ECONOMIC INNOVATION GROUP

April 14, 2023

Submitted Electronically (http://www.regulations.gov)
Federal Trade Commission
600 Pennsylvania Avenue Northwest
Washington, District of Columbia 20580

Re: Non-Compete Clause Rule, Docket No. FTC-2023-0007

Dear Commissioners:

The Economic Innovation Group (EIG) is a bipartisan research and public policy organization dedicated to forging a more dynamic, entrepreneurial, and inclusive U.S. economy. The growing prevalence of noncompete agreements is anathema to economic dynamism, economic opportunity, and the bargain at the heart of the American labor market: that employment in the U.S. economy should be at will, and that individuals are always free to seek out the best wages and working conditions available to them in an open, free, and fair market.

One need look no further than the label—noncompete—to see that noncompete agreements are inherently anticompetitive. Economically, EIG believes that the scope of the FTC's proposed ruling is the right one, namely a near complete ban on the use of noncompete agreements. EIG has worked with a bipartisan, bicameral group of lawmakers to pass legislation of broadly similar scope (the *Workforce Mobility Act*) since 2019.

This comment letter aims to do three things. In the first section, we underscore the FTC's own rationale for proposing the rule by reiterating the most salient points from the literature and the multiple ways in which noncompete agreements are both anticompetitive and harmful to various economic actors. The second section conveys why it is essential that the FTC's final ruling covers high-earning workers, in addition to lower-earning ones, in order to achieve the stated goals of the proposed ruling. We implore the FTC to adhere to a key guiding principle that their final ruling should endeavor to treat how noncompete agreements are administered in all instances and across the economy, and that the final ruling should not discriminate among categories of workers. The third and final section discusses the core principles that should guide the FTC as it crafts its final rule.

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Section 1. The empirical evidence is clear that noncompetes are economically harmful to workers, firms, and the public.

Noncompete agreements are by their very nature anti-competitive. This conclusion stems not only from their design and the rationales underlying their use, but also from the empirical evidence of their impact on the economy. As is customary for anticompetitive behavior, noncompetes stifle innovation, curtail new business formation, impede worker mobility, and stymie wage growth. They exhibit strongly negative externalities on multiple fronts, from consumers to competitors and on society as a whole, by allowing employers to extract or preserve excessive rents.[1] Other tools exist to protect company secrets and relationships that do not result in such widespread negative economic impact.

As the FTC noted in its proposed rule, the economic harms of noncompetes are manifold:

- Noncompetes harm the wages of both covered and uncovered workers. Noncompete agreements significantly reduce worker wages,[2] including at the high end of the earnings distribution.[3] They do this by impeding job mobility and restricting workers' ability to bargain for higher wages with their current employer or seek them with another. They distort market wages for both covered and uncovered workers[4] and across state boundaries.[5] Research into state-level reforms have found immediate positive effects on worker wages from restricting the use of noncompetes.[6]
- Noncompetes obstruct other firms' ability to access talent, especially in rural areas. When one firm uses and enforces noncompetes, it denies competing firms the chance to approach–and perhaps more productively employ–that worker without facing extra costs or litigation risks. This leads to a deadweight loss in the economy as it interferes with forging the highest quality employer-employee matches.[7] Such labor market obstructions may be felt especially acutely in rural labor markets, where potential buyers and sellers of labor are both relatively scarcer, and harm firm growth and individual career advancement in these areas disproportionately.[8]
- Noncompetes impede the formation of new businesses and competitors. A significant body of evidence indicates that noncompete agreements hinder entrepreneurship and new

[1] Lipsitz and Tremblay (2021); Liyan Shi (2023).
[2] Matthew Johnson, Kurt Lavetti, & Michael Lipsitz (2020); Evan Starr (2019); Michael Lipsitz & Evan Starr (2021).
[3] Natarajan Balasubramanian, et al (2022); Mark Garmaise (2011); Omesh Kini, Ryan Williams, & Sirui Yin (2021).
[4] Evan Starr, Justin Frake, & Rajshree Agarwal (2019).
[5] Matthew S. Johnson, Kurt Lavetti, & Michael Lipsitz (2020).
[6] Lipsitz, Michael and Evan Starr (2019); Natarajan Balasubramanian, et al (2022).
[7] Liyan Shi (2023).
[8] Ioana Marinescu (2021).

business formation.[9] EIG's own analysis points to a significant increase in entrepreneurial activity among technology workers once non-competes are restricted, revealing the startup potential that noncompetes stymie.[10] Even firms that do start in high-enforcement states launch smaller, are less likely to survive, and grow more slowly.[11]

- Noncompetes reduce job creation. New businesses are the primary driver of net job growth in the United States. When non-competes obstruct their creation or slow their growth, incumbent firms are unlikely to pick up the slack, leading to less overall job creation economy-wide.[12] By simultaneously holding down net job creation *and* reducing job mobility and the churn of workers across firms, non-competes also block the vacancy chains that are vital for bringing all workers, especially the disadvantaged, into the labor market.[13]

