While many countries are discussing substantial increases in the minimum wage, policy makers lack a comprehensive analysis of the macroeconomic and distributional consequences of raising the minimum wage. This paper investigates how employment, output and worker welfare respond to increases in the minimum wage beyond observable levels -- both in the short- and long run. To that end, I incorporate endogenous job search effort, differences in employment levels, and a progressive tax-transfer system into a search-matching model with worker and firm heterogeneity. I estimate my model using German administrative and survey data. The model replicates the muted employment response, as well as the reallocation effects in terms of productivity and employment levels documented by reduced form research on the German introduction of a federal minimum wage in 2015. Simulating the model, I find that long-run employment increases slightly until the minimum wage is equal to 60% of the full-time median wage (Kaitz index) as higher search effort offsets lower vacancy posting. In addition, raising the minimum wage reallocates workers towards full-time jobs and high-productivity firms. Total hours worked and output peak at Kaitz indices of 73% and 79%. However, policy makers face an important inter-temporal trade-off as large minimum wage hikes lead to substantial job destruction, unemployment and recessions in the short-run. Finally, I show that raising the minimum wage largely benefits men. For women, who often rely on low-hours jobs, the disutility from working longer hours outweighs the utility of higher incomes.

Moritz Drechsel-Grau is a Postdoctoral Researcher at the University of Zurich and will be joining the University of Munich (LMU) as an Assistant Professor in fall 2022. Moritz received his Ph.D. in Economics from the University of Mannheim in summer 2021. His research studies the causes and consequences of socio-economic inequalities using structural models, reduced-form techniques and micro data from a variety of sources.