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Interactions between Formal and Informal Labor Dynamics: Revealing Job Flows from Household Surveys

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ABSTRACT

In its characterizations of job creation and job destruction rates, the literature on labor dynamics has largely ignored informal labor markets. The interrelationships between job creation and destruction among informal and formal labor markets are therefore still generally unknown, despite recent developments in the study of labor market dynamics. These interrelationships are important, however, because much of what researchers identify as formal job creation in developing countries involves substitution of informal jobs for formal ones. In this paper, we use an original methodology to derive hires as well as job creation, separation, and destruction flows from standard household surveys. The great advantage of this technique is that it allows measurements of these labor dynamic measures for the informal labor market. We find that informal labor markets are less fluid than formal ones, mainly because informal job-to-job transitions seem to have a low incidence. In addition, we characterize the relationship between informal job destruction and formal job creation. We find that almost 50% of job creation in the formal sector is caused by job destruction in the informal sector, and identify this formalization process as countercyclical. Our findings portray the informal labor market as an inferior segment; in good economic times, it loses importance as a source of formal jobs and as a recipient of jobs from the formal sector.

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