

Informality and minimum wage: Evidence for Colombia

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Abstract

This paper estimates the effect of the minimum wage on the likelihood of participating in the informal sector in Colombia. Based on information from an on-going household survey by DANE in thirteen metropolitan areas in Colombia from 2001 to 2005, seven cohorts were built consisting of individuals in the age range from 18 to 56 and we estimate a pseudo panel of the likelihood of participating in the informal sector using an IV-probit. The findings show that an increase in the actual minimum wage results in a decrease in the likelihood of participating in the informal sector in the old cohorts and an increase in the likelihood of participating in the young cohorts. Therefore, an increase in the actual minimum wage leads to substitution effects into young/older workers. The findings also show that each further year of education decreases the likelihood of participating in the informal sector by 6 percentile points, while non-labor income decreases the likelihood of participating in the informal sector by 0.04 percentile points.

Key words: Employment labor participation, informal sector, minimum wages, pseudo panel

JEL: C35, J32

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