3 Steps to Build a Labor Market for the Gig Economy

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It's no secret that the Gig Economy – made up of consultants, independent contractors, freelancers, and on-demand workers – is disrupting how we work. The growth of independent work challenges the traditional structure of office-based full-time jobs for a single employer.

Current data suggests the Gig Economy is here and here to stay. An estimated 20 to 30 percent of the U.S. and EU-15 workforce engages in some form of independent work, and that share is growing. Almost all net employment growth in the U.S. since 2005 has come from "alternative work arrangements" such as independent work, rather than traditional full-time jobs. At highly valued, high-growth, multinational tech companies like Google, traditional employees are already a minority of the workforce.

The benefits of the Gig Economy are evident. McKinsey's Global Institute found in a study of 8,000 independent workers in the U.S. and EU that independent work mitigates unemployment, increases labor force participation, and raises productivity. Companies benefit from a more flexible workforce that allows them to staff up and down based on their business cycles and access the specific talent, skills, and expertise they need when and for how long they need them.

The Gig Economy increases entrepreneurship. Independent workers who start side gigs or take the risk to strike out on their own are the new entrepreneurs, launching new products and services, growing their own small businesses, and creating economic opportunities by hiring other independent workers or employees. McKinsey also reports – and other surveys confirm the findings – that independent workers are more satisfied than employees with their work, feel more empowered and creative, are more productive, and are happier with the number of hours they work and the flexibility they have.

The downsides of the Gig Economy are also clear. There are corporate bad actors that hire independent workers to avoid the costs and responsibilities of complying with labor laws and regulations for employees. There are also a minority of individuals who work independently out of necessity and would rather have a full-time job.

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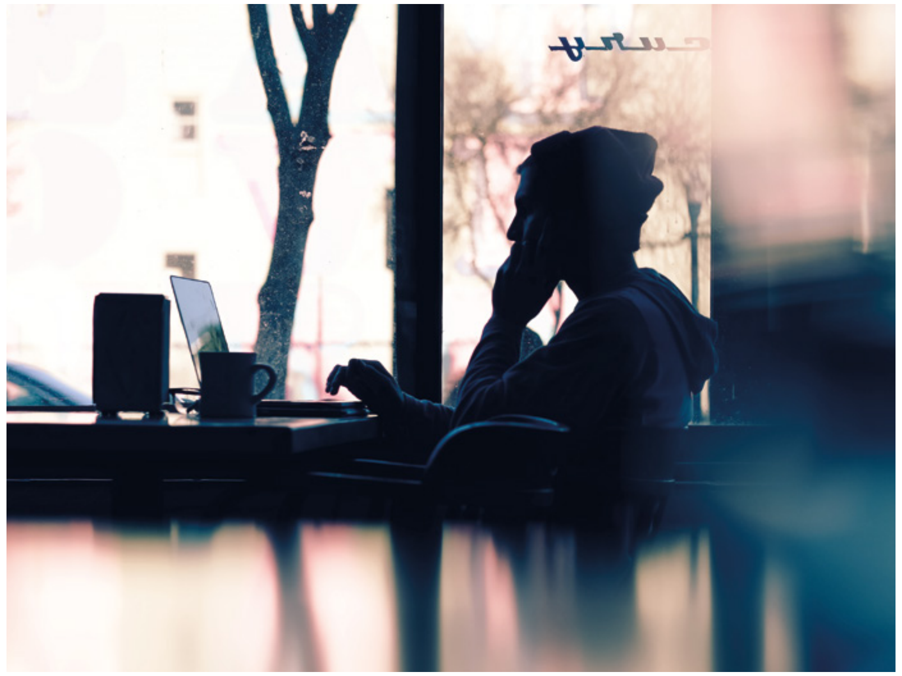

But the real culprit in the Gig Economy is outdated labor laws and regulations that fail independent workers by denying them the benefits, rights, and protections only awarded to employees. Our labor laws have simply not kept pace with the changes in the workforce that allow people to work more flexibly, independently, and for more than one employer. Anyone who chooses – or isn't able – to work in a traditional full-time job is denied critical labor protections and benefits.

Our labor markets weren't designed for the varied, diverse, and flexible workforce, or the choices about how to work, that we have today. They were designed to only support employees in a traditional job with a single employer. As a result, they penalize independent workers and fail to support the entrepreneurs who leave full-time employment to launch their own business. They also stifle innovation, restrict choice, and create a two-tier workforce of employees and everyone else. This needs