0.998	1.002	0.998
UpperUcayali	0.999	0.970	1.004	1.001	1.001	1.002	0.999
<b>(C) Not allowing for small communities</b>							
Napo	0.997	0.869	1.009	1.002	1.002	1.003	0.996
Pastaza	0.996	0.936	1.003	1.002	0.999	1.003	0.996
LowerUcayali	0.998	0.900	1.008	1.003	1.001	1.000	0.994
UpperUcayali	0.999	0.927	1.009	1.005	1.001	1.003	0.999

Notes: Values shown in the table are relative values in the counterfactual scenarios in terms of those in the benchmark spatial equilibrium.

Table 8: Counterfactual Experiments of Improving Transport Infrastructure

Basin	Welfare	Deforestation	Q (Ag)	Q (Nr)	N (Ag)	N (Nr)	N (Urban)
<b>(A) Transport infrastructure improved (<math>\lambda_{upgraded} = 0.8</math>) along river order = 2</b>							
Napo	1.018	0.989	0.992	0.997	0.996	0.998	1.004
Pastaza	1.013	0.976	1.028	0.995	1.003	0.999	0.998
LowerUcayali	1.023	1.014	1.022	0.978	1.000	0.995	1.023
UpperUcayali	1.012	0.989	1.024	1.003	1.002	1.005	0.998
<b>(B) Transport infrastructure improved (<math>\lambda_{upgraded} = 0.8</math>) along river order = 1</b>							
Napo	1.010	1.060	0.974	0.997	0.994	0.997	1.007
<b>(C) Transport infrastructure improved (<math>\lambda_{upgraded} = 0.8</math>) along river order = 1, 2</b>							
Napo	1.029	1.051	0.969	0.995	0.991	0.995	1.011
<b>(D) Symmetric trade cost (<math>\lambda_{up} = 1</math>)</b>							
Napo	1.011	1.023	0.985	0.997	0.996	0.997	1.005
Pastaza	1.008	1.006	1.002	0.999	1.000	1.000	1.000
LowerUcayali	1.009	1.035	1.003	0.992	0.999	0.998	1.018
UpperUcayali	1.005	1.011	1.005	1.004	1.003	1.006	0.998
<b>(E) Transport infrastructure improved (<math>\lambda_{upgraded} = 0.8</math>) along river order = 2 with checkposts that prohibit transporting natural resource goods</b>							
Napo	1.012	0.968	0.998	1.002	1.000	1.002	0.999
Pastaza	1.007	0.979	1.021	0.999	1.000	1.002	0.996
LowerUcayali	1.010	1.020	1.011	0.991	0.996	1.002	1.007
UpperUcayali	1.009	0.988	1.026	1.007	1.002	1.009	0.998

Notes: Values shown in the table are relative values in the counterfactual scenarios in terms of those in the benchmark spatial equilibrium.

Table 9: Counterfactual Outcomes of a Composite Intervention

Basin	Welfare	Deforestation	Q (Ag)	Q (Nr)	N (Ag)	N (Nr)	N (Urban)
<b>Protecting the rural frontier &amp;</b>							
<b>Transport infrastructure improved (<math>\lambda_{upgraded} = 0.8</math>) along river order = 2</b>							
Napo	1.016	0.933	0.990	0.994	0.999	1.001	1.011
Pastaza	1.010	0.953	1.024	0.997	1.004	0.999	0.996
LowerUcayali	1.021	0.990	1.019	0.976	1.000	0.996	1.021
UpperUcayali	1.010	0.969	1.024	0.995	1.003	1.009	0.997

*Notes:* Values shown in the table are relative values in the counterfactual scenarios in terms of those in the benchmark spatial equilibrium.

# — Appendix —

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## A Additional Figures and Tables

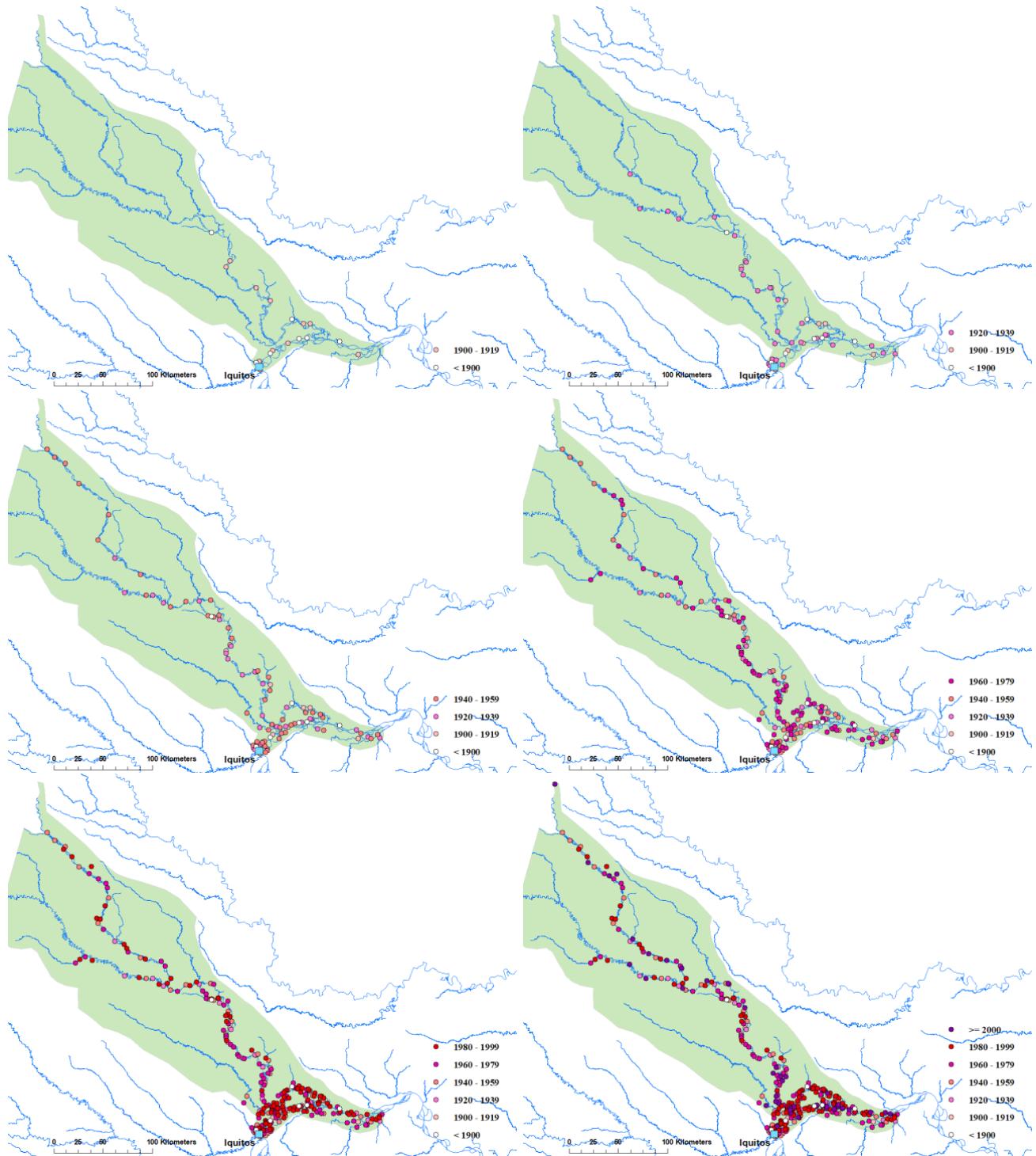


Figure A.1: Establishment of Rainforest Communities over Decades in the Napo-Amazon Basin

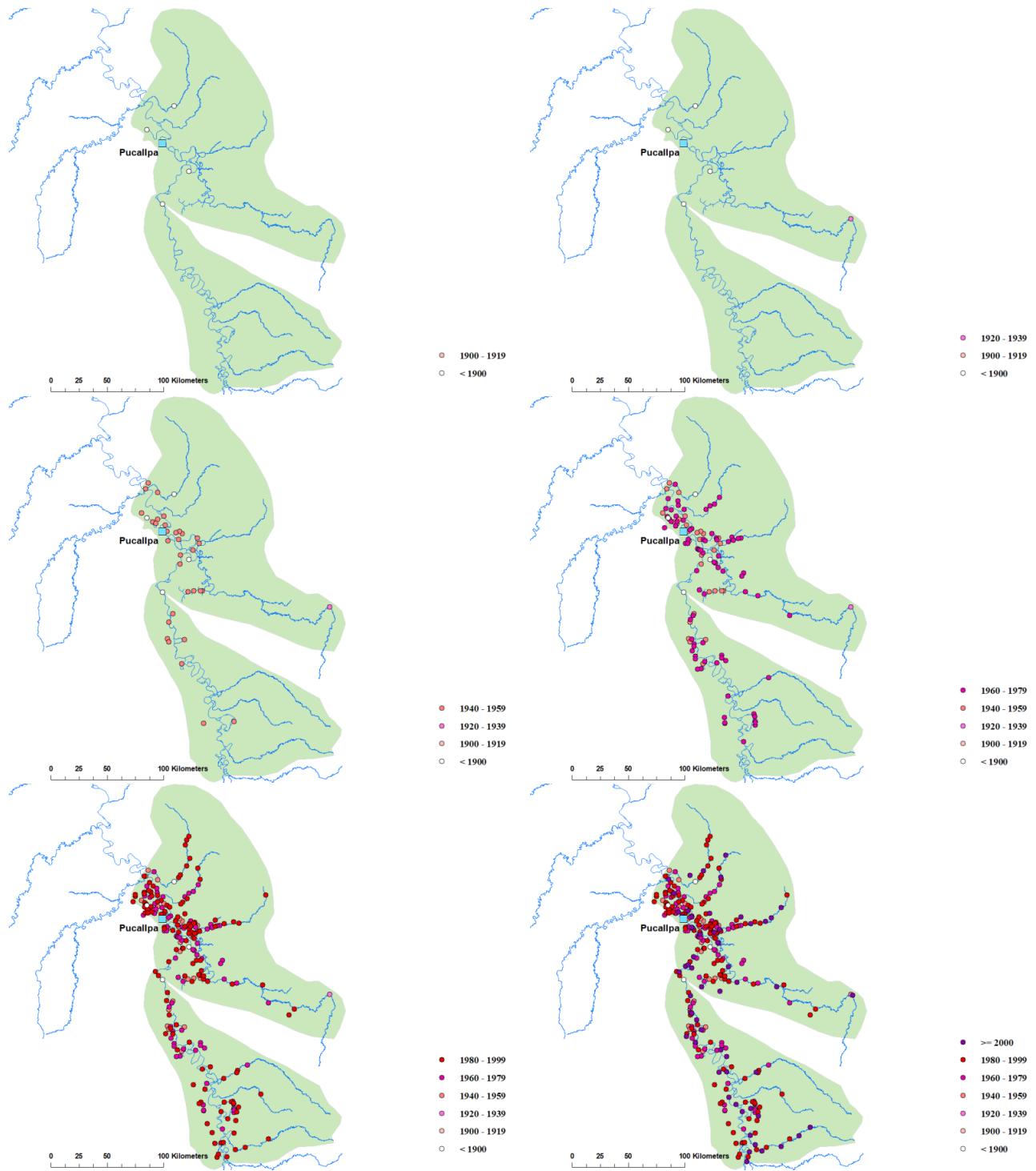


Figure A.2: Establishment of Rainforest Communities over Decades in the Upper Ucayali Basin

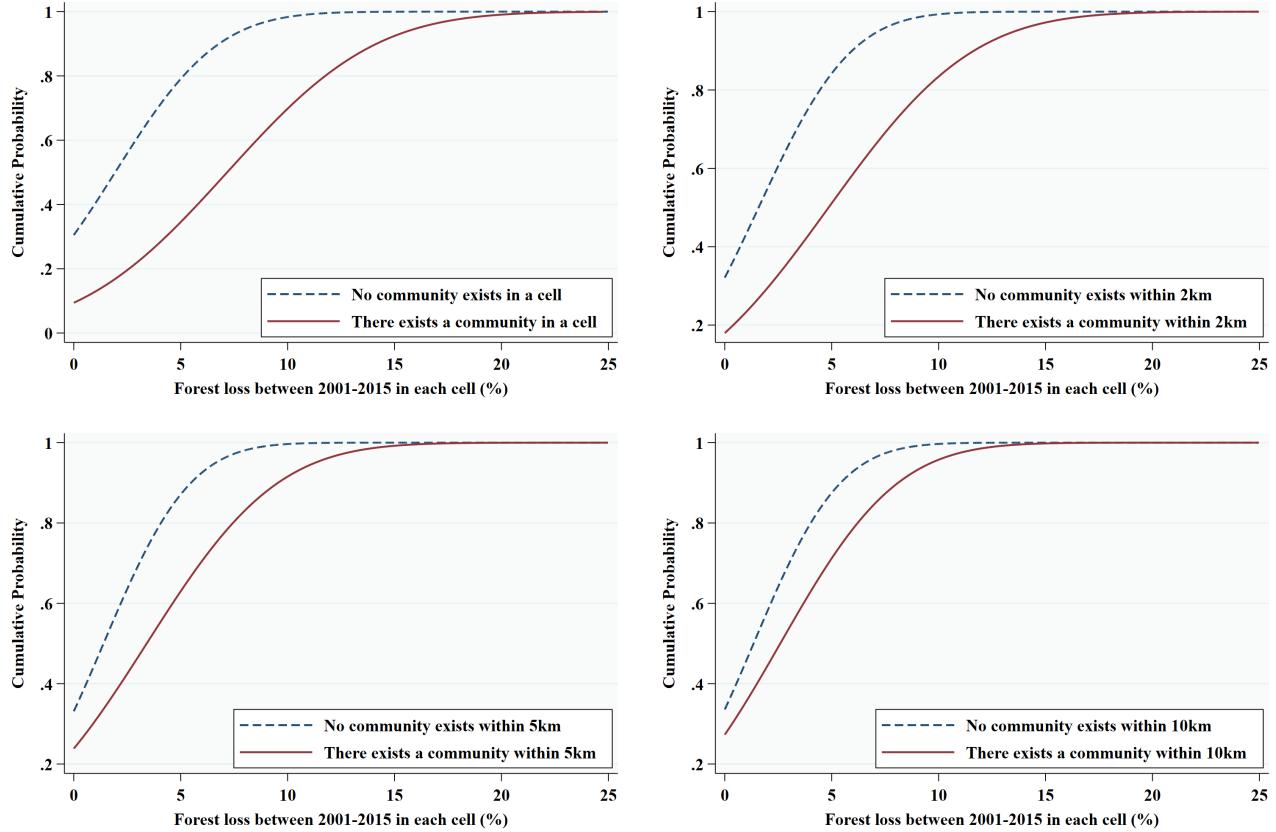


Figure A.3: Communities and Deforestation (2001-2015)

Notes: The unit of analysis is a  $1\text{km} \times 1\text{km}$  grid cell in the four river basins. The forest loss measure represents a percentage of the deforested area inside each grid cell. The information of community locations is from the Peru Population and Housing Census in 2007.

