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Abstract

This ESPE examines the causes and consequences of labor and firm informality in Colombia. Notable differences in the informality rate are highlighted, varying by region, education level, and demographic factors. Among firms, size influences access to formalization mechanisms. Additionally, the report analyzes structural factors affecting labor informality, such as the minimum wage, payroll taxes, rigidities in labor legislation, and business registration costs. The macroeconomic effects of informality are explored using general equilibrium models, emphasizing that informality exacerbates volatility in GDP and its components, reduces aggregate productivity, and limits the effectiveness of monetary policy. The aggregate effect of a reduction in payroll taxes is also evaluated, finding that such a measure would promote the creation of formal employment and lead to higher long-term economic growth. Finally, key policy recommendations are presented to reduce informality, contributing to the debate on its causes and effects in the Colombian economy.