

THE EFFECT OF MINIMUM WAGES ON THE NAIRU

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To Julie

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ABSTRACT

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This dissertation examines the effect of minimum wages on the Non-Accelerating Inflation Rate of Unemployment, or NAIRU.

The first chapter is empirical, examining whether minimum wages raise the NAIRU. I find that the level of the minimum wage is highly significant in regressions explaining nominal wage growth. Because this inflationary effect can be offset by increased unemployment, the minimum wage raises the NAIRU. A reduction in the relative minimum wage seems to account for a reduction in the NAIRU of about 1½ percentage points in the USA over the last two decades. Meanwhile, a compression of wage relativities has increased the NAIRU in continental Europe. These estimated effects are robust to variations in policy, controls, sample period and model specification. They are corroborated by a wide range of additional information.

The second chapter discusses some related empirical results.

The third chapter examines how these empirical results should be interpreted. Perhaps the most important explanation is that the minimum wage provides a safety net, facilitating aggressive wage bargaining. The low level of the minimum wage over the last decade seems to have made workers more afraid of large wage reductions should they lose their job. This insecurity seems to account for a large reduction in the

NAIRU. The minimum wage also increases the NAIRU by reducing labor demand and through maintenance of wage relativities.

The fourth chapter examines microeconomic foundations of the wage equation. In the steady state of a matching model, wages are an increasing function of the minimum wage (which provides an outside option) and a decreasing function of the unemployment rate. If wage negotiations are staggered then there is a unique Nash equilibrium in which wages only gradually approach this steady state. Wages, vacancies and unemployment are simultaneously determined along this equilibrium path. There is a Phillips curve that can be shifted by the minimum wage.

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