Economic Review

What Happens When the Minimum Wage Rises? It Depends on Monetary Policy

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The central bank's policy stance may influence how an increase in the minimum wage affects the economy.

Members of Congress have proposed new legislation to increase the national minimum wage from $7.25 per hour, where it has been set for over a decade, to $15 per hour. Although it is not yet clear whether the proposed minimum wage bill will become law, the effects of any such bill may depend on the stance of monetary policy—both during and after the bill's implementation.

Andrew Glover and José Mustre-del-Río examine how monetary policy may amplify or dampen the response of employment and inflation to an increase in the minimum wage. Their model-based analysis suggests a minimum wage increase has expansionary effects on the economy if the central bank is relatively unresponsive to current inflation, and contractionary effects if the central bank responds more aggressively (more than one-for-one) to current inflation. More generally, their framework suggests that if an increase in the minimum wage engenders contractionary effects, the central bank can mitigate these effects by allowing inflation to rise by more than the nominal interest rate.

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