
[Download](#)

Keep in mind

The series Working Papers on Economics is published by the Office for Economic Studies at the *Banco de la República* (Central Bank of *Colombia*). The works published are provisional, and their authors are fully responsible for the opinions expressed in them, as well as for possible mistakes. The opinions expressed herein are those of the authors and do not necessarily reflect the views of Banco de la República or its Board of Directors.

AUTHOR OR EDITOR

Ávila-Montealegre, Oscar Iván

Grajales-Olarte, Anderson

Ospina-Tejeiro, Juan J.

Ramos-Veloza, Mario A.

The series [Borradores de Economía](#) (Working Papers on Economics) contributes to the dissemination and promotion of the work by researchers from the institution. On multiple occasions, these works have

been the result of collaborative work with individuals from other national or international institutions. This series is indexed at Research Papers in Economics (RePEc). The opinions contained in this document are the sole responsibility of the author and do not commit Banco de la República or its Board of Directors.

Publication Date:

Thursday, 28 December 2023

Abstract

We examine the adjustment of a small, open, emerging market economy (SOEME) to an unexpected increase in the minimum wage using an extended New-Keynesian SOE model that incorporates heterogeneous households, a flexible production structure, and a minimum wage rule. We calibrate the model for Colombia and find that an unexpected increase in the minimum wage has significant effects on the low-skilled labor market, and weaker impacts on inflation and the policy interest rate. The rise in the minimum wage increases production costs and prompts the substitution of formal low-skilled labor with informal workers and machinery, resulting in reduced output, increased inflation, and higher policy interest rates. We also observe that the minimum wage influences the transmission of productivity, demand, and monetary shocks, leading to a more persistent impact on macroeconomic variables, and a less efficient monetary policy to control inflation. Our findings suggest that the minimum wage has important macroeconomic implications, and affects emerging market economies through different channels than in developed economies.