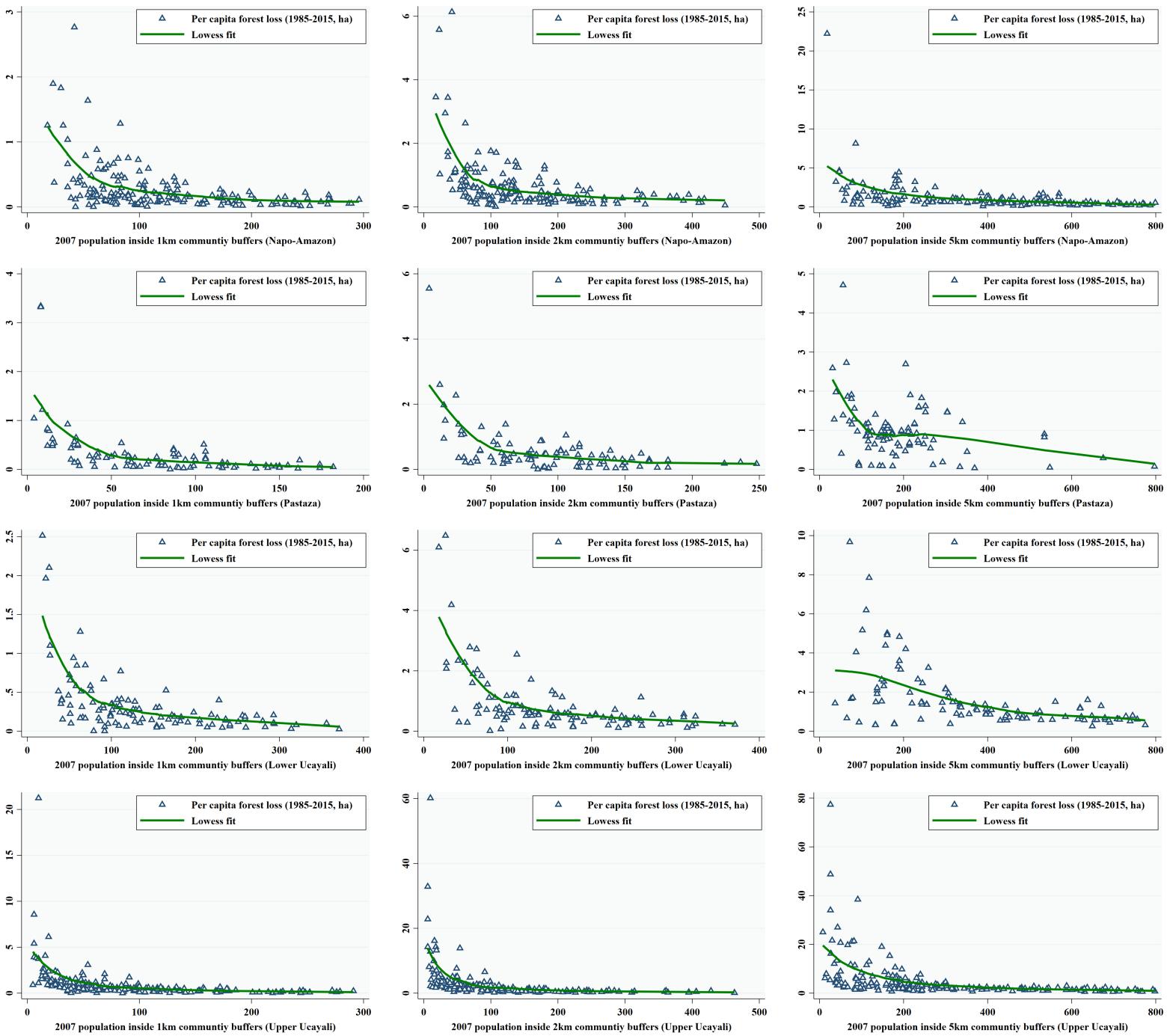


Figure A.4: Populations and Per Capita Deforestation with Different Buffers

Notes: The population information is from the Peru Population and Housing Census in 2007. The total population in the  $x\text{km}$  buffer surrounding a community is measured by summing populations from communities whose centroid are inside the buffer.

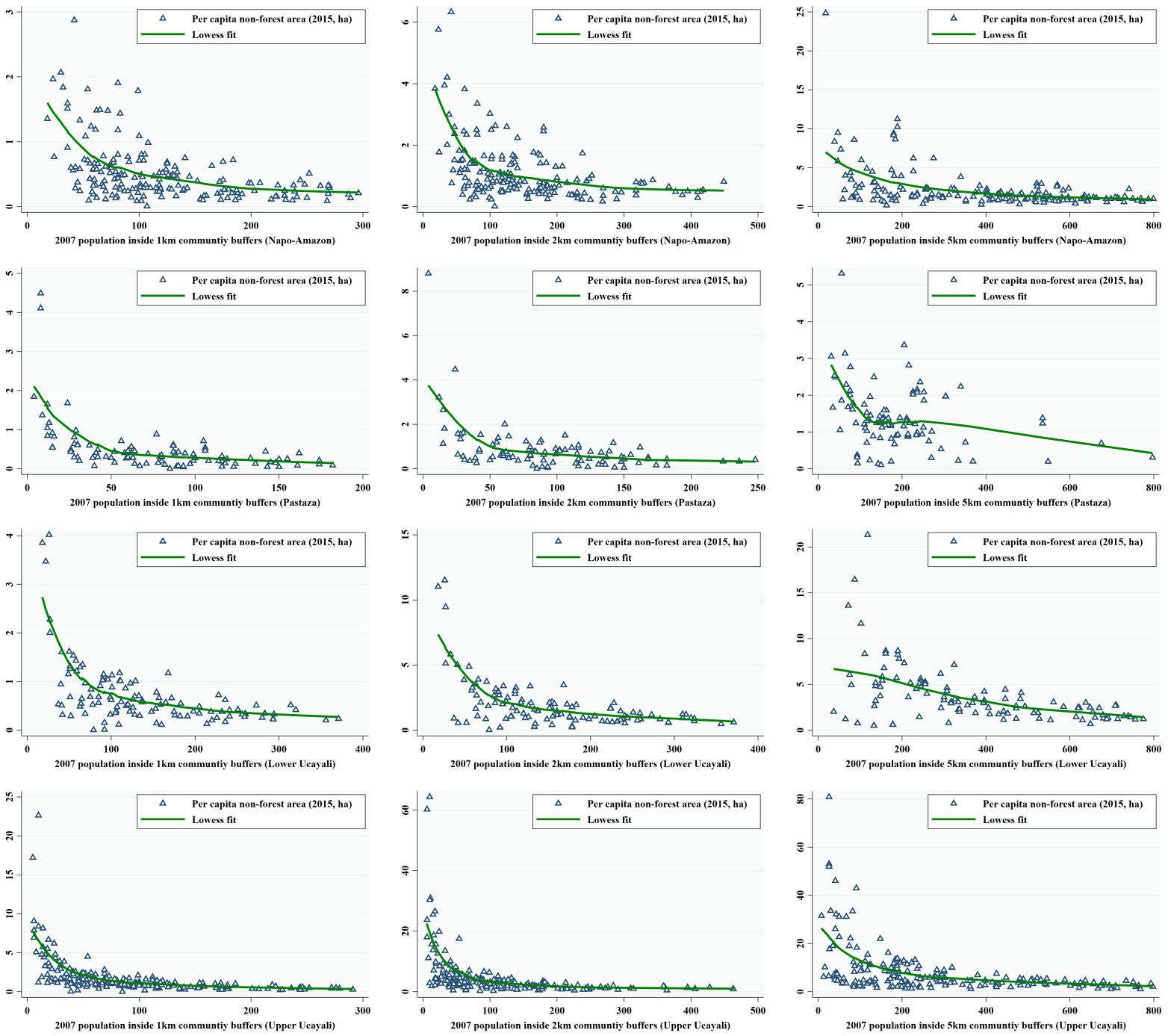


Figure A.5: Populations and Per Capita Non-Forest Area with Different Buffers

Notes: The population information is from the Peru Population and Housing Census in 2007. The total population in the  $k\text{km}$  buffer surrounding a community is measured by summing populations from communities whose centroid are inside the buffer.

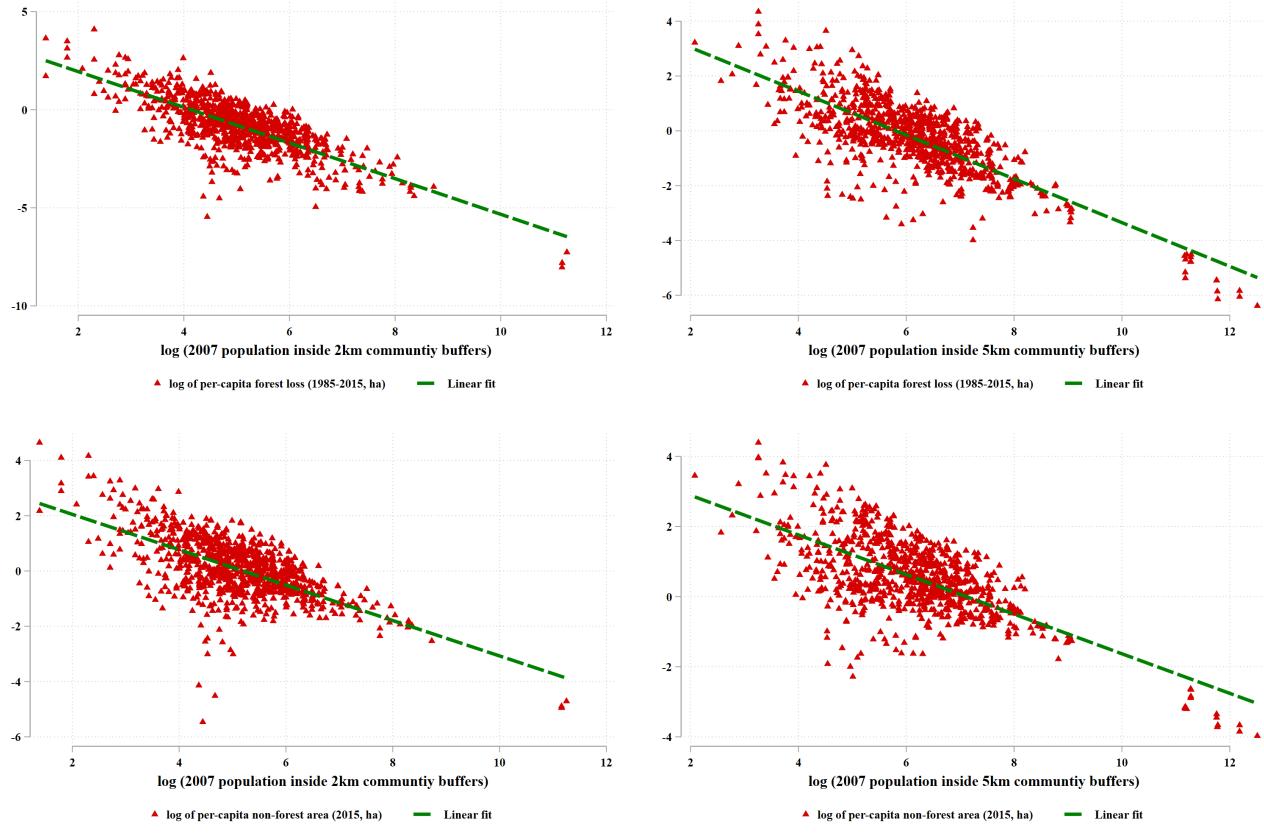


Figure A.6: Populations and Per Capita Deforestation

*Notes:* The population information is from the Peru Population and Housing Census in 2007. The total population in the 2 km and 5 km buffers surrounding a community is measured by summing populations from communities whose centroid are inside the buffers.