Put it all together, and noncompetes place a significant drag on U.S. economic dynamism.[14] Covering an estimated 30 million to 60 million people,[15] noncompete agreements reduce the churn of workers both within and across industries. They reduce startup rates, slow productivity growth, and prevent both buyers and sellers of labor from enjoying the benefits of fair competition in an open market. And to what end? The latest research suggests that even if noncompetes induce firms to invest more in R&D, the positive marginal impact is negligible when weighed against the costs.[16] Noncompete agreements are widespread restraints on trade that impose severe costs on covered workers, affected firms, and the public.

Section II. The FTC's final ruling should apply to all workers regardless of earnings or occupation.

As an unfair method of competition, noncompetes are unnecessary, harmful, and unfair except in the rarest of circumstances. As such, EIG believes that the empirical evidence strongly favors uniform treatment and a full ban on noncompete agreements, rather than differential treatment or a partial one that may only affect certain categories of workers, as some states have recently done, and the FTC describes in its notice as a possible alternative. The next section will make several points supporting broad action. First, higher-earning workers are more likely to become successful entrepreneurs. The FTC's own pro-entrepreneurship rationale for action points directly to ensuring these workers are covered by its ruling. Second, any potential earnings

[9] Sampsa Samila & Olav Sorenson (2011); Jessica Jeffers (2019); Matt Marx (2021).
[10] Benjamin Glasner (2023).
[11] Evan Starr, Natarajan Balasubramanian, & Mariko Sakakibara (2018).
[12] Sampsa Samila and Olav Sorenson (2011); Gerald Carlino (2021); Fikri and Lettieri (2022).
[13] Davis and Haltiwanger (2014); Engbom (2022).
[14] Fikri and Lettieri (2022).
[15] For varying estimates see Rothstein and Starr (2022); Starr, Prescott, and Bishara (2021); Shierholz (2019).
[16] Liyan Shi (2023).

threshold that might limit the reach of the FTC's ruling would be arbitrary. Third, the nation has compelling public policy interests in ensuring its high-earning knowledge-based workforce is free to be deployed to its most innovative and productive uses. Even if the FTC's final ruling falls short of a full ban, EIG favors an approach that treats agreements uniformly, affecting noncompetes when- and wherever they arise in the marketplace and, ideally, dramatically curtailing their use and burden.

The FTC's ruling will boost entrepreneurship by covering high-wage workers

Restrictions on noncompete agreements should cover both high- and low-wage workers because many of noncompetes' negative externalities on markets and competition operate by stymying latent entrepreneurs—who are disproportionately likely to be high-earning—from starting new enterprises.

The literature on self-employment and entrepreneurship finds that individuals with higher levels of human capital,[17] prior work experience,[18] knowledge of a system, market, or technology,[19] and access to non-banking networks of capital[20] are more likely to create businesses that survive and grow. All of these characteristics are more common among highly-paid workers.

Entrepreneurs start and own businesses in the area of their expertise. This point is obvious, of course, but it bears repeating in the context of noncompete agreements, which are designed to block such moves. Only six percent of all U.S. businesses are owned by individuals under the age of 35—a proxy for means but also experience. By contrast, more than three-quarters of businesses are owned by individuals ages 45 and up—experienced individuals in their peak earning years. Noncompete agreements directly obstruct such entrepreneurial transitions, preventing covered individuals from deploying their accumulated expertise in their lines of work and home labor markets to create new enterprises.

According to the Annual Business Survey (ABS), 56 percent of U.S. business owners view starting their own business as the best avenue for their ideas, meaning they have or had business ideas, models, or innovations that could not be realized within the confines of other employers. This figure rises to 63 percent for Black business owners. When and where noncompete agreements are strictly enforced, these ideas may never come to market.

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[17] Robert Cressy (1996).
[18] Colombatto and Melnik (2007).
[19] Aldrich and Cliff (2003); Shane and Venkataraman (2000).
[20] Asterbro and Bernhardt (2003); Evans and Jovanovic (1989); Goetz and Freshwater (2001); Glaeser and Kohlhase (2004); Aldrich and Cliff (2003); Shane and Venkataraman (2000).

Another 63 percent of business owners identified greater income as a very important reason for owning their own business, implying that they were able to earn more as entrepreneurs than they could working for someone else. When and where noncompete agreements are strictly enforced, these avenues for income growth are blocked. Among women, a greater share of business owners identified balancing work and family life as a very important reason for owning their own business (60 percent) than any other reason—a figure that rises to 70 percent for Black and Hispanic women. Noncompete agreements deny such flexibility to too many would-be women entrepreneurs.

