

Enforcement, Displacement, and Informality: Labor Market Adjustment under the USMCA's Rapid Response Mechanism

Research Question

How does sustained enforcement of labor regulations affect labor market outcomes?

Introduction & Theory

The first-of-its-kind **Rapid Response Labor Mechanism (RRM)** in the **United States-Mexico-Canada** agreement (USMCA) represents a model for future trade agreements by providing a facility-specific enforcement process for labor disputes.

- Despite considerable scholarly and legal attention, **the empirical impact of the RRM remains uncertain.**
- Investigations may **improve worker welfare** by strengthening enforcement and collective bargaining, encouraging **shifts from informal to formal employment** to obtain negotiated benefits.
- However, investigations may **trigger worker displacement** if firms respond to higher labor costs by shedding formal employees, forcing some workers into the informal economy.
- The **formal/informal dynamic is important** for workers' welfare because informal work is closely associated with **dangerous working conditions, inequality, and increased poverty.**
 - In a study of 28 developing and emerging countries, the **poverty rate for informal workers** was found to be **5x higher** than that of formal workers in eight countries and **10x higher** in three countries.

The RRM is an excellent case to study the effect of labor provisions because the USMCA preserved NAFTA's tariff structure, removing the confounding effects between trade liberalization and labor regulation found in many agreements.

Hypotheses

	Unionized / Permanent Employment Contracts	Informal Employment
Worker-Protection mechanism (H1)	↑ Increase	↓ Decrease
Displacement mechanism (H2)	↓ Decrease	↑ Increase

Methodology

This study utilizes a time-series cross-sectional sample of **38 Mexican cities** spanning from the **first quarter of 2015 to the third quarter of 2025.**

To isolate the localized effects of labor enforcement, investigated facilities are **geolocated and matched to the nearest city.** A city is coded as treated if the driving distance between the city and the investigated facility is **50 kilometers (~31 miles) or less.**

Cities with RRM investigations are matched with similar cities that do not, or have not yet, had an investigation on a variety of potentially confounding covariates. After matching treated and control cities, we estimate the **average treatment effect on the treated (ATT)** via a **difference-in-differences (DiD)** analysis.



Figure 1 Distribution of RRM investigations across Mexico by industry.

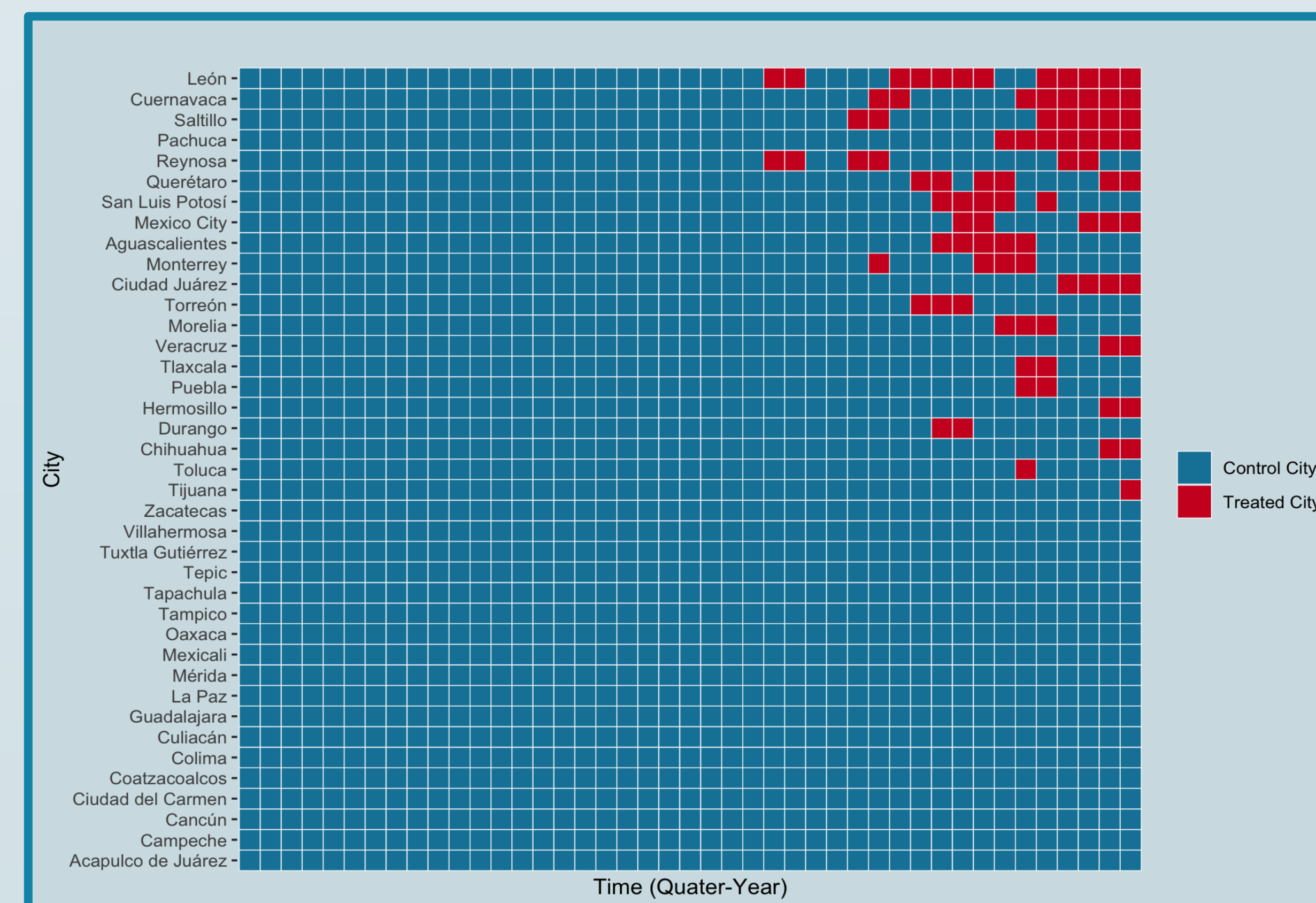


Figure 2 USMCA RRM investigations across cities and time.