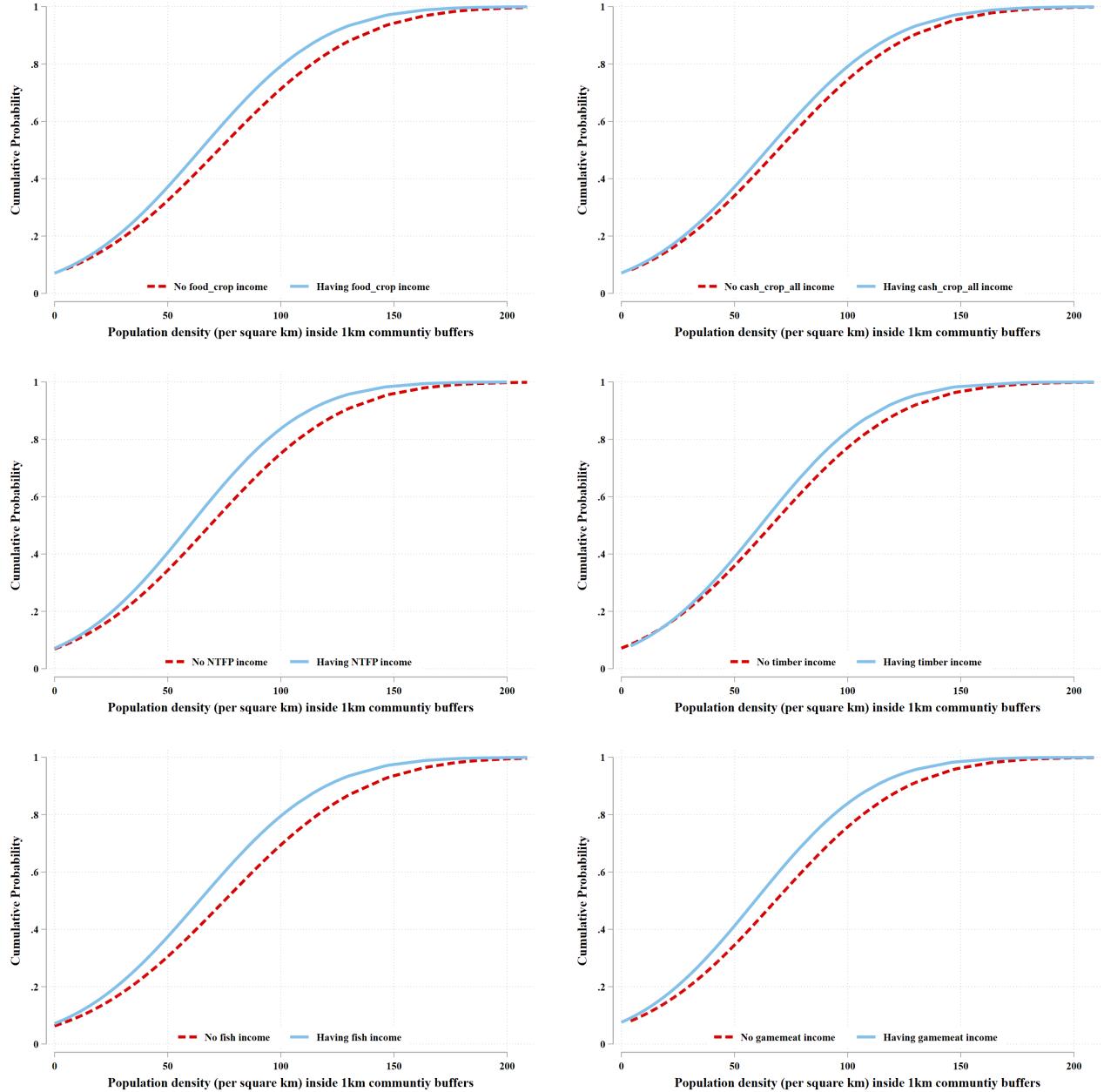


Figure A.7: Population Density (1km buffer) and Distribution of Activities (Household-level)—Agriculture vs. Forest Products vs. Wild Animal Extractions

*Notes:* The population information is from the PARLAP community census. We divide the total population in the  $x\text{km}$  buffer by the area of buffer ( $x^2\pi$ ) to calculate the population density in the  $x\text{km}$  buffer. The total population in the  $x\text{km}$  buffer surrounding a community is measured by summing populations from communities whose centroid are inside the buffer.

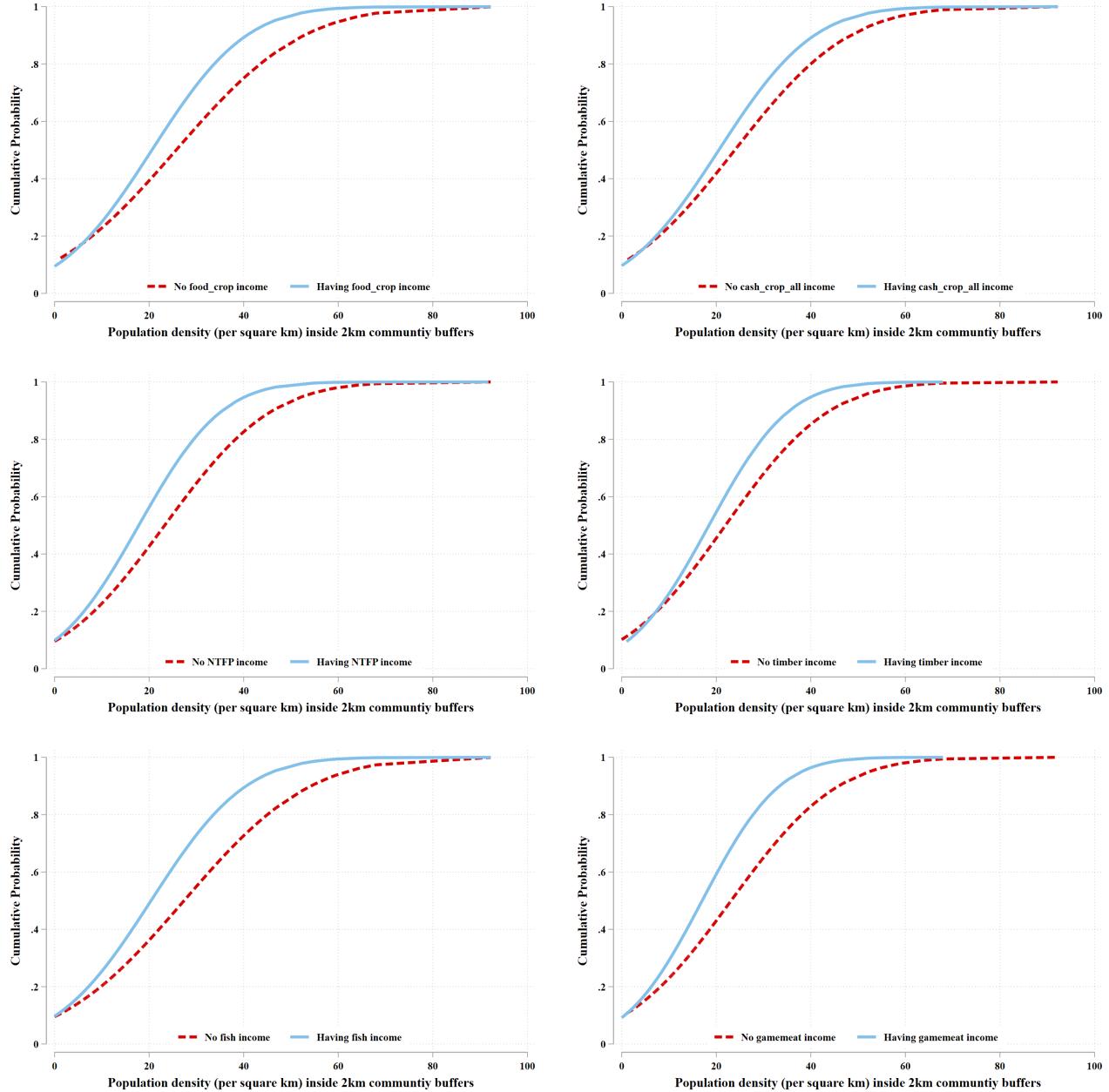


Figure A.8: Population Density (2km buffer) and Distribution of Activities (Household-level)—Agriculture vs. Forest Products vs. Wild Animal Extractions

*Notes:* The population information is from the PARLAP community census. We divide the total population in the  $x\text{km}$  buffer by the area of buffer ( $x^2\pi$ ) to calculate the population density in the  $x\text{km}$  buffer. The total population in the  $x\text{km}$  buffer surrounding a community is measured by summing populations from communities whose centroid are inside the buffer.

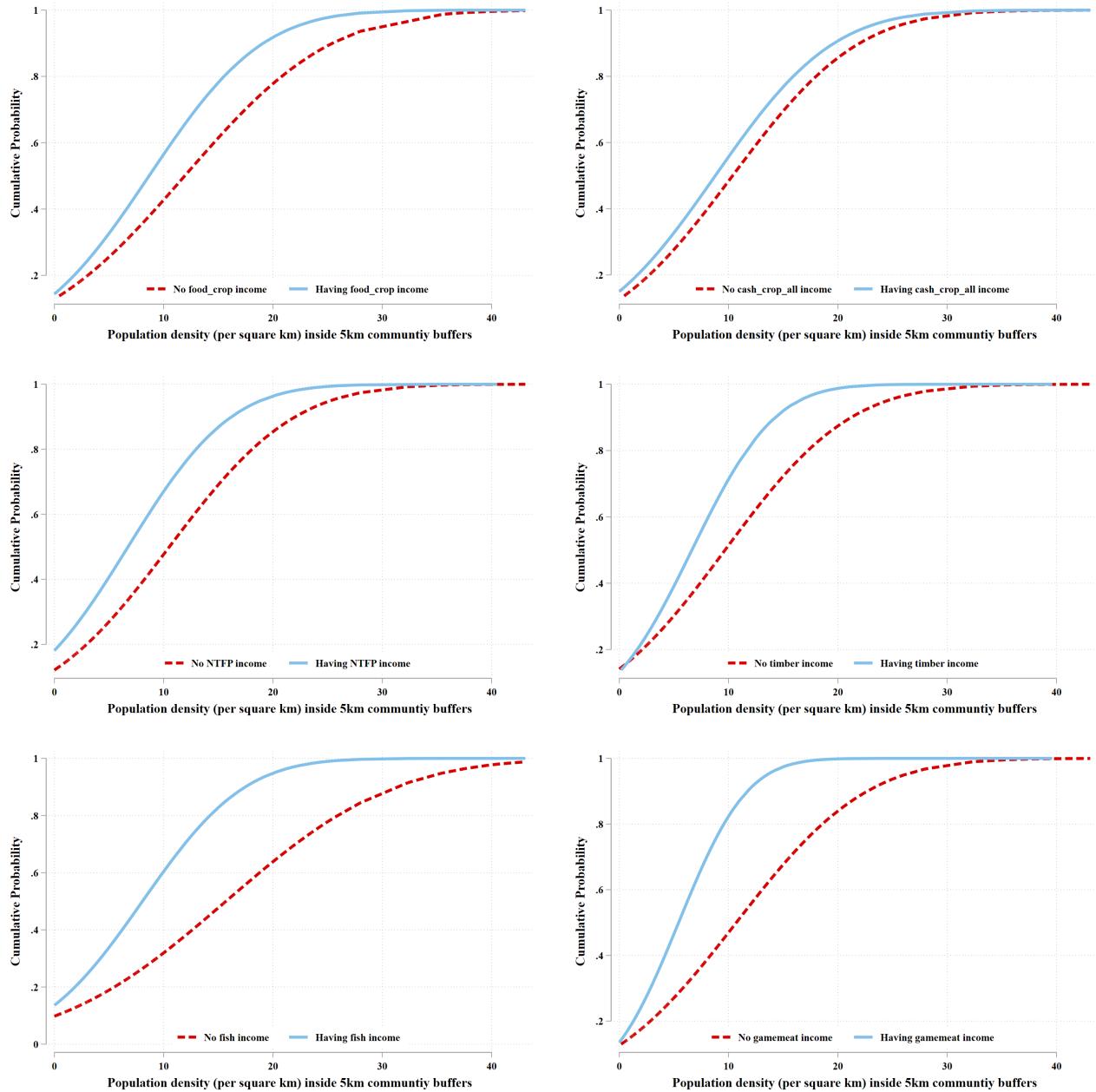


Figure A.9: Population Density (5km buffer) and Distribution of Activities (Household-level)—Agriculture vs. Forest Products vs. Wild Animal Extractions

*Notes:* The population information is from the PARLAP community census. We divide the total population in the  $x\text{km}$  buffer by the area of buffer ( $x^2\pi$ ) to calculate the population density in the  $x\text{km}$  buffer. The total population in the  $x\text{km}$  buffer surrounding a community is measured by summing populations from communities whose centroid are inside the buffer.



Figure A.10: Transport Modes in the Peruvian Amazon

*Notes:* Canue (top-left) is the most traditional transport mode. Peque-peque (top-right) is the most widely-available transport mode with engine. Rapido (bottom-left) is an express motor boat. Lancha (bottom-right) is the largest boat type to carry people and cargo. The latter two types are faster, but they are not commonly available in all communities.

