

This paper studies the relationship between trade liberalization and informality. It is often claimed that increased foreign competition in developing countries leads to an expansion of the informal sector, defined as the sector that does not comply with labor market legislation. Using data from two countries that experienced large trade barrier reductions in the 1980's and 1990's, Brazil and Colombia, we examine the response of the informal sector to liberalization. In Brazil, we find no evidence of a relationship between trade policy and informality. In Colombia, we do find evidence of such a relationship, but only for the period preceding a major labor market reform that increased the flexibility of the Colombian labor market. These results point to the significance of labor market institutions in assessing the effects of trade policy on the labor market.