Abstract

It is often tempting to attempt to infer the welfare effects of minimum wage changes from empirical observations on pre- and post-change employment and unemployment levels and wage or earnings distributions. Using a simple model of search, matching, and bargaining, we characterize the relationship between minimum wage levels, labor market outcomes, and the welfare of labor market participants. Using observations on wage distributions before and after changes in the nominal minimum wage, we determine what can and cannot be learned about welfare impacts from changes in various features of these distributions. Our results are illustrated using simulation exercises and a small empirical example. Using U.S. data for young labor market participants in March 1997 and March 1998, we conclude that the increase in the minimum wage which occurred in September 1997 may have been welfare-enhancing, though various implications of the model are not consistent with the data. This analysis illustrates the fact that well-specified behavioral models are required to evaluate the impact of changes in institutional constraints on the welfare of labor market participants.