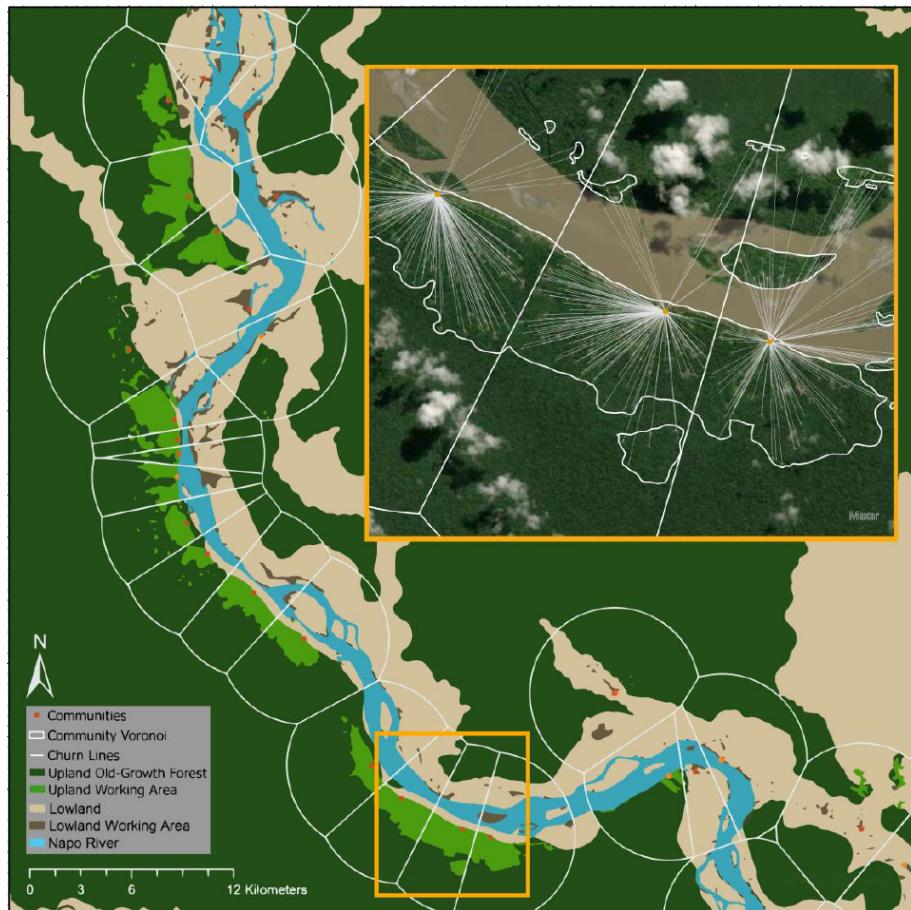


Figure A.11: Voronoi Polygons and Working Areas around the Census Communities  
Source: Coomes et al. (2021)

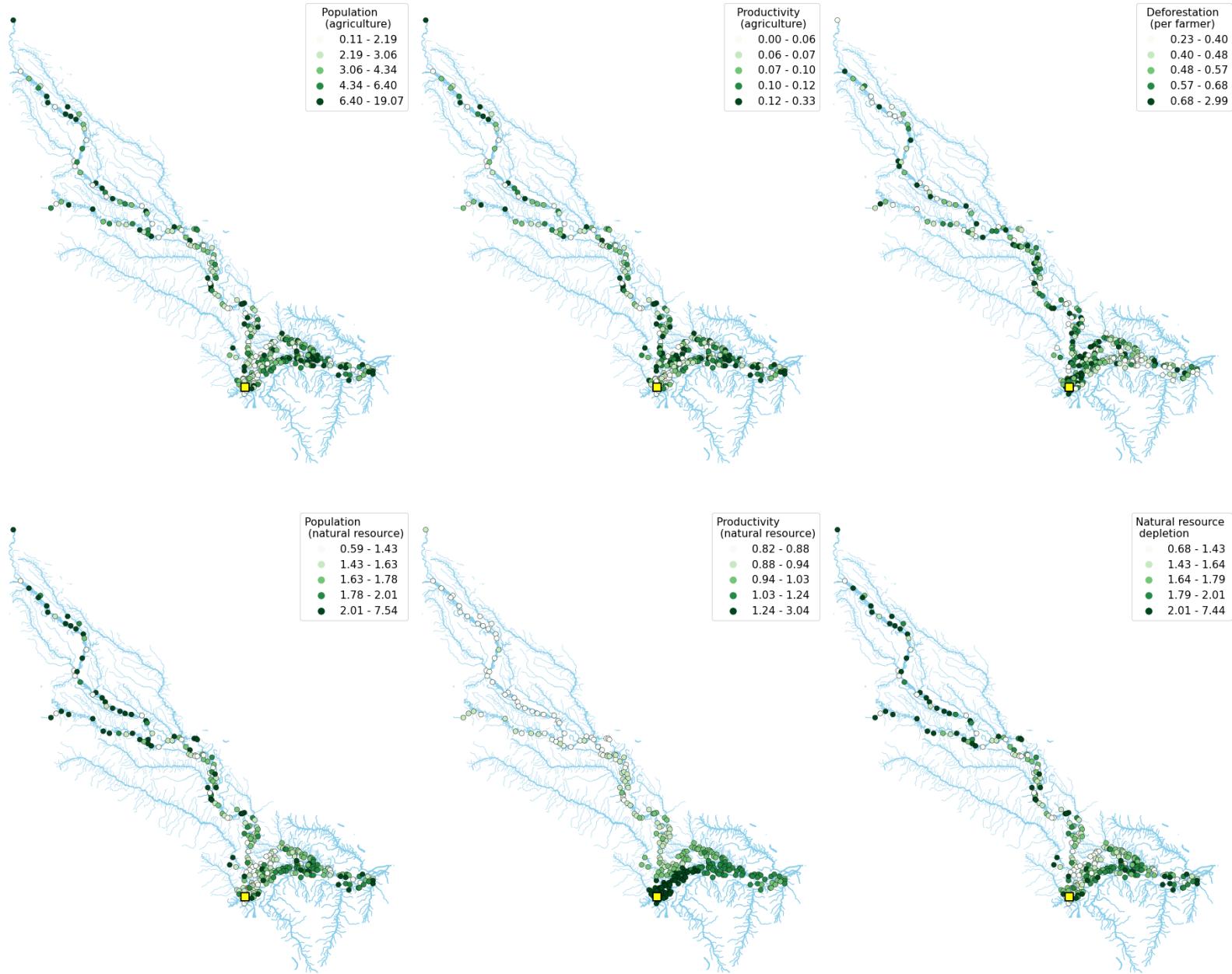


Figure A.12: Counterfactual Outcomes without the Agglomeration Externality (Napo-Amazon)

Notes: These maps present the counterfactual outcomes of shutting down the agglomeration externality in agriculture. Values shown in the legend of the circle dots are relative values in the counterfactual scenarios in terms of those in the benchmark spatial equilibrium in rural locations. The yellow square represents the urban center.

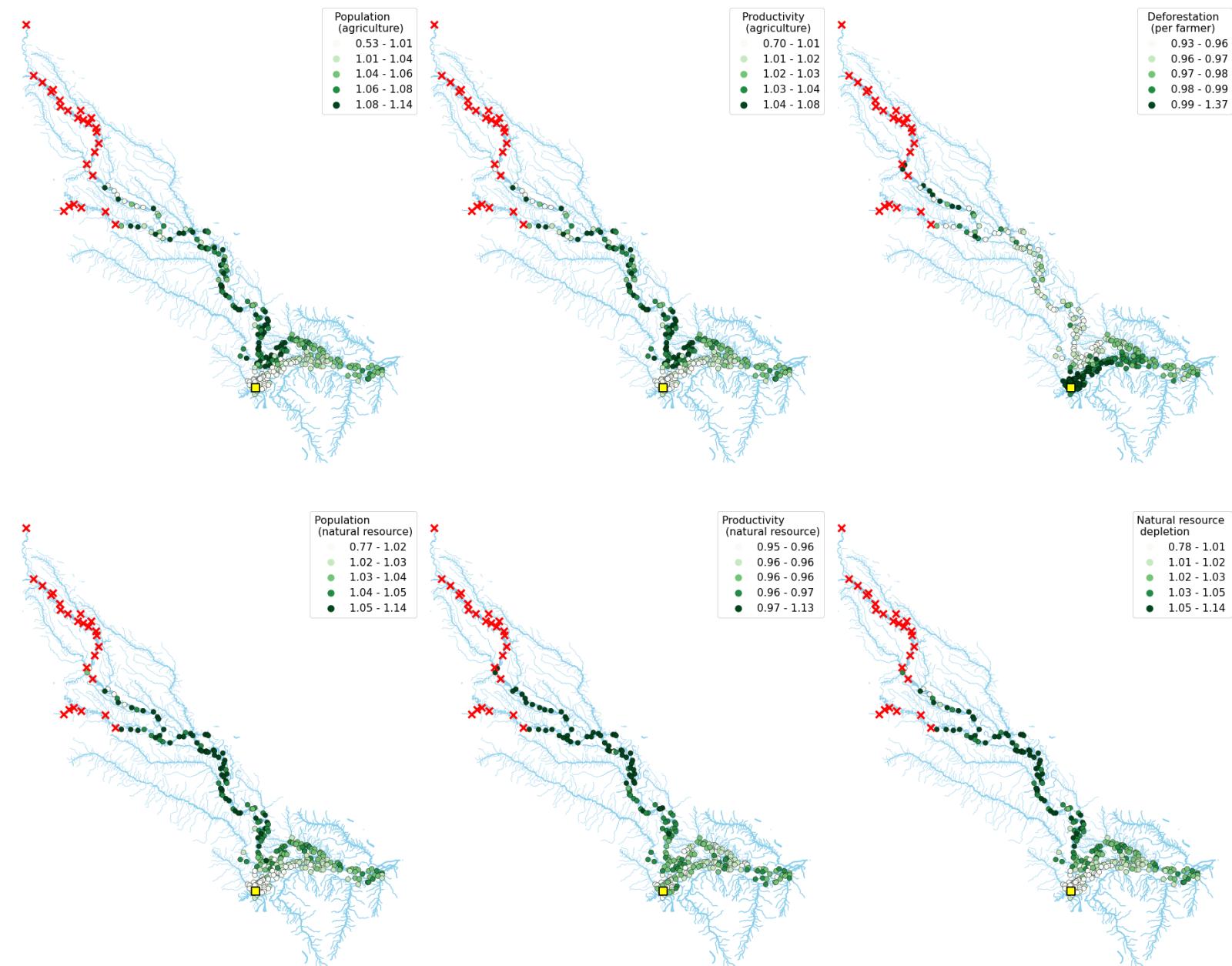


Figure A.13: Counterfactual Outcomes of Protecting the Rural Frontier (Napo-Amazon)

*Notes:* These maps present the counterfactual outcomes of a place-based protection policy of controlling the expansion of rural frontier. This experiment chooses rural locations to be treated in order, starting with those farthest from the urban center, until the treated population reaches 2.5% of the total rural population in each basin. The red x marks indicate the treated locations. Values shown in the legend of the circle dots are relative values in the counterfactual scenarios in terms of those in the benchmark spatial equilibrium in rural locations. The yellow square represents the urban center.

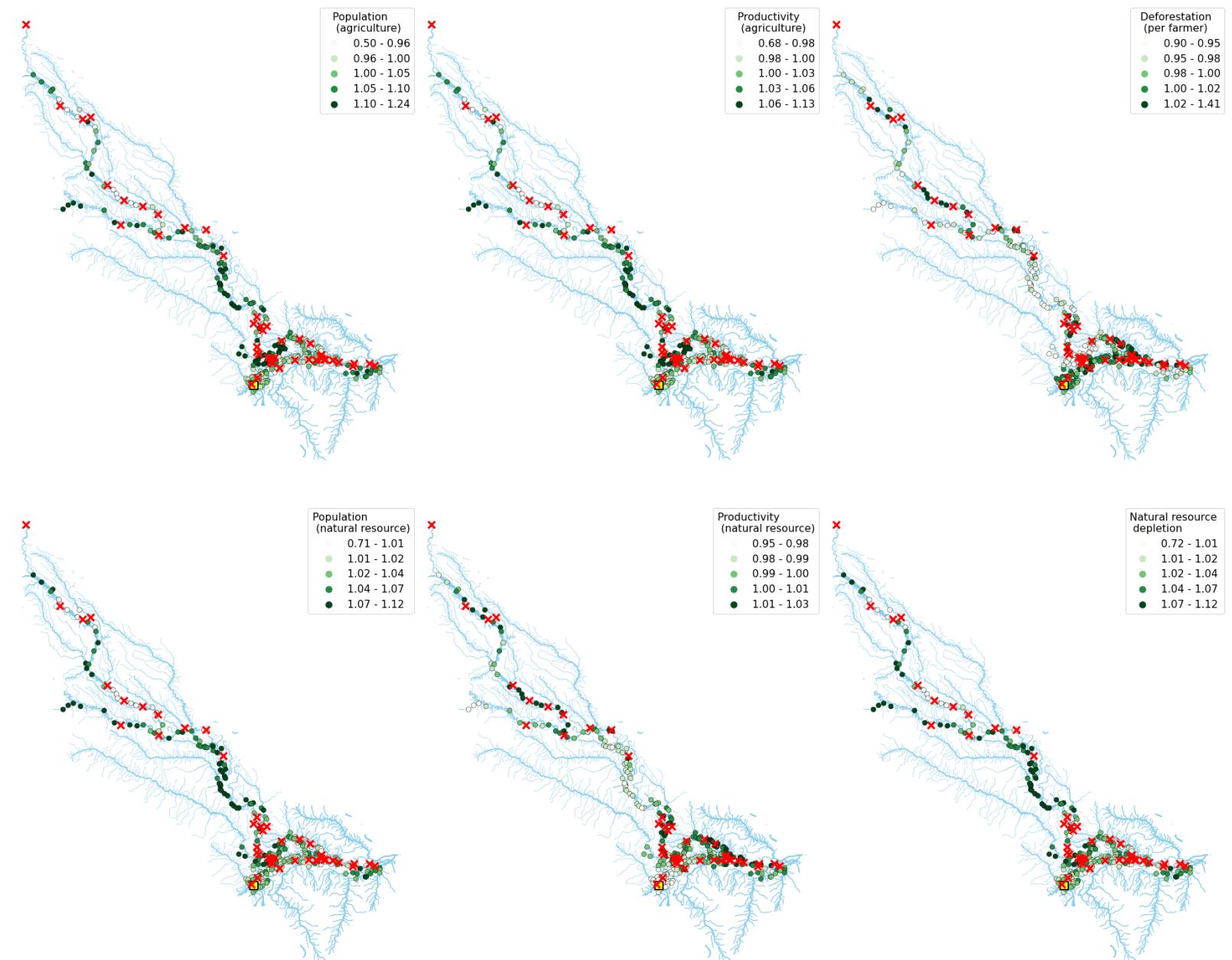


Figure A.14: Counterfactual Outcomes without New Community Formation (Napo-Amazon)

*Notes:* These maps present the counterfactual outcomes of not allowing new community formation. This experiment chooses rural locations to be treated in order, starting with newly established communities, until the treated population reaches 2.5% of the total population in each basin. The red x marks indicate the treated locations. Values shown in the legend of the circle dots are relative values in the counterfactual scenarios in terms of those in the benchmark spatial equilibrium in rural locations. The yellow square represents the urban center.