EIG's own recent research found that Hawaii's 2015 reform to ban noncompetes for high-tech workers led to a significant 10 percent increase in the number of employer establishments in the industry, while Oregon's more low-wage reform had no effect on entrepreneurship.[21] This attests to the latent entrepreneurial energy among high-earning knowledge workers that had built up under Hawaii's old noncompetes regime and was unleashed once reforms had been enacted.

Any likely wage threshold would arbitrarily ensnare millions of American workers

While media reporting on the most egregious abuses of noncompete agreements focuses on low-wage workers, the incidence of such agreements is greatest among higher-wage workers, who are also more likely to work with intellectual property and trade secrets or maintain strategic relationships. Estimates suggest that 36 percent of individuals in engineering and architectural occupations (average annual wage: $91,740) and 35 percent in computer and mathematical occupations (average annual wage: $99,860) are covered by a noncompete.[22] Sliced by wages, *one-third* of those making between $100,000 and $120,000 are subject to a noncompete, as are 46 percent of those earning over $150,000. Those figures compare to 21 percent of those earning between $40,000 and $60,000 per year, and 15 percent of those earning in the band below.[23] Restricting the use of noncompete agreements for low-wage workers but not for high-wage workers would leave much of the underlying problem unaddressed.

Differentiating between low- and high-wage workers would inevitably require establishing an arbitrary wage cut-off above which noncompetes were permissible, but below which they were not. There is no clear place in the earnings ladder at which to draw such a line. Some states have opted for multiples of the poverty threshold or fractions of the mean wage in recent reforms in attempts to proxy where bargaining power falls off. These thresholds are not grounded in economic evidence, however, and the approaches leave large potential benefits of reform on the

[21] Benjamin Glasner (2023).
[22] Evan Starr (2021); EIG analysis of BLS Occupational Employment Statistics data.
[23] Evan Starr (2021).

table while perpetuating the deadweight economic loss of keeping many other noncompetes in place.

Nationally, 38 percent of American workers earn more than the average wage in their states.[24] A rule that exempted only those earning less than the state-adjusted mean wage would still leave nearly two out of every five American workers eligible to be subject to a noncompete.

Wage-based cutoffs inevitably ensnare certain types of workers disproportionately. Across the 801 detailed occupations tracked by the Bureau of Labor Statistics, *the average worker earns more than the national mean wage in 371 different lines of work, or 46 percent of all occupations*. The *median* worker earns more than that amount across 40 percent of occupations, including software developers, aerospace engineers, information security analysts, materials scientists, occupational therapists, radiation therapists, web designers, first-line supervisors, loan officers, HR specialists, and food service managers. Solely by dint of their occupation, most Americans in these lines of work would remain exposed to the career risks of a noncompete agreement were the FTC to limit its ruling to low-wage workers.

Recent research suggests that firms do not actually value their noncompete agreements up to at least the $100,000 threshold, based on behavioral evidence following Washington State's reforms.[25] This implies that any cutoff should be placed even higher than that. Additional research recently found that even among executives—the labor market actors most able to fairly bargain over their noncompete agreements and extract financial compensation in exchange for signing one—the broad costs of noncompete agreements outweigh any narrow benefits that might accrue to signatories.[26] The evidence base simply does not support an exclusively low-wage ban, and the FTC would be hard-pressed to establish a credible threshold with available empirical evidence.

Noncompetes among higher-earning knowledge workers hold back American innovation and competitiveness

Reining in the use of noncompete agreements against knowledge workers is an issue of national competitiveness. Higher-earning workers in the fields of science and technology are the lifeblood of American innovation. An FTC ruling that reduced the share of workers in these occupations covered by a noncompete would provide an immediate and timely boost to the country's

[24] EIG analysis of American Community Survey microdata.
[25] Hiraiwa, Lipsitz, and Starr (2023).
[26] Liyan Shi (2023).

innovation enterprise aligned with both Congress' and the Biden administration's competitiveness agendas.

The churn of workers in the labor market is one of the primary avenues through which knowledge diffuses through an economy. This process fosters innovation, enhances productivity, and fuels growth. But to really understand how noncompetes relate to—and impede—innovation and competitiveness, it is helpful to look to regional industry clusters—the geographic areas in which most of the country's most innovative and competitive industries concentrate. These clusters are sustained by networks of complementary firms, healthy worker churn, new entrepreneurs, technology spillovers, and intense competition in both product and labor markets. Numerous studies have identified job-hopping as a primary mechanism through which tacit, non-appropriated knowledge spreads through these local economies and then nationally.[27] The ability to start-up, spin-out, and jump-ship is intrinsic to the story of Silicon Valley's success—and a key ingredient in what sustains so many world-leading industries from entertainment to aerospace in California, a state in which noncompete agreements are unenforceable. And yet noncompetes are designed to obstruct exactly these natural economic processes through which advanced economies grow.

