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The Case against Non-Compete Agreements

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Abstract

This paper reviews the empirical evidence on the economic effects of non-compete agreements. Non-compete agreements are supposed to be an incentive compatible mechanism to enhance employer investments in employee human capital. This micro mechanism is thought to stimulate macroeconomic performance. The review shows that noncompetes are a significant constraint on labour mobility. This serves the interest of incumbent firms, but constrains the founding and growth of new innovative firms. These new innovative firms develop and diffuse new knowledge that challenge the position of incumbents. The net macroeconomic effect is likely to be negative when dynamic efficiency is severely harmed due to the microeconomic constraints on labour market mobility. Labour market policy for a dynamic knowledge based economy should more explicitly balance the ‘traditional’ legal protection for human capital investments on the one hand against innovation resulting from employee mobility on the other hand. In this way positive spillovers can be enhanced and negative spillovers can be constrained more effectively.