

The Aggregate Productivity Cost of Labor Informality in Colombia*

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Abstract

Informality is a prominent feature of labor markets in developing economies. Workers in the informal sector often engage in activities or work for firms with lower productivity compared to their formal counterparts. Additionally, they usually do no work in their desired occupations, indicating a greater misallocation of its workforce across sectors. These two channels - productivity differentials and the greater misallocation of labor among informal workers-, imply that informality reduces aggregate labor productivity. We quantify these aggregate losses in Colombia, a country with more than half of its workforce in the informal sector, through the lens of a Roy model of sectoral choice. Our estimates reveal that informality contributes to an aggregate labor productivity loss of 19.3%, with the productivity differentials channel being the most significant, accounting for approximately 80% of the calculated loss.

Keywords: Informality, aggregate productivity, labor misallocation, Roy model.

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