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Working papers economics - Formal Labor Market Dynamics and Development

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When we observe an increase in labor formality associated with a higher level of economic development, is it because more people gain access to the formal sector, or because those already working remain longer in formal jobs? This study shows that labor formality rises with the level of development primarily because more people gain access to the formal sector, rather than because those who enter formal employment remain longer in formal jobs.

Publication Date: Tuesday, 11 of August 2026 **Approach**
This paper starts from a central question: when we observe an increase in labor formality associated with a higher level of economic development, is this because more people gain access to the formal sector, or because those already employed remain longer in formal jobs? To answer this question, we use matched employer-employee administrative records from eight countries, namely Brazil, Chile, Colombia, Ecuador, Kenya, South Africa, Thailand, and Uruguay, covering a broad range of income levels. The analysis combines cross-country evidence with subnational comparisons for Brazil and Colombia. The latter approach makes it possible to examine differences in formal labor market fluidity using only regional variation in economic development, while holding constant the institutional framework established by national labor legislation.

Contribution
The paper's main contribution is to decompose the increase in labor formality into two margins: the extensive margin, which measures the share of individuals who access formal employment at least once, and the intensive margin, which measures how long those who enter the formal sector remain in formal jobs. This decomposition provides a more precise understanding of the mechanisms underlying the expansion of formal employment during the development process.

The paper also contributes to the literature on labor markets in developing countries by showing that mobility within the formal sector follows a different dynamic from mobility in the aggregate labor market, where flows are typically dominated by movements into and out of informal or low-quality jobs. By focusing on the formal sector, the analysis makes it possible to examine whether greater labor market fluidity is associated with improved wage trajectories for workers.

Results

The results show that labor formality increases with the level of development primarily because more individuals gain access to the formal sector (an increase in the extensive margin), rather than because those who enter formal employment remain longer in formal jobs (the intensive margin).

However, the fact that the intensive margin changes little with development conceals important transformations in the dynamics of formal employment. As economies develop, workers hold a larger number of formal jobs, spend less time in each one, and transition more rapidly from one formal job to another. This suggests that formal labor markets become more fluid.

Finally, the paper finds that this greater formal labor market fluidity is associated with stronger wage growth over the life cycle. This higher wage growth is not driven primarily by wage gains from changing employers, but rather by wage growth within firms as workers accumulate tenure and experience with the same employer. Taken together, the results suggest that, as economies develop, their labor markets become more formalized and workers' career paths within the formal sector increasingly resemble those observed in higher-income economies.

Fuente: https://www.banrep.gov.co/en/publications-research/working-papers-economics/formal-labor-market-dynamics