Trade and Minimum Wages in General Equilibrium: Theory and Evidence*

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Abstract

This paper develops a new model with heterogeneous firms under perfect competition in a Heckscher-Ohlin setting to show that a binding minimum wage, surprisingly, raises (lowers) firm and industry productivity in the labor (capital) intensive sector by making selection stricter (weaker). It reduces exports in the labor intensive sector, despite increasing price, and encourages substitution away from labor. Exploiting rich regional variation in minimum wages across Chinese cities and using Chinese Customs data matched with firm level production data, we find robust evidence in support of causal effects of minimum wage consistent with our theoretical predictions.

Keywords: Trade, Minimum Wage, General Equilibrium, Heterogeneous Firms

JEL Classification: F1, F14, F16, J38

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