



## FEDERAL RESERVE BANK OF MINNEAPOLIS

*Pursuing an economy that works for all of us*

### NON-COMPETE CONTRACTS HARM LOW-WAGE WORKERS

*States, counties, and cities can act to limit this labor practice*

#### What are non-compete contracts?

Non-compete contracts have a number of negative impacts on the labor market and the economy as a whole. These contracts restrict the ability of an employee to either work for or start a rival firm after leaving their current employer. Economic research strongly suggests that these contracts can depress wages and entrepreneurship.

National surveys suggest that nearly one in five workers in the U.S. are subject to some form of non-compete contract. Minneapolis Fed research indicates that non-competes exist across all industries, occupations, and wage levels. The data refute the common narrative that non-competes are only frequently used for executives or in technical sectors.

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**12% of workers making less than \$20,000 in annual earnings had signed a non-compete contract.**—Minneapolis Fed analysis of Bureau of Labor Statistics data

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When non-compete contracts are used in the low-wage workforce, they are often presented to workers after a job offer has been extended, leaving workers with little leverage to negotiate or refuse. Only 10 percent of workers with non-compete contracts report actually negotiating over them.

The usage of these contracts with low- and middle-income workers decreases labor market competition,

#### Learn more:

[minneapolisfed.org/article/2021/noncompete-contracts-sideline-low-wage-workers](https://minneapolisfed.org/article/2021/noncompete-contracts-sideline-low-wage-workers)

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limits innovation, and lowers wages. Non-compete contracts differ from, but may be used in conjunction with, other restrictive employment covenants like non-solicitation clauses and nondisclosure agreements.

#### What are the solutions?

States can act to restrict the use of these contracts and many have. States like North Dakota and Oklahoma have made non-compete contracts unenforceable. Other states prohibit them for workers earning less than a particular wage or for particular occupations.

The most straightforward reform would be to **ban non-compete contracts for low- and middle-income workers altogether**. An alternative option would be to **limit the enforcement of non-compete contracts**. This option differs from a ban in that there are no penalties for employers that ask employees to sign non-competes. As with a non-compete contract ban, limits to enforcement can be instituted for particular groups of workers.

Outright bans are more likely to prove effective in eliminating their harms. Workers are often uninformed about whether and how their state enforces non-competes. Even if in a particular state a non-compete is unenforceable, low-income workers often lack access to legal advice to inform them as to the particulars of their state's law.

Other policy options that governments at all levels could adopt:

- Make non-compete enforcement less stringent with policies like the *red pencil doctrine*—i.e., when a non-compete contract is found by a court to be unenforceably broad in scope, it must be thrown out.
- Mandate *garden leave*, which is the requirement that an employer pay a fraction of the prior wage to a former employee abiding by a non-compete.
- Require that non-competes be provided to workers at the time of job offer, with all details fully specified.