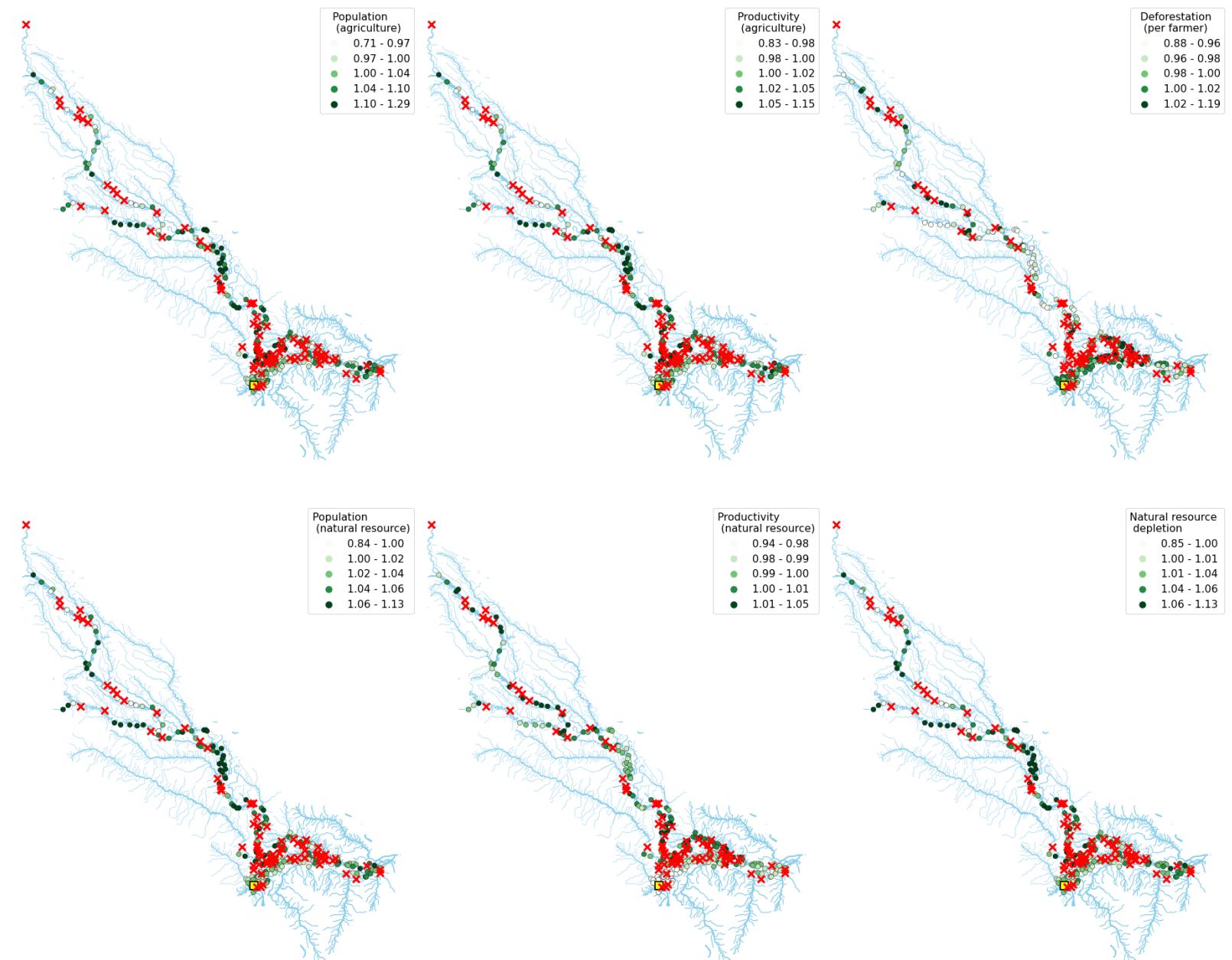


Figure A.15: Counterfactual Outcomes without Small Communities (Napo-Amazon)

*Notes:* These maps present the counterfactual outcomes of a place-based protection policy that targets the smallest communities. This experiment chooses rural locations to be treated in order, starting with the location with the smallest population size, until the treated population reaches 2.5% of the total population in each basin. The red x marks indicate the treated locations. Values shown in the legend of the circle dots are relative values in the counterfactual scenarios in terms of those in the benchmark spatial equilibrium in rural locations. The yellow square represents the urban center.

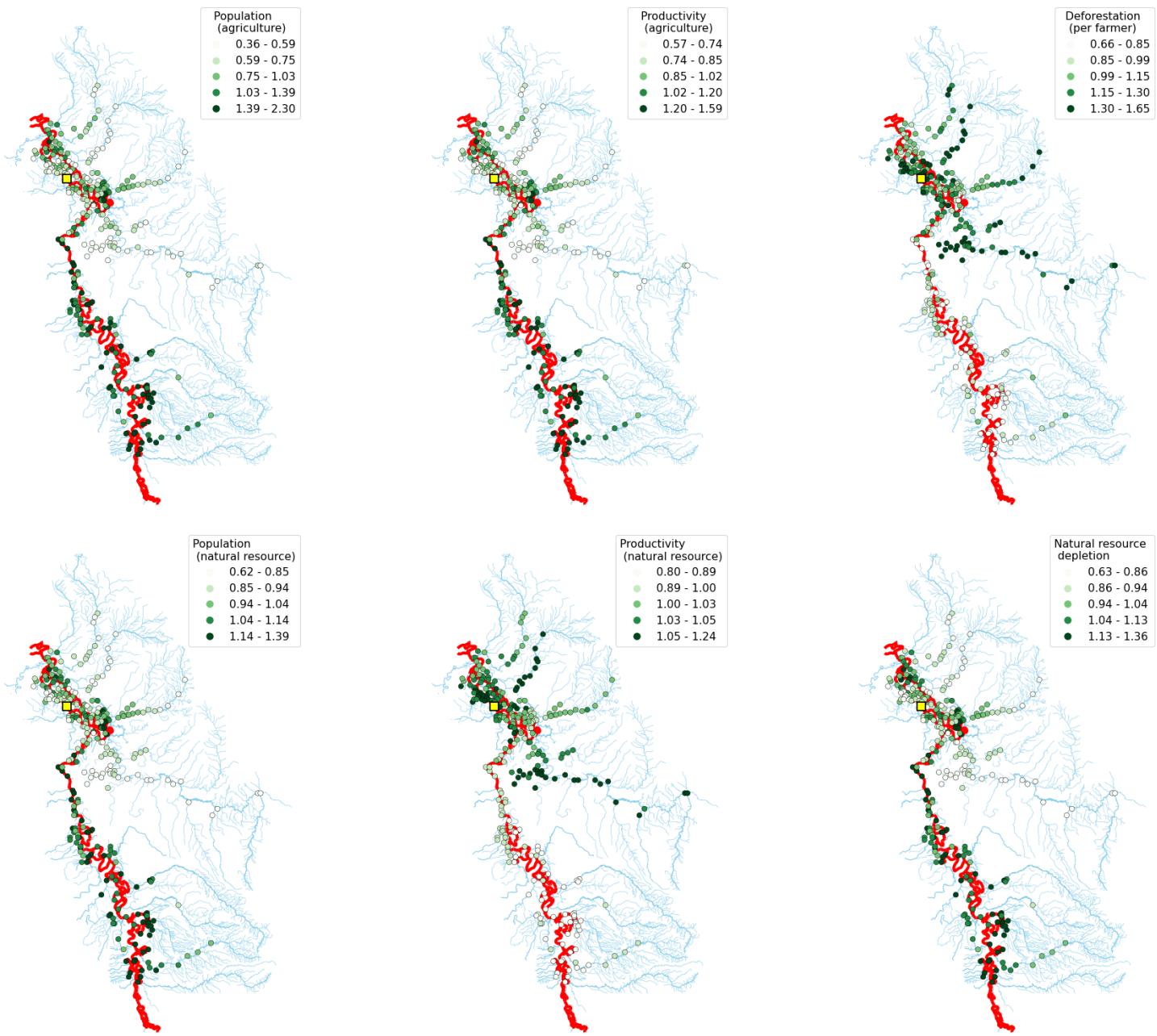


Figure A.16: Counterfactual Outcomes with Improved Transport Infrastructure along River Order 2 (Upper Ucayali)

*Notes:* These maps present the counterfactual outcomes of improving the transport infrastructure in a way that hinterlands are connected to the central area of the basin. Values shown in the legend of the circle dots are relative values in the counterfactual scenarios in terms of those in the benchmark spatial equilibrium in rural locations. The light blue lines indicate the river lines without the improvement of transport infrastructure. The red lines indicate the river lines where the transport infrastructure is upgraded. The yellow square represents the urban center.

Table A.1: Natural Resource Endowments and Calibrated Productivity

	Number of Species found around a Community				
	(1) Total	(2) Fish	(3) Timber	(4) NTFP	(5) Game
$\log(\tilde{A}_{o,Nr})$ (calibrated)	0.206*** (0.0306)	0.0220 (0.0334)	0.386*** (0.0407)	0.0488** (0.0204)	0.380*** (0.0437)
Basin FE	Yes	Yes	Yes	Yes	Yes
Geographic controls	No	No	No	No	No
Mean (Dep. var.)	2.025	3.161	1.788	0.552	1.958
SD (Dep. var.)	1.145	1.163	1.676	0.893	1.636
R <sup>2</sup>	0.059	0.150	0.126	0.349	0.213
Observations	909	909	909	909	909

Notes: Robust standard errors in parentheses. The unit of analysis is a community in the PARLAP Community Census (CC) in 2014.

\*  $p < 0.1$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$ .

Table A.2: River Networks, Initial Communities, and Current Populations

	Community existence (1940)		$\log(N_{o,Ag})$		
	(1)	(2)	(3)	(4)	(5)
$\log(RNA_o)$	-0.0145 (0.0254)	0.0699 (0.0726)	0.758*** (0.223)		0.711*** (0.218)
Community existence (1940)				0.740*** (0.0983)	0.730*** (0.0980)
Basin FE	Yes	Yes	Yes	Yes	Yes
Geographic controls	No	Yes	Yes	Yes	Yes
Mean (Dep. var.)	0.194	0.194	4.322	4.322	4.322
SD (Dep. var.)	0.395	0.395	1.192	1.192	1.192
R <sup>2</sup>	0.094	0.117	0.154	0.195	0.206
Observations	904	899	893	893	893

Notes: Robust standard errors in parentheses. The sample includes 1 square km grid cells that have positive populations. Geographical controls include a dummy of high river orders (4 and 5), distance to the urban center, distance to the river, squared distance to the river, interaction terms of these two variables with a river cell dummy, elevation, river confluences, flood vulnerability, geology measures, and open water access measures.

\*  $p < 0.1$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$ .

Table A.3: Correlations between Instrumental Variables and Geographic Controls

<b>(A) Accessibility of Water</b>				
	(1) Water share: main channel	(2) Water share: non-main channel	(3) River confluence: 1st×2nd or 2nd×3rd	(4) River confluence: 3rd×4th
log( $RNA_o$ )	0.194*** (0.0319)	0.00653 (0.0162)	0.0509 (0.0474)	-0.0717 (0.0611)
Community existence (1940)	0.0235 (0.0186)	-0.00118 (0.00688)	0.00841 (0.0256)	0.0441** (0.0215)
Mean (Dep. var.)	0.109	0.030	0.077	0.083
SD (Dep. var.)	0.203	0.087	0.266	0.277
R <sup>2</sup>	0.229	0.075	0.115	0.152
Observations	899	899	899	899
<b>(B) Land conditions</b>				
	(1) Flood vulnerability	(2) Floodplain soil share	(3) Pleistocene soil share	(4) Tertiary soil share
log( $RNA_o$ )	-0.236 (0.310)	0.248*** (0.0625)	-0.0467 (0.0366)	-0.0417 (0.0452)
Community existence (1940)	0.236* (0.141)	-0.000842 (0.0265)	0.00955 (0.0117)	0.00440 (0.0159)
Mean (Dep. var.)	1.606	0.584	0.021	0.211
SD (Dep. var.)	1.606	0.359	0.115	0.344
R <sup>2</sup>	0.136	0.304	0.065	0.769
Observations	899	899	899	899
Basin FE	Yes	Yes	Yes	Yes
Geographic controls	Yes	Yes	Yes	Yes

Notes: Robust standard errors in parentheses. The sample includes 1 square km grid cells that have positive populations. Geographical controls include a dummy of high river orders (4 and 5), distance to the urban center, distance to the river, squared distance to the river, interaction terms of these two variables with a river cell dummy, elevation, river confluences, flood vulnerability, geology measures, and open water access measures.

\*  $p < 0.1$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$ .

Table A.4: Agglomeration Externality in Agriculture

	The calibrated value of $\log(\tilde{A}_{o,Ag})$							
	All locations				$N_o < 1000$			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
$\log(N_{o,Ag})$	0.676*** (0.0207)	0.440** (0.171)	0.514*** (0.0809)	0.501*** (0.0790)	0.735*** (0.0196)	0.384** (0.169)	0.509*** (0.124)	0.464*** (0.109)
Basin FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Geographic controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
IV: RNA	No	Yes	No	Yes	No	Yes	No	Yes
IV: Historical	No	No	Yes	Yes	No	No	Yes	Yes
Mean (Dep. var.)	-0.096	-0.096	-0.096	-0.096	-0.172	-0.172	-0.172	-0.172
SD (Dep. var.)	4.578	4.578	4.578	4.578	4.614	4.614	4.614	4.614
First stage F-stat		11.502	56.653	31.005		15.298	35.632	22.822
Hansen's J test p-value				0.648				0.472
Observations	893	893	893	893	852	852	852	852

Notes: Robust standard errors in parentheses. The sample includes 1 square km grid cells that have positive populations. We use  $\log(RNA_o)$  (IV: RNA) and the initial community existence in 1940 (IV: Historical) as instruments for  $\log(N_{o,Ag})$ . Geographical controls include a dummy of high river orders (4 and 5), distance to the urban center, distance to the river, squared distance to the river, interaction terms of these two variables with a river cell dummy, elevation, river confluences, flood vulnerability, geology measures, and open water access measures.

