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FERTILITY AND RURAL LABOR MARKET INEFFICIENCIES: EVIDENCE FROM INDIA

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Abstract. Informational frictions are an important source of inefficiency in rural labor markets. I examine the role of family size in mitigating costs that arise due to these frictions. I show that an increase in family size decreases the demand for hired labor in tasks for which worker output and effort are difficult to observe (monitoring intensive tasks). In contrast, in tasks for which worker output is easily observed, I find no relationship between family size and hired labor use. I provide evidence that supervision costs drive the preference for family labor in monitoring intensive tasks. As a consequence, larger families spend less time in supervision. I develop a theoretical framework, that illustrates the empirical challenge of identifying the link between family size and labor demand: factors that determine labor demand on the farm also determine family size. To address this endogeneity problem, I use exogenous variation in fertility induced by both a family planning policy in India, which provides cash incentives for sterilization take up, and income shocks. I show that while neither incentive payments nor income shocks by themselves are valid instruments for completed fertility, their interaction is a valid instrument. I infer that population control policies must take into account market inefficiencies that make larger families profitable.

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