Free exchange

Part-time palaver

Turning freelancers for firms like Uber into employees would not necessarily improve their lot

Sep 19th 2015 | From the print edition

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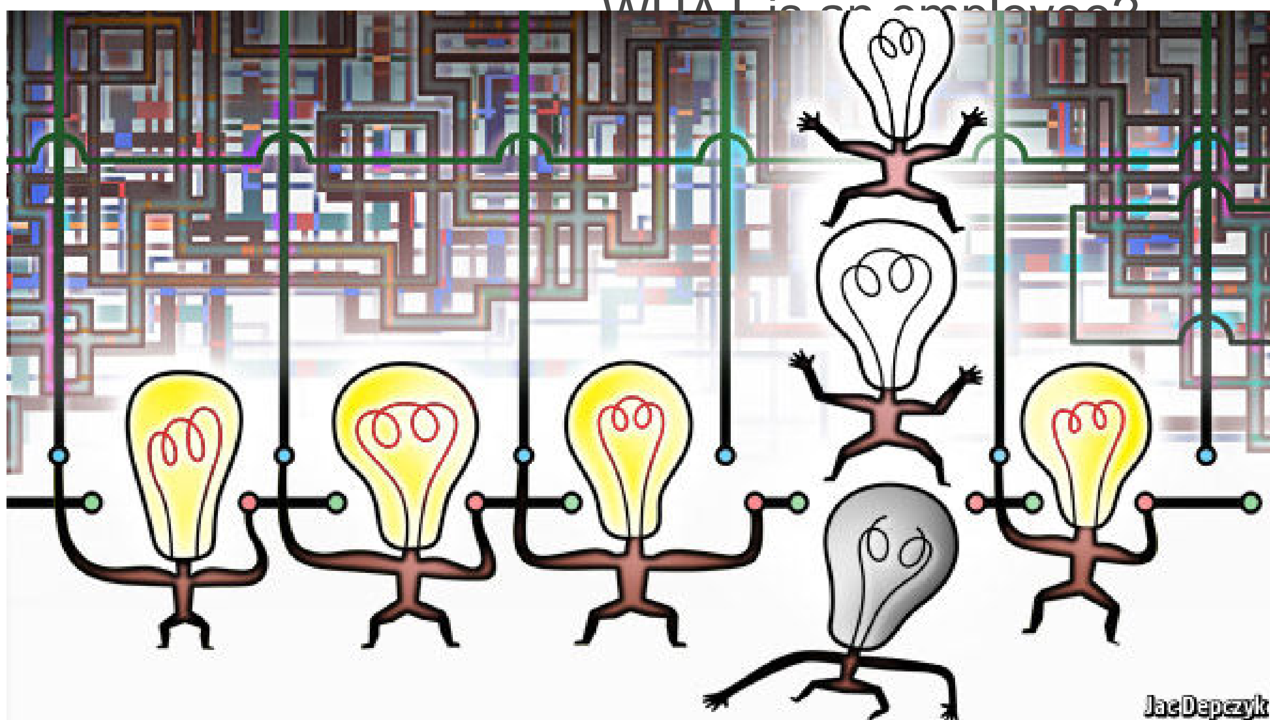
WHAT is an employee?



Judges in several American courts are grappling with just this question. Most notably, some drivers for Uber, an app-based taxi service, are suing to have themselves declared employees, rather than independent contractors, in a bid to gain more rights. With technology making it ever easier to farm out small tasks, and freelancing on the rise, the traditional definition of employment may eventually break down. Yet the importance of the "employee" label—and the benefits that come with it—is often overstated.

Historically, the challenge for economists has been to explain

employment rather than contracting. Firms with employees use plans and hierarchies to get things done; those who use contractors rely on markets and prices instead. In 1937 Ronald Coase, an economist, argued that this comes down to transaction costs. For instance, it is difficult to contract on output when it is tough to judge quality (as with, say, a spreadsheet). When transaction costs are high, it may be better to replace contractors with employees, who are paid for their input rather than outputs.

A corollary to Coase's theory is that when transaction costs are low, there is no need for a firm. Industries in which tasks can be neatly divided and where output is easily tracked, such as building, haulage and logging, contractors have been prevalent for decades. In 2009, the year Uber was founded, 88% of taxi drivers were already contractors.

Contracting, then, is not new. But campaigners for workers' rights worry about the use of contractors in the rapidly growing app economy. Often, governments and companies provide benefits exclusively to employees. Are contractors missing out?

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The main benefits associated with employment fall into three

broad categories: public pensions, health care, and unemployment insurance. In the case of pensions, governments usually levy payroll taxes on firms in proportion to their workforce, and use the proceeds to support pensioners. Hire a worker as a contractor, and firms need not pay the levy; in America the self-employed must instead pay it themselves. Workers' advocates claim this means contractors face higher tax rates than employees.

However, conventional economics says the burden of a tax cannot be altered just by changing which party writes the cheque. America's Congressional Budget Office considers payroll taxes part of a worker's tax burden, even though employers pay them. Were Uber forced to pay social-security contributions instead of its drivers, it would presumably offset this extra cost by reducing the share of each fare that goes to drivers. Their take-home pay would remain the same. This argument cuts both ways: if it does not matter who pays, firms may as well cough up (though businesses may legitimately worry about the associated administrative costs of paying contributions).

Then there is health care, which is often tied to jobs in America. Again, there is no free lunch for workers when employers foot the bill. Numerous studies have found that the more firms pay for health insurance, the less they pay in wages. For instance, in 1994 Jonathan Gruber of MIT found that when some states began insisting on better coverage for

childbirth, married 20- to 40-year-old women—whose insurance costs rose most on average—took an offsetting hit to their pay.

The third main benefit, support for the jobless, relies on the label “employee” by definition. Temporary and part-time work muddies the rules on eligibility. In many countries those working more than a certain number of hours a week cannot claim benefits. That creates a sharp incentive for on-demand workers to limit their hours to remain eligible. In New York, for instance, weekly benefits are reduced by 25% for every day on which any work is performed.

Elsewhere, eligibility depends on the circumstances in which the employee left his previous job: if he quit voluntarily, the government may not pay anything. In a world of flexible hours, this can open up tricky questions. If a worker signs up for a job with irregular hours, but then quits when his shifts change in an intolerable way, many American states will not pay any benefits.

Fortunately, there is a relatively simple fix: make welfare payments contingent only on income, rather than circumstances. Benefits can be withdrawn gradually as income increases, perhaps at a rate comparable to income tax. That would encourage jobhunters to take on piecemeal work in the gig economy.

Pushing on a string

If compulsory benefits are offset by lower wages, why should Uber's drivers care how they are labelled? Accepted economic wisdom provides one possible answer: wages are "sticky", or hard to cut in cash terms. If it takes time for pay to fall in real terms, workers who win more benefits in court would be better off for a short while. Workers may also recognise that there is one benefit attached to employee status—a minimum wage—that cannot be offset by lower pay.

Is that an argument for a minimum wage for contractors? Opponents point to its distorting effect on incentives. Workers would look to boost hours rather than output, requiring firms to monitor their effort closely. In Uber's case, a driver could stay in a quiet area, take few passengers and still make money. What might tip the balance the other way is if firms have too much bargaining power over their workers. This should not apply to a traditional contractor, such as a plumber, who works for lots of clients. But were apps to dominate a whole market—as some suspect Uber eventually might—then contractors may feel outgunned. If that happens, they will need more protection.

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