Results

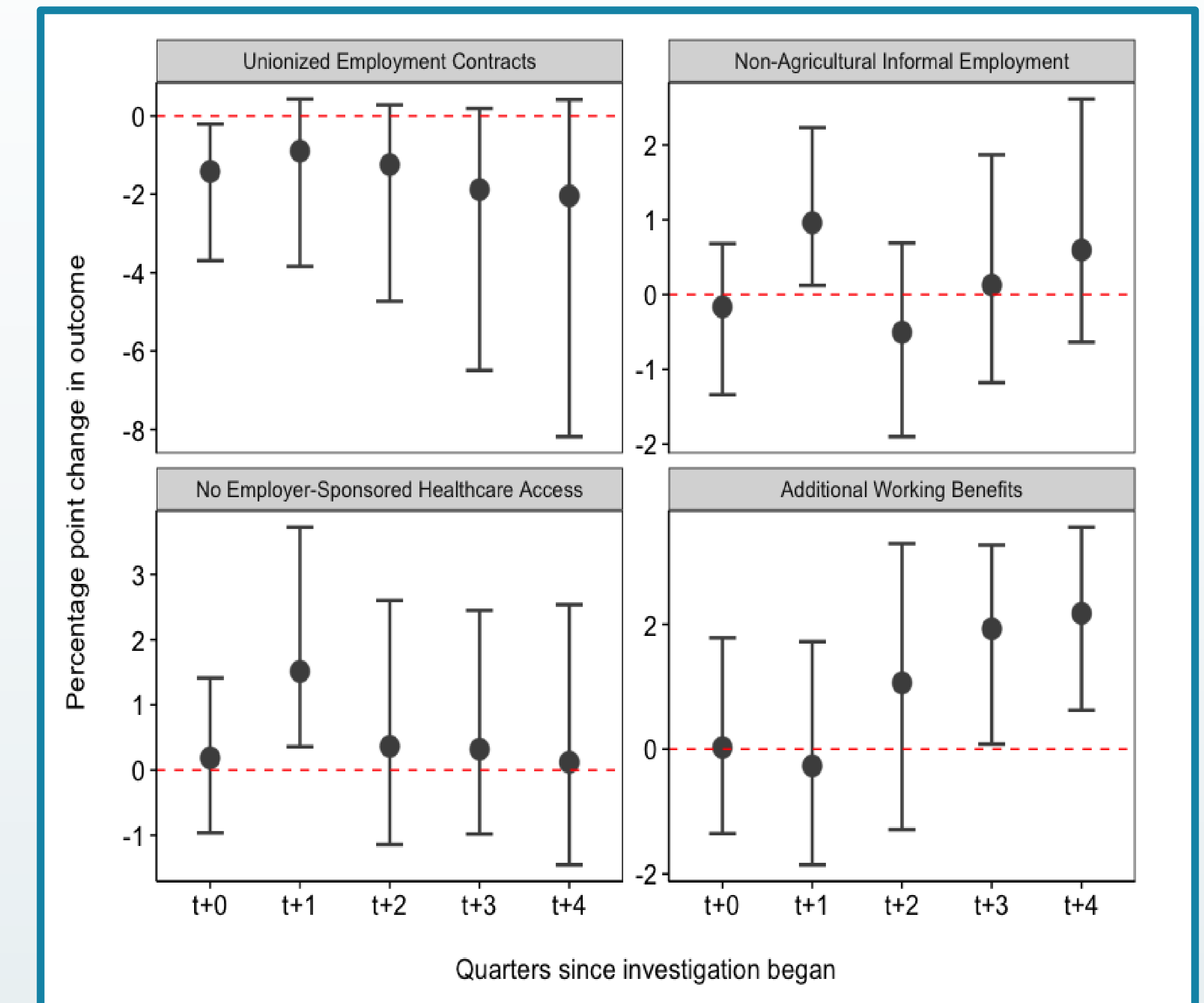


Figure 3 Estimated effect of RRM investigations on labor-market outcomes.

Conclusion

Some workers gain while others lose. The analyses support a **short-term displacement mechanism (H2)** as firms shed formal labor in anticipation of higher labor costs.

- Permanent or unionized employment declines by **~2 percentage points** in the quarter an RRM investigation begins.
- Non-agricultural informal employment increases by **~1 percentage point** in the following quarter.
- Lack of employer-sponsored healthcare coverage rises by **~1.5 percentage points.**
- However, receipt of additional benefits or payments increases by **~2 percentage points** for some workers, consistent with stronger collective bargaining agreements negotiated by newly elected worker-centric unions.

These findings suggest that future policy implementation should account for **localized spillover effects** from RRM investigations that may push displaced workers into the informal economy.

References

