Banco de la República | Colombia
Somos el banco central de Colombia

The Efficiency of the Informal Sector on the Search and Matching Framework

Working Paper No. 832 Keep in mind
The series Working Papers on Economics is published by the Office for Economic Studies at the *Banco de la República* (Central Bank of *Colombia*). It contributes to the dissemination and promotion of the work by researchers from the institution. This series is indexed at Research Papers in Economics (RePEc).

On multiple occasions, these works have been the result of collaborative work with individuals from other national or international institutions. The works published are provisional, and their authors are fully responsible for the opinions expressed in them, as well as for possible mistakes. The opinions expressed herein are those of the authors and do not necessarily reflect the views of Banco de la República or its Board of Directors.

AUTHOR OR EDITOR Luz Adriana Flórez
This paper analyzes efficiency in an economy with an informal sector that consists of unregulated self-employment, and where there are no costs of being informal, (Albrecht et al. (2009)). First, assuming workers in the formal sector are ex-ante heterogeneous, I show that this type of economy is inefficient. Second, I identify the optimal policies the government can implement, where the informal sector is unobserved (or search effort is unobserved). Allowing the government to use different policies such as social security payment, severance payment, formal tax, and job creation subsidy, I show that the government cannot affect worker's behavior by using severance and social security payments because of the risk neutrality assumption (Lazear (1990)). However, it can achieve an efficient allocation through a tax-credit policy. This result is interesting since it can guide the way in which social security programs can be implemented in developing countries, where in general social protection programs are assumed to subsidize informal activities.

The opinions expressed here do not necessarily correspond neither to the Banco de la República nor its Board of Directors.

Fuente: https://www.banrep.gov.co/en/borrador-832