In the past two years, the federal government has committed to investing hundreds of billions of dollars into the country's technological prowess. In the CHIPS and Science Act, Congress authorized $20 billion to invest in a network of regional technology and innovation hubs. For these efforts to succeed, workers should be able to follow the best ideas and technologies. Freeing the nearly two out of every five science and engineering workers in the country who are currently restricted in where and for whom they may work due to their noncompete agreements would provide a powerful and complementary pro-innovation push.

Section III. The FTC has multiple policy levers at its disposal to curtail the use of noncompete agreements and resulting damage.

Whatever the contours of its final ruling, the FTC should use its powers to ensure that new minimum uniform standards are set around several parameters of noncompete agreements and how they are used. The FTC should focus on transparency, fairness, and incentives.

- **Transparency.** A significant portion of noncompetes' harm to individual labor market participants arises from the way in which employers communicate to employees about them. More than 30 percent of individuals with a noncompete learn about the agreement

[27] Fallick et al. (2006); Franco and Filson (2006); Franco and Mitchell (2008); Samila and Sorenson (2011); Baslandze (2017).

only after they have already accepted their offer,[28] potentially after workers have left their prior employer and turned down other job offers. Few employees are given much time to review their noncompetes, and even fewer retain counsel to review the documents. The earlier workers are notified that the position they are pursuing is covered by a noncompete agreement, the better able they will be to make an informed decision and/or bargain over the terms. Ideally a job posting would be required to state that the position is covered by a noncompete; at a minimum, the noncompete should be disclosed at the same time the job offer is extended. The FTC could stipulate when and how a worker must be notified that they are about to enter into a role or organization in which a noncompete will be required.

- **Fairness.** The FTC can work to make the terms of noncompetes fairer and increase the penalties for bad behavior. Limiting the scope and duration of a noncompete would do much to curtail an agreement's harm. The FTC could set a bar that no noncompete may be enforced for longer than one year, for example. It could set limits on relevant markets so that employers do not define them overly broadly. The FTC could make clear that noncompetes are unenforceable against workers who have been terminated or laid off.

  Ensuring fairness involves policing bad behavior, as well. For example, because workers are often unaware of their state's laws governing the use of noncompete agreements, they sign noncompetes in states where they are unenforceable at similar rates to states where they are enforceable. This provides further evidence that state-level bans on enforcement are not enough to quell unfair and deceptive practices. Employers should be prohibited from putting forward agreements that are banned in the jurisdiction in which the worker is employed, and firms who engage in such activities should be subject to penalties. Too many employers push the limits on who can be covered by a noncompete, for how long, and in how wide of an area because doing so involves little risk or cost. The FTC can change that calculus by articulating economically significant penalties for employers who violate terms set by the FTC (e.g. damages and attorney's fees in cases where they attempted to enforce an overly broad agreement).

- **Incentives.** Noncompetes have become so pervasive because utilizing them incurs little cost to companies. The FTC can remedy the situation by ensuring that employers face meaningful disincentives to using and enforcing noncompete agreements. Here "garden leave" is a powerful tool that several states have recently embraced, including Massachusetts and Oregon. Garden leave provisions require that workers receive some portion of their salary or other "consideration" for the duration of the enforcement period.

[28] Evan Starr, JJ Prescott, and Norman Bishara (2020).

> By imposing a financial cost on the firm, garden leave clauses require the firm to demonstrate that it has real economic interest in enforcing each individual agreement. The clauses also ensure that workers are compensated at least partially for forgoing their trade in the place they live (it is important that garden leave not become a loophole in which workers receive only token consideration, however). The FTC could stipulate that the only valid noncompete agreements are those that include fair compensation for the worker against whom the agreement is being enforced, for example.

Individually, the steps outlined in this section fall short of the ideal: a complete ban of the use of noncompete agreements in nearly all instances. However, if the FTC did nothing other than take these steps to set standards, adjust incentives, and prevent abuses, employees and the economy would be much better off. These steps would reduce the share of the workforce covered by a noncompete as employers rein in their practices. Attractively, these steps would benefit all workers subject to noncompete agreements, not just certain classes of workers or those making certain incomes, too.

Conclusion

The Economic Innovation Group appreciates the opportunity to comment on the FTC's draft ruling. The impulse to avoid or circumvent competition is deeply ingrained in commerce, and noncompete agreements are among the most harmful examples in that long tradition. Noncompetes have spread so extensively across the economy not because they are legitimate restraints on trade, but because their basic premise has gone largely unchallenged. To that end, we hope that the final rulemaking results in far-reaching restrictions on noncompetes to the benefit of workers, employers, and the broader economy. In the meantime, we will continue to work with partners on both sides of the aisle in Congress to advance legislative solutions in line with the scope of the FTC's proposed rule.