\*  $p < 0.1$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$ .

Table A.5: Agglomeration Externality in Agriculture

	The calibrated value of $\log(\tilde{A}_{o,Ag})$						OLS	
	IV							
	(1)	(2)	(3)	(4)	(5)	(6)		
$\log(N_{o,Ag})$	0.434*** (0.0920)	0.519*** (0.0789)	0.519*** (0.0788)	0.521*** (0.0789)	0.509*** (0.0789)	0.501*** (0.0790)	0.676*** (0.0207)	
log (Elevation)		2.341*** (0.171)	2.354*** (0.175)	2.324*** (0.179)	2.360*** (0.176)	2.397*** (0.177)	2.252*** (0.176)	
River confluence (1st×2nd or 2nd×3rd)			0.0155 (0.0958)	0.0186 (0.0964)	0.0206 (0.0982)	0.0309 (0.0995)	0.0180 (0.0969)	
River confluence (3rd×4th)				-0.0356 (0.0724)	-0.0339 (0.0723)	-0.0246 (0.0730)	-0.0266 (0.0733)	
Flood vulnerability (1-4)					-0.0115 (0.0136)	-0.00947 (0.0137)	-0.0123 (0.0137)	
Water share: non-main channel						0.0806 (0.238)	0.123 (0.238)	
Water share: main channel						0.161 (0.122)	0.185 (0.121)	
Floodplain soil share							0.127** (0.0625)	
Pleistocene soil share							0.175 (0.222)	
Basin FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	
Mean (Dep. var.)	-0.094	-0.096	-0.096	-0.096	-0.096	-0.096	-0.096	
SD (Dep. var.)	4.576	4.578	4.578	4.578	4.578	4.578	4.578	
First stage F-stat	28.030	29.419	29.974	29.634	30.770	31.005		
Observations	894	893	893	893	893	893	893	

Notes: Robust standard errors in parentheses. The sample includes 1 square km grid cells that have positive populations. We use  $\log(RNA_o)$  and the initial community existence in 1940 as instruments for  $\log(N_{o,Ag})$ . Other controls include distance to the urban center, distance to the river, squared distance to the river, and interaction terms of these two variables with a river cell dummy.

\*  $p < 0.1$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$ .

Table A.6: Density Externality in Forest Clearing

	log (per capita deforestation)					
	All locations		$N_o < 1000$		$N_o < 500$	
	(1) OLS	(2) IV	(3) OLS	(4) IV	(5) OLS	(6) IV
$\log(N_{o,Ag})$	-0.650*** (0.0307)	-0.522*** (0.0940)	-0.654*** (0.0323)	-0.552*** (0.109)	-0.674*** (0.0346)	-0.545*** (0.123)
Basin FE	Yes	Yes	Yes	Yes	Yes	Yes
Geographic controls	Yes	Yes	Yes	Yes	Yes	Yes
Mean (Dep. var.)	0.929	0.929	0.956	0.956	0.981	0.981
SD (Dep. var.)	1.231	1.231	1.218	1.218	1.223	1.223
First stage $F$ -stat		34.198		28.141		23.709
Hansen's $J$ test $p$ -value		0.987		0.896		0.969
Observations	895	895	878	878	847	847

Notes: Robust standard errors in parentheses. The unit of analysis is a community in the PARLAP Community Census (CC) in 2014. We use  $\log(RNA_o)$  and the initial community existence in 1940 as instruments for  $\log(N_{o,Ag})$ . Geographical controls include a dummy of high river orders (4 and 5), distance to the urban center, distance to the river, squared distance to the river, interaction terms of these two variables with a river cell dummy, elevation, river confluence, flood vulnerability, geology measures, and open water access measures for a grid cell where each census community belongs.

\*  $p < 0.1$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$ .

Table A.7: Congestion Externality in Natural Resource Extraction with Spatial Spillovers

	The calibrated value of $\log(\bar{A}_{o,Nr})$									OLS	
	IV										
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)		
$\log(N_{o,Nr})$	-2.127** (1.075)	-1.385 (0.939)	-0.879 (0.688)	-0.581 (0.558)	0.0960 (0.322)	0.278 (0.280)	0.573*** (0.208)	0.634*** (0.179)	0.606*** (0.184)	0.950*** (0.0516)	
$\log(\sum_{d D_{o,d} \leq 2km} N_{d,Nr})$		-0.573* (0.331)	-0.0343 (0.282)	0.0235 (0.236)	-0.0745 (0.143)	-0.0705 (0.122)	-0.0648 (0.0883)	-0.0745 (0.0822)	-0.0856 (0.0838)	-0.0663 (0.0611)	
$\log(\sum_{d D_{o,d} \leq 5km} N_{d,Nr})$			-0.596*** (0.189)	-0.286 (0.183)	-0.138 (0.106)	-0.130 (0.0888)	-0.120* (0.0637)	-0.111* (0.0597)	-0.112* (0.0613)	-0.132*** (0.0425)	
$\log(\sum_{d D_{o,d} \leq 10km} N_{d,Nr})$				-0.337** (0.141)	0.0345 (0.107)	0.0364 (0.0885)	0.0579 (0.0625)	0.0425 (0.0596)	0.0322 (0.0639)	0.0140 (0.0378)	
$\log(\sum_{d D_{o,d} \leq 25km} N_{d,Nr})$					-0.470*** (0.0918)	-0.357*** (0.0837)	-0.327*** (0.0584)	-0.294*** (0.0560)	-0.285*** (0.0571)	-0.165*** (0.0283)	
$\log(\sum_{d D_{o,d} \leq 50km} N_{d,Nr})$						-0.195*** (0.0610)	-0.0318 (0.0581)	-0.0548 (0.0526)	-0.0480 (0.0548)	-0.0619** (0.0242)	
$\log(\sum_{d D_{o,d} \leq 75km} N_{d,Nr})$							-0.280*** (0.0779)	-0.0758 (0.125)	-0.0407 (0.142)	-0.0989*** (0.0352)	
$\log(\sum_{d D_{o,d} \leq 100km} N_{d,Nr})$								-0.258* (0.141)	-0.439* (0.231)	-0.263*** (0.0498)	
$\log(\sum_{d D_{o,d} \leq 150km} N_{d,Nr})$									0.187 (0.171)	0.0970* (0.0567)	
Basin FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	
Geographic controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	
Mean (Dep. Var.)	0.337	0.337	0.337	0.337	0.337	0.337	0.337	0.337	0.337	0.337	
SD (Dep. Var.)	2.862	2.862	2.862	2.862	2.862	2.862	2.862	2.862	2.862	2.862	
Observations	894	894	894	894	894	894	894	894	894	894	

Notes: Robust standard errors in parentheses. The sample includes 1 square km grid cells that have positive populations. We use  $\ln RNA_o$  and  $\{\ln \sum_{d|D_{o,d} \leq x} RNA_d\}$  for  $x \in \mathcal{X}$  as instruments when endogenous variables include  $\log(N_{o,Nr})$  and  $\{\ln \sum_{d|D_{o,d} \leq x} N_{d,Nr}\}$  for  $x \in \mathcal{X}$ . Geographical controls include a dummy of high river orders (4 and 5), distance to the river, squared distance to the river, interaction terms of these two variables with a river cell dummy, elevation, river confluence, flood vulnerability, geology measures, and open water access measures.

\*  $p < 0.1$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$ .

Table A.8: Community Population and Frequency of Transport Modes Available

	Frequency of Transport Modes Passing a Community per Week							
	Lancha		Colectivo		Rapido		Peque-peque	
	(1) OLS	(2) IV	(3) OLS	(4) IV	(5) OLS	(6) IV	(7) OLS	(8) IV
$\log(N_{o,Ag})$	0.162 (0.118)	1.055** (0.468)	0.213** (0.0958)	0.336 (0.305)	0.0439 (0.283)	-0.287 (0.574)	0.225 (0.177)	0.518 (0.677)
Basin FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Geographic controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Mean (Dep. var.)	3.429	3.429	5.154	5.154	6.164	6.164	5.835	5.835
SD (Dep. var.)	2.468	2.468	2.368	2.368	1.772	1.772	2.019	2.019
First stage F-stat		7.351377		10.26028		3.757641		3.2333
Observations	330	330	276	276	61	61	144	144

Notes: Robust standard errors in parentheses. The unit of analysis is a community in the PARLAP Community Census (CC) in 2014. We use  $\log(RNA_o)$  and the initial community existence in 1940 as instruments for  $\log(N_{o,Ag})$ . Geographical controls include a dummy of high river orders (4 and 5), distance to the urban center, distance to the river, squared distance to the river, interaction terms of these two variables with a river cell dummy, elevation, river confluence, flood vulnerability, geology measures, and open water access measures for a grid cell where each census community belongs.

\*  $p < 0.1$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$ .

Table A.9: Community Population and Trade Environment

	Availability of a river trader		Community population being contracted		Contractors living in the community	
	(1) OLS	(2) IV	(3) OLS	(4) IV	(5) OLS	(6) IV
$\log(N_{o,Ag})$	0.0102 (0.00693)	0.0430* (0.0244)	0.0412*** (0.0125)	0.0988** (0.0395)	0.0489*** (0.0101)	0.118*** (0.0350)
Basin FE	Yes	Yes	Yes	Yes	Yes	Yes
Geographic controls	Yes	Yes	Yes	Yes	Yes	Yes
Mean (Dep. var.)	0.031	0.031	0.182	0.182	0.056	0.056
SD (Dep. var.)	0.173	0.173	0.386	0.386	0.231	0.231
First stage F-stat		24.84462		26.12503		23.28224
Observations	906	906	891	891	853	853

Notes: Robust standard errors in parentheses. The unit of analysis is a community in the PARLAP Community Census (CC) in 2014. We use  $\log(RNA_o)$  and the initial community existence in 1940 as instruments for  $\log(N_{o,Ag})$ . Geographical controls include a dummy of high river orders (4 and 5), distance to the urban center, distance to the river, squared distance to the river, interaction terms of these two variables with a river cell dummy, elevation, river confluence, flood vulnerability, geology measures, and open water access measures for a grid cell where each census community belongs.

\*  $p < 0.1$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$ .

Table A.10: Community Population and Contracts for Trading Products

	Community population being contracted for							
	Maize		Rice		Fish		Timber	
	(1) OLS	(2) IV	(3) OLS	(4) IV	(5) OLS	(6) IV	(7) OLS	(8) IV
$\log(N_{o,Ag})$	0.0120*	0.0599**	0.0275***	0.0254				
	(0.00637)	(0.0300)	(0.00780)	(0.0164)				
$\log(N_{o,Nr})$					0.0282*** (0.00788)	0.0283 (0.0440)	0.0325*** (0.00967)	-0.248* (0.138)
Basin FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Geographic controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Mean (Dep. var.)	0.034	0.034	0.020	0.020	0.029	0.029	0.112	0.112
SD (Dep. var.)	0.180	0.180	0.141	0.141	0.168	0.168	0.316	0.316
First stage F-stat		14.59049		14.59049		8.799949		8.799949
Observations	891	891	891	891	892	892	892	892

Notes: Robust standard errors in parentheses. The unit of analysis is a community in the PARLAP Community Census (CC) in 2014. We use  $\log(RNA_o)$  and the initial community existence in 1940 as instruments for  $\log(N_{o,Ag})$ . Geographical controls include a dummy of high river orders (4 and 5), distance to the urban center, distance to the river, squared distance to the river, interaction terms of these two variables with a river cell dummy, elevation, river confluence, flood vulnerability, geology measures, and open water access measures for a grid cell where each census community belongs.

\*  $p < 0.1$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$ .

Table A.11: Community Population and Form of Crop Seed Acquisition

(A)	Obtain crop seeds from			
	Others in the community		City or other communities	
	(1) OLS	(2) IV	(3) OLS	(4) IV
$\log(N_{o,Ag})$	0.0104 (0.0106)	0.0497 (0.0371)	-0.00290 (0.0150)	-0.0908* (0.0514)
Mean (Dep. var.)	0.859	0.859	0.445	0.445
SD (Dep. var.)	0.348	0.348	0.497	0.497
First stage F-stat		24.875		24.875
Observations	907	907	907	907
(B)	Obtain crop seeds from outside the community via			
	Market transactions		Non-market transactions	
	(1) OLS	(2) IV	(3) OLS	(4) IV
$\log(N_{o,Ag})$	0.00242 (0.0148)	0.0228 (0.0420)	0.0385* (0.0216)	-0.0683 (0.0662)
Mean (Dep. var.)	0.900	0.900	0.286	0.286
SD (Dep. var.)	0.300	0.300	0.452	0.452
First stage F-stat		12.049		12.049
Observations	402	402	402	402
Basin FE	Yes	Yes	Yes	Yes
Geographic controls	Yes	Yes	Yes	Yes

Notes: Robust standard errors in parentheses. The unit of analysis is a community in the PAR-LAP Community Census (CC) in 2014. We use  $\log(RNA_o)$  and the initial community existence in 1940 as instruments for  $\log(N_{o,Ag})$ . Geographical controls include a dummy of high river orders (4 and 5), distance to the urban center, distance to the river, squared distance to the river, interaction terms of these two variables with a river cell dummy, elevation, river confluence, flood vulnerability, geology measures, and open water access measures for a grid cell where each census community belongs.

\*  $p < 0.1$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$ .

