Opinion **Employment**

In labour markets, the devil is often in the detail

Non-compete clauses buried in contracts stack the deck against workers

SARAH O'CONNOR

© FT montage/Dreamstime

Sarah O'Connor 3 HOURS AGO

There are some good whodunits in the field of economics. One of my favourites is the question of why real wage growth has slowed down in a range of different countries over the past two decades. Economists have identified several likely culprits, from the slowdown in global productivity growth to the decline of trade unions. To that list I would like to add one more suspect: lawyers. Or rather, the small print that lawyers write.

Until recently, economists haven't paid much attention to the Ts and Cs of employment contracts. But what is written in these documents is quietly shaping how labour markets work — and not necessarily for the better.

The story starts in the US, where economists and law professors such as Evan Starr and Orly Lobel have mapped out the extent to which employment clauses traditionally associated with top executives have actually spread across the workforce. Non-disclosure agreements; non-disparagement clauses; non-compete clauses — many American workers are now tangled in a thicket of the stuff.

Non-competes have caught the most attention. Almost a fifth of American workers are bound by these clauses, which ban them from going to work for, or starting, a competing business within a certain period of time after leaving their job. They are more common among professionals but the research suggests roughly 14 per cent of people earning less than $40,000 are also subject to them. The Federal Trade Commission took legal action this year against a security company which, according to the FTC, had banned its low-paid guards from working for a competing business within a 100-mile radius of their job site for two years after leaving the company. The guards were threatened with a $100,000 penalty if they broke the clause.

The argument in favour of non-compete clauses is that they incentivise employers to innovate and train workers, because they know their investments will be protected. If an employee could just go straight to a competitor, why bother training them in the first place? People on this side of the argument concede that some companies apply overly restrictive non-competes to workers who don't have valuable trade secrets or training. But they point out the courts can and do judge unreasonable clauses to be unenforceable. The problem is that workers might not know that, or be prepared to go to court to find out. One study by Starr found that 70 per cent of employees with unenforceable non-competes mistakenly believed they were enforceable.

Critics believe they stifle innovation and "gum up" the labour market by preventing workers from moving freely to where they would be most productive. They see non-competes as a way for capital to quietly stack the deck against labour.

A number of studies do suggest that such clauses depress labour mobility and wages. When Hawaii banned non-competes for technology workers, researchers found that worker mobility increased by 11 per cent and wages for new hires rose 4 per cent. Non-competes seem to make life harder for young start-ups too: another study found that in US states where non-competes were more enforceable, new companies were more likely to die and even those that survived stayed smaller in their first five years. It's probably no coincidence that non-competes are legally unenforceable in California, the innovation capital of the world. The FTC announced plans to ban them altogether this month.

But the story doesn't end there. In Europe, many economists have assumed it is a uniquely American phenomenon. But that doesn't look true. A recent study by Italian economists found what Andrea Garnero, one of the authors, called "stunningly similar patterns" of non-compete usage in Italy to the US. A survey in Japan, a different type of economy again, has found similar patterns too.

Lawyers aren't necessarily the bad guys. It is increasingly popular for employers to use boilerplate language which can result in more restrictive clauses than are really necessary for most staff. "I try to advise clients all the time [that] it's a bad approach [to stick the same clause in for everyone] but of course it happens," says David Samuels, an employment partner at Lewis Silkin.

But whether they have spread inadvertently or not, the effect of these clauses on productivity, pay, innovation and mobility is significant. Time to get the magnifying glass out: the economics of small print could have a big impact on how we understand the world today.

sarah.oconnor@ft.com