

# The Distributional Impact of the Minimum Wage

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## **Abstract**

We develop a general equilibrium framework with worker heterogeneity, monopsony power, and putty-clay frictions in order to study the distributional impact of large changes in the minimum wage. Our production technology is consistent with small elasticities of substitution among inputs in the short run and large elasticities in the long run. In the short run, a change in the minimum wage has a small effect on employment, so it increases the labor income of the workers for whom it binds. Over time, however, firms replace their old machines with new ones that can be operated by fewer low-wage workers and more high-wage workers. In the long run, a high minimum wage has perverse distributional impacts in that it reduces the employment, income, and welfare of precisely the low-income workers it was meant to help. Transfer programs, such as the earned-income tax credit, are more effective at improving long-run outcomes for workers at the bottom of the wage distribution. An earned income tax credit policy coupled with a modest increase in the minimum wage does even better.