Table A.12: Community Population and Crop-Specific Form of Seed Acquisition

	Obtain seeds from a city or other communities for							
	Maize		Plantain		Rice		Yuca	
	(1) OLS	(2) IV	(3) OLS	(4) IV	(5) OLS	(6) IV	(7) OLS	(8) IV
$\log(N_{o,Ag})$	0.00682 (0.0150)	-0.238* (0.143)	0.00373 (0.0138)	-0.200 (0.122)	0.0104 (0.00963)	0.0636 (0.0756)	0.00121 (0.0103)	0.0904 (0.0819)
Basin FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Geographic controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Mean (Dep. var.)	0.393	0.393	0.305	0.305	0.126	0.126	0.165	0.165
SD (Dep. var.)	0.489	0.489	0.461	0.461	0.332	0.332	0.372	0.372
First stage F-stat		13.77193		13.77193		13.77193		13.77193
Observations	907	907	907	907	907	907	907	907

Notes: Robust standard errors in parentheses. The unit of analysis is a community in the PARLAP Community Census (CC) in 2014. We use  $\log(RNA_o)$  and the initial community existence in 1940 as instruments for  $\log(N_{o,Ag})$ . Geographical controls include a dummy of high river orders (4 and 5), distance to the urban center, distance to the river, squared distance to the river, interaction terms of these two variables with a river cell dummy, elevation, river confluence, flood vulnerability, geology measures, and open water access measures for a grid cell where each census community belongs.

\*  $p < 0.1$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$ .

## B Data Appendix

### B.1 Forest Cover Measures

The detail is under construction.

### B.2 PARLAP

#### Prices

The PARLAP CC data collects the following price information in the census communities.

**Producer prices.** The producer price is the gate price for products when people sell their products in the community. The producer price is collected for three agricultural products (plantain, yuca, and rice) and four natural resource products (aguaje fruit, fresh fish, salted fish, and salt bush meat). If a product cannot be sold in the community, its price is missing. It may not always be the case that these products are produced in the community where they are sold people from other communities can also sell their products.

**Consumer prices.** Consumer price is the price for commodities when people buy them in the community. The consumer price is collected for the following products: milled rice, sugar, cooking oil, soap, batteries, and kerosene. All these commodities including milled rice come from places outside the community (towns). If they cannot buy a product in the community, its price is missing.

#### Sectoral employment shares

The PARLAP CC data collects information about a census community's current economic activities and those when the community was established in the current location. The CC data collects the following three types of information about economic activities. First, it asks whether people in the community currently engage (or engaged in the past) in each of the following broadly-defined activities: agriculture, livestock, fishing, timber extraction, non-timber forest products (NTFPs), hunting, aquarium fish, petroleum industry, tourism, the state activity, and religious mission. Second, if people in the community engage (or engaged) in an economic activity categorized above, then the principal products produced in the community are listed. Third, among the broadly-defined economic activities that people in the community engage (or engaged) in, ranks in the order of importance are collected. We exploit the first and third information to construct the sectoral employment shares in a community.

### B.3 Survey of travel time and transportation costs

The PARLAP team conducted the survey of travel time and transportation costs. The survey was done during December 2017-January 2018 in Loreto and during February 2018-June 2019 in Ucayali. All monetary values are in Soles.

The survey provides travel time, passenger fees, gasoline, freights (one bundle of platano and one sack of 50kg) by season (low water/high water) and direction (upstream/downstream) for about 20 selected river routes with multiple modes of transport. Modes of transport (boat types) include lancha, peque-peque, canoe, and rapido. Figure A.10 shows these transport modes. The

survey also provides the cost for transporting 50kg package for 500 meter by land transport at the selected communities and towns that are covered in the above travel time module.

## B.4 Other Data and Variables

### Other Data

We additionally use the following data.

**Peru National Household Survey (ENAHO).** ENAHO is an annual living standard survey, also collected by the INEI in Peru. The data is publicly available from 2004 to present. To keep consistent periods and geography with other data, we use the data from Loreto and Ucayali departments in the Peruvian Amazon collected in 2013, 2014, 2015, 2016, and 2017. ENAHO contains detailed household-level information of consumption expenditure and we use this data to estimate demand parameters.

### Other variables

## C Estimation and Quantification Appendix

### C.1 Empirical Tests of the Simplified Model with a Density Externality

We consider a simplified version of the main model in section 4 in the following three dimensions. First, we consider one sector with a continuum of goods (that implicitly pool both agricultural and natural resource goods), in contrast to the multi-sector model. This sector has land and labor as inputs while the land production process is same as the main model. Second, we consider symmetric (or quasi-symmetric) trade costs between locations, in contrast to asymmetric ones in the main model. The quasi-symmetric cost of transporting a good from  $o$  to  $d$  is defined as  $\tau_{od} = \tilde{\tau}_{od} \tau_o^A \tau_d^B$  where  $\tilde{\tau}_{od} = \tilde{\tau}_{do}$ . That is, the term that depends on both  $o$  and  $d$  is symmetric. The simplest example is  $\tau_o^A = 1/\text{elevation}_o$  and  $\tau_d^B = \text{elevation}_d$ . Third, we incorporate the density externality from population in the own location but without spatial spillovers across locations.

Given this setup, following a similar derivation as [Donaldson and Hornbeck \(2016\)](#), we can derive the measure of consumer's accessibility to low-price products ('Consumer Market Access'):

$$CMA_d \equiv P_d^{-\theta} = \kappa_2 \sum_o A_o N_o^{\mu\theta} \kappa_1^\theta (w_o \tau_{od})^{-\theta}$$

and the measure of firm's accessibility to consumers with low CMA ('Firm Market Access'):

$$FMA_o \equiv \sum_d \tau_{od}^\theta CMA_d^{-1} Y_d$$

Under the quasi-symmetric trade cost with  $\tau_o^A = (\tau_o^B)^{-1}$ , we can define the Market Access measure with the following relationship :

$$MA_o \equiv FMA_o = \rho (\tau_o^B)^{2\theta} CMA_o \quad \exists \rho > 0$$

Solving the balanced trade condition, we can use the Market Access measure to express community population:

$$N_o = \kappa_3 A_o^{\frac{1}{1-\theta\bar{\mu}}} (\tau_o^B)^{-\frac{2(1+\theta)}{1-\theta\bar{\mu}}} MA_o^{\frac{1+2\theta}{\theta(1-\theta\bar{\mu})}}$$

deforestation and per capita deforestation:

$$\begin{aligned} DF_o &= \kappa_4 A_o^{\frac{1-\mu_L}{1-\theta\bar{\mu}}} (\tau_o^B)^{-\frac{2(1+\theta)(1-\mu_L)}{1-\theta\bar{\mu}}} MA_o^{\frac{(1+2\theta)(1-\mu_L)}{\theta(1-\theta\bar{\mu})}} \\ \frac{DF_o}{N_o} &= \kappa_4 A_o^{\frac{-\mu_L}{1-\theta\bar{\mu}}} (\tau_o^B)^{\frac{2(1+\theta)\mu_L}{1-\theta\bar{\mu}}} MA_o^{-\frac{(1+2\theta)\mu_L}{\theta(1-\theta\bar{\mu})}} \end{aligned}$$

nominal and real incomes:

$$Y_o = \kappa_5 A_o^{\frac{1}{1-\theta\tilde{\mu}}} (\tau_o^B)^{-\frac{2\theta(1+\tilde{\mu})}{1-\theta\tilde{\mu}}} MA_o^{\frac{2+\tilde{\mu}}{\theta(1-\theta\tilde{\mu})}}$$

$$Y_o^R \equiv \frac{Y_o}{P_o} = \kappa_6 A_o^{\frac{1}{1-\theta\tilde{\mu}}} (\tau_o^B)^{-\frac{2\theta(1+\tilde{\mu})}{1-\theta\tilde{\mu}}} MA_o^{\frac{1+2\theta}{\theta(1-\theta\tilde{\mu})}}$$

where  $\mu_L$  is the parameter governing congestion externality in forest clearing,  $\mu$  is the parameter governing agglomeration externality given the obtained land, and  $\tilde{\mu} \equiv \mu + \mu_L(1 - \gamma)$  captures the net agglomeration.

The one-sector model implies the following empirical specification:

$$\ln y_{o,t} = \beta_0 + \beta_1 \ln MA_{o,t} + \theta X_o + \phi_{B,t} + \epsilon_{o,t} \quad (C.1)$$

where  $y_{o,t}$  is an outcome measure of human settlements and forest cover at grid cell  $o$ ,  $X_o$  is a vector of cell-level geographical controls and  $\phi_{B,t}$  represents basin  $\times$  year fixed effects. The Market Access measure is approximated as:

$$MA_{o,t} \approx \sum_d N_{d,t} (\tau_{od})^{-\theta} = \sum_d N_{d,t} (D_{od}^\delta)^{-\theta} \quad (C.2)$$

where  $o, d \in 1\text{km} \times 1\text{km}$  grid cells within 5km from a river (with order 1-6),  $N_{d,t}$  is the population in  $d$  at period  $t$ ,  $\tau_{od}$  is the trade cost, and  $D_{od}$  represents river-equivalent distance (kilometer) along the least-cost route. To calculate this measure, we set a composite value of parameters  $\delta \cdot \theta = 1.3182$  drawing from [Donaldson \(2018\)](#). We report results of both OLS and IV regressions. The IV regressions use the following River Network Access (RNA) measure, solely defined by river shapes, as an instrument variable for the Market Access:

$$RNA_o = \sum_{d \in RC} \tau_{od}^\theta$$

where  $RC$  is a set of all river cells in the basin (cells that contain a river) whether or not they have positive populations. We will exploit the variation in this River Network Access measure to estimate density externality parameters in a later section. In interpreting the results of the Market Access regression, however, we confine our discussion to be correlational from a conservative perspective as it suffices to motivate the model.<sup>35</sup>

Table C.1 reports the relationship between the Market Access and human settlements. The Market Access is significantly associated with both community formation and population size. The size of the estimated coefficient based on the IV specification under a reasonable range of  $\theta$  implies that congestion force is likely to be dominating on net. The multi-sector model in a later section will nevertheless emphasize sector-specific agglomeration and congestion externalities.

Table C.3 reports the relationship between the Market Access and forest cover change over decades.<sup>36</sup> The Market Access is significantly associated with forest disturbance, forest loss, and

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<sup>35</sup>We also check that the reduced form results are robust with different sets of controls, the RA and MA measures adjusted by river order at origin, considering river networks only up to river order 4 or 5, and the MA measure with earlier period (1940) population.

<sup>36</sup>Using static measures of forest covers, Table C.2 reports that the Market Access is negatively associated with forest areas and positively associated with non-forest areas.

forest recovery. The following three points are noteworthy. First, interpretation of the positive associations with forest disturbance and forest loss is straightforward. Locations with higher market access might attract more people to reside and clear forest for agricultural land use. Second, the Market Access is also associated with forest recovery, an inverse measure of forest loss. This result reflects the practice of sustainable land use in the shifting cultivation cycle. This result is also consistent with the recent finding by Coomes et al. (2021) that forest cover relative to population engaging in small-scale agriculture is stable over time. Finally, the rightmost column reports that the Market Access is negatively associated with per capita deforestation.<sup>37</sup> This observation is consistent with the statement of Fact 2B and the presence of congestion force in forest clearing. To summarize, the empirical results in this section imply the following fact.

**Fact 2B: Human settlements and forest cover changes (both forest loss and recovery) increase with Market Access.**

## C.2 Parameters without Solving the Model

### Downstream-River-Equivalent Distance

We use our original records of travel times and freight costs (Appendix B.3).

**Upstream-river distance.** We calibrate  $\lambda_{up}$  by taking the average ratio of upstream-river travel time to downstream-river travel time by *peque-peque* across all the travel routes available in the survey. We obtained  $\hat{\lambda}_{up} = 1.282$ .

**Land distance.** For comparing the freight costs on land and river transports, we focus on communities in the land transport data where the river transport data (either as origin or destination community) is also available. Since we also use the information on the distance on river network, we further focus on river routes that are found in our river network data in the four basins. There are two routes that satisfy these criteria: (1) Mazan-Santa Clotilde (Loreto) and (2) Puerto Alegre-Vinuncuro (Ucayali). For each of these two routes, we first use the observed river cost,  $\hat{\delta}_M$  (obtained in the previous step in the main text), and the following relationship:

$$\text{River transport cost (observed)} \approx p_{od} - p_{oo} = (\tau_{od} - 1)p_{oo} = (D_{od, \text{river}}^{\hat{\delta}_M} - 1)p_{oo}$$

to back out hypothetical  $\hat{p}_{oo}$ . In these two routes, the reported river costs are same in both directions and thus we assume  $D_{od, \text{river}} = D_{do, \text{river}}$ . We next use the following relationship:

$$\text{Land transport cost (observed)} \approx [(D_{od', \text{land}} \times \lambda_{\text{land}})^{\hat{\delta}_M} - 1]\hat{p}_{oo}$$

to obtain  $\hat{\lambda}_{\text{land}}$  where  $D_{od', \text{land}} = 0.5(\text{km})$  and in each route we use the average value of the 500m land transport cost between those collected in origin and destination locations. We then take the average value of  $\hat{\lambda}_{\text{land}}$  between those obtained from the two routes. We obtained  $\hat{\lambda}_{\text{land}} = 36.767$ .

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<sup>37</sup>The forest loss is between 1985 and 2015 and the denominator population is from the INEI population census in 2007.

Table C.1: Market Access and Human Settlements

	Community existence		log (population)	
	(1) OLS	(2) IV	(3) OLS	(4) IV
log(MA)	0.0151*** (0.000563)	0.0134*** (0.000533)	0.0705*** (0.00277)	0.0646*** (0.00259)
log (Elevation)	0.000839** (0.000397)	-0.000397 (0.000460)	0.00441** (0.00201)	0.000290 (0.00227)
Confluence (1 or 2)	0.0687*** (0.00739)	0.0690*** (0.00739)	0.348*** (0.0371)	0.348*** (0.0372)
Confluence (3)	0.0253*** (0.00249)	0.0251*** (0.00248)	0.114*** (0.0115)	0.114*** (0.0115)
Flood	0.00244*** (0.000171)	0.00243*** (0.000171)	0.0108*** (0.000816)	0.0108*** (0.000817)
Holocene	0.0000232*** (0.00000448)	0.0000245*** (0.00000446)	0.000107*** (0.0000220)	0.000111*** (0.0000219)
Pleistocene	-0.0000285*** (0.00000446)	-0.0000294*** (0.00000447)	-0.000160*** (0.0000205)	-0.000163*** (0.0000205)
Non-Main Channel	0.000465*** (0.0000712)	0.000472*** (0.0000713)	0.00234*** (0.000351)	0.00237*** (0.000352)
Main Channel	0.0000192 (0.0000407)	0.0000230 (0.0000406)	0.0000950 (0.000200)	0.000108 (0.000200)
Basin × Year FE	Yes	Yes	Yes	Yes
River Order FE	Yes	Yes	Yes	Yes
R <sup>2</sup>	0.038	0.015	0.036	0.014
Mean (Dep. Var.)	0.008	0.008	0.037	0.037
SD (Dep. Var.)	0.089	0.089	0.431	0.431
Observations	403938	403938	403938	403938

Notes: Robust standard errors in parentheses. The sample includes 1 square km grid cells within 5km from rivers (up to 6th order). Other controls include distance to the river, squared distance to the river, and interaction terms of these two variables with a river cell dummy.

\*  $p < 0.1$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$ .

Table C.2: Market Access and Forest Cover

	Forest area		Non-forest area		Per-capita non-forest area	
	(1) OLS	(2) IV	(3) OLS	(4) IV	(5) OLS	(6) IV
log(MA)	-0.206*** (0.00607)	-0.208*** (0.00491)	1.970*** (0.0243)	1.586*** (0.0441)	0.126** (0.0621)	-0.0726 (0.216)
log (Elevation)	-0.174*** (0.00702)	-0.176*** (0.00723)	1.057*** (0.0459)	0.753*** (0.0554)	-0.996*** (0.312)	-1.626** (0.723)
Confluence (1 or 2)	-0.0544 (0.0385)	-0.0541 (0.0385)	0.383*** (0.125)	0.434*** (0.121)	-0.201* (0.121)	-0.211* (0.122)
Confluence (3)	-0.0660*** (0.00889)	-0.0662*** (0.00886)	0.218** (0.0920)	0.176* (0.0919)	-0.156 (0.138)	-0.153 (0.140)
Flood	-0.0124*** (0.00130)	-0.0124*** (0.00130)	0.261*** (0.0102)	0.257*** (0.0102)	0.0155 (0.0224)	0.00816 (0.0233)
Holocene	-0.00137*** (0.0000470)	-0.00136*** (0.0000471)	0.0158*** (0.000373)	0.0159*** (0.000375)	-0.00155 (0.00117)	-0.00164 (0.00119)
Pleistocene	0.000209*** (0.0000387)	0.000207*** (0.0000384)	-0.0136*** (0.000604)	-0.0141*** (0.000607)	-0.000415 (0.00267)	-0.00113 (0.00282)
Non-Main Channel	-0.0260*** (0.000720)	-0.0260*** (0.000723)	0.0718*** (0.00270)	0.0729*** (0.00263)	-0.0140*** (0.00477)	-0.0138*** (0.00487)
Main Channel	-0.0296*** (0.000877)	-0.0296*** (0.000878)	0.0366*** (0.00116)	0.0369*** (0.00114)	-0.00567** (0.00260)	-0.00677** (0.00284)
Basin FE	Yes	Yes	Yes	Yes	Yes	Yes
River Order FE	Yes	Yes	Yes	Yes	Yes	Yes
R <sup>2</sup>	0.252	0.181	0.205	0.090	0.141	0.032
Mean (Dep. Var.)	13.642	13.642	6.553	6.553	7.737	7.737
SD (Dep. Var.)	0.554	0.554	4.781	4.781	1.312	1.312
Observations	132369	132369	132369	132369	1189	1189

Notes: Robust standard errors in parentheses. The sample includes 1 square km grid cells within 5km from rivers (up to 6th order). Other controls include distance to the river, squared distance to the river, and interaction terms of these two variables with a river cell dummy.

\*  $p < 0.1$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$ .

Table C.3: Market Access and Forest Cover Change

	Forest disturbance		Forest loss		Forest recovery		Per-capita forest loss	
	(1) OLS	(2) IV	(3) OLS	(4) IV	(5) OLS	(6) IV	(7) OLS	(8) IV
log(MA)	1.411*** (0.0247)	1.742*** (0.0338)	0.375*** (0.00570)	0.366*** (0.00832)	0.402*** (0.00662)	0.520*** (0.00963)	-0.282*** (0.0873)	-0.733*** (0.273)
log (Elevation)	0.345*** (0.0521)	0.606*** (0.0551)	-0.00510 (0.0110)	-0.0117 (0.0121)	0.313*** (0.0115)	0.400*** (0.0130)	-0.532 (0.403)	-1.897** (0.878)
Confluence (1 or 2)	0.205 (0.194)	0.160 (0.195)	-0.0151 (0.0375)	-0.0138 (0.0374)	0.0766* (0.0437)	0.0604 (0.0444)	-0.342* (0.187)	-0.382** (0.189)
Confluence (3)	0.0247 (0.0817)	0.0606 (0.0820)	0.0487** (0.0193)	0.0478** (0.0193)	0.0128 (0.0217)	0.0252 (0.0216)	-0.287 (0.184)	-0.283 (0.186)
Flood	0.0882** (0.00901)	0.0912*** (0.00902)	0.0419*** (0.00214)	0.0418*** (0.00214)	0.0686*** (0.00263)	0.0695*** (0.00263)	-0.0246 (0.0289)	-0.0404 (0.0303)
Holocene	0.0111*** (0.000302)	0.0111*** (0.000302)	0.00386*** (0.0000753)	0.00386*** (0.0000753)	0.00536*** (0.0000850)	0.00532*** (0.0000850)	0.000957 (0.00156)	0.000965 (0.00156)
Pleistocene	-0.00109*** (0.000384)	-0.000699* (0.000385)	-0.00168*** (0.0000931)	-0.00169*** (0.0000934)	-0.000195 (0.000139)	-0.0000684 (0.000140)	0.00342 (0.00290)	0.00185 (0.00311)
Non-Main Channel	0.0268*** (0.00360)	0.0258*** (0.00363)	0.00580*** (0.000662)	0.00583*** (0.000662)	0.00582*** (0.000783)	0.00539*** (0.000799)	-0.00927** (0.00444)	-0.00846* (0.00494)
Main Channel	0.0124*** (0.00209)	0.0121*** (0.00210)	-0.000594* (0.000361)	-0.000582 (0.000360)	-0.0110*** (0.000333)	-0.0111*** (0.000339)	-0.00981*** (0.00345)	-0.0119*** (0.00365)
Basin FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
River Order FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
R <sup>2</sup>	0.118	0.065	0.175	0.104	0.218	0.105	0.128	0.002
Mean (Dep. Var.)	1.606	1.606	0.668	0.668	1.043	1.043	-2.819	-2.819
SD (Dep. Var.)	3.462	3.462	0.919	0.919	1.055	1.055	1.716	1.716
Observations	132369	132369	134646	134646	134646	134646	1203	1203

Notes: Robust standard errors in parentheses. The sample includes 1 square km grid cells within 5km from rivers (up to 6th order). Other controls include distance to the river, squared distance to the river, and interaction terms of these two variables with a river cell dummy. We are taking logarithms for the dependent variables.

\*  $p < 0.1$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$ .

## Demand Parameters

We estimate elasticity of substitution between varieties within each sector ( $\sigma$ ) and between sectoral composite products ( $\bar{\sigma}$ ), using detailed household-level information on expenditures and unit values (interpreted as buying prices) over time from the Peru National Household Survey (Appendix B.4).

**Elasticity of substitution between varieties.** We first estimate the elasticity of substitution between varieties in each sector. We estimate the following empirical specification partly, derived in part from the expenditure share of each variety (1) in the model and also using the household-level expenditure information from outside the model:

$$\ln(\tilde{\alpha}_{o,K,t,h}(j)) = \beta_0 + (1 - \sigma) \ln p_{o,K,t,h}(j) + \beta_1 X_{o,t,h} + \phi_K + \phi_t + \epsilon_{o,K,t,h}(j) \quad (C.3)$$

where  $\tilde{\alpha}_{o,K,t,h}(j)$  is the expenditure share of household  $h$  on good  $j$  (classified by ENAHO) of sector  $K$  (classified by us) at period  $t$  in location  $o$ ,  $X_{o,t,h}$  is a vector of household-level demographic variables at  $t$  in  $o$ , and  $\phi_K$  and  $\phi_t$  are the sector fixed effect and period fixed effects.<sup>38</sup>  $p_{o,K,t,h}(j)$  is a unit value of good  $j$  of sector  $K$  that household  $h$  at  $t$  in  $o$  pays. This measure is obtained by deriving the value of expenditure on good  $j$  by the quantity of its expenditure and can thus be interpreted as a buying price. We instrument  $\ln p_{o,K,t,h}(j)$  by  $\ln RNA_o$  (where  $RNA_o$  is defined by (17)) which is an exogenous price shifter due to a trade mechanism but plausibly uncorrelated with local preference shocks given controls. Table C.4 reports the results in left columns. The point estimate with the instrument implies the estimated value to be  $\hat{\sigma} = 2.401$ . Since  $\hat{\sigma} > 1$ , this estimate implies that consumption demands of varieties within the agricultural or natural resource sector are substitute.

**Elasticity of substitution between sectoral composite goods.** We next estimate the elasticity of substitution between sectoral composite goods, using the estimated  $\hat{\sigma}$  above to approximate the price index measure  $\hat{P}_{o,K,t,h} = [\sum_j P_{o,K,t,h}^{(1-\hat{\sigma})}]^{1/(1-\hat{\sigma})}$ . We estimate the following empirical specification, derived in part from the expenditure share of each sectoral good (2) and also using the household-level expenditure information from outside the model:

$$\ln(\tilde{\alpha}_{o,K,t,h}) = \bar{\beta}_0 + (1 - \bar{\sigma}) \ln \hat{P}_{o,K,t,h} + \bar{\beta}_1 X_{o,t,h} + \bar{\phi}_K + \bar{\phi}_t + \epsilon_{o,K,t,h} \quad (C.4)$$

where  $\tilde{\alpha}_{o,K,t,h}$  is the expenditure share of household  $h$  on sector  $K$  goods at period  $t$  in location  $o$ . We implement LASSO to select instruments from exogenous productivity shifters in addition to  $\ln RNA_o$ .<sup>39</sup> Table C.4 reports the results in right columns. The point estimate with the instruments implies the estimated value to be  $\hat{\sigma} = 0.752$ . Since  $\hat{\sigma} < 1$ , this estimate implies that consumption demands across composites of agricultural and natural resource sectors are com-

<sup>38</sup>The household-level demographic variables include household size, number of adult members, and number of male members in each household. The period fixed effects include both year fixed effects and the fixed effects of interview month. The interview month matters because the expenditure variable is based on the household's expenditure within 15 days prior to the interview date.

<sup>39</sup>We add exogenous productivity shifters to instruments because the price index, an aggregated measure across varieties, is likely to contain varieties produced in each location and thus local productivity shifters in theory have direct influence on it. This empirical design is internally consistent in that the candidate productivity shifters for LASSO are same as the controls used to estimate density externalities from inverted productivity composites in a later stage. We use adaptive LASSO to select a tuning parameter. We did not include productivity shifters for estimating the elasticity of substitution between varieties because each location does not produce many varieties observed in ENAHO and thus local productivity shifters have poor explanatory power for prices disaggregated at varieties.

plementary. Note also that the estimated value is larger than a general parameter value (0.5) of the elasticity of substitution across sectoral goods of agriculture and manufacturing in the literature of structural transformation (e.g., Ngai and Pissarides 2007). This difference is reasonable because both agricultural and natural resource goods are food items and the complementarity between them would be weaker than that between food and non-food consumption.

Table C.4: Elasticity of Substitution across Varieties and Sectors

	log(Expenditure share)			
	Across varieties		Across sectors	
	(1) OLS	(2) IV	(3) OLS	(4) IV
$\log(p_{o,K}(j)), K = Ag, Nr$	-0.326*** (0.00810)	-1.401*** (0.540)		
$\log(P_{o,K}), K = Ag, Nr$			0.00626 (0.0371)	0.248** (0.126)
Basin FE	Yes	Yes	Yes	Yes
Mean (Dep. var.)	-4.419	-4.419	-1.068	-1.068
SD (Dep. var.)	1.366	1.366	0.447	0.446
First stage F-stat		19.148		13.652
Observations	58115	58115	3276	3270

*Notes:* Robust standard errors in parentheses. The coefficients correspond to  $1 - \sigma$  and  $1 - \bar{\sigma}$  regarding elasticity of substitution across varieties and sectors, respectively. For estimating the elasticity of substitution between sectors, we use the implied  $\sigma$  from the IV estimation of the elasticity of substitution to construct the price index measure. The estimation sample includes variety-level or sector-level expenditures of households from ENAHO during 2013-2017. We control for year fixed effects, month fixed effects, a dummy of agricultural sector, and household-level demographic variables. Household-level demographic variables include household size, number of adult members, and number of male members in each household. For estimating the elasticity of substitution between varieties, we use log of RNA as an IV. For estimating the elasticity of substitution between sectors, we implement LASSO to select IVs from exogenous productivity shifters in addition to log of RNA.

\*  $p < 0.1$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$ .

### C.3 Algorithm for the Model Inversion

The detail is under construction.

### C.4 Algorithm for the Model Simulation

The detail is under construction.