

# How do Firms Respond to an Increase in Minimum Wage? \*

## Direct Evidence on Firms' Internal Adjustment

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[http://www.geocities.jp/hiroko\\_okudaira/result.html](http://www.geocities.jp/hiroko_okudaira/result.html)

### Abstract

When minimum wage increases and binds a firm's maximization decision, does the firm reallocate its input factors, or does it maintain its employment level and internally absorb the burden? This paper examines this question by directly estimating the wedge between plants' value of marginal product of labor and wage rate. Using data from the Japanese manufacturing census, we find that plants with initially negative wedges (i.e. value of marginal product of labor is less than wage rate) experience a significant increase in the absolute wedge when minimum wage is raised. Moreover, plants also reduce their employment levels in response to an increase in minimum wage, although this effect is weak and insignificant in some specifications. We also report moderate evidence that an increase in minimum wage disproportionately impacts a firm's wedge, depending on the competitiveness of labor market.

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