

Push and Pull: The Effect of Increasing the Minimum Wage and Reducing the VAT on Prices in Mexico

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Abstract

We estimate the effect of doubling the minimum wage and halving the value-added tax (VAT) on the Mexican side of the border between the United States and Mexico, using micro-data on the prices of around a hundred thousand goods and services. Unlike previous studies, we explicitly separate the effect of the minimum wage and the VAT using separate identification strategies. We account for differential effects of the minimum wage on prices of goods with and without VAT. In the border, we find that the increase in the minimum wage significantly increased prices of goods that pay VAT and are produced in sectors with a large share of minimum wage workers. These increases were more than offset by the decrease in VAT, resulting in an overall decrease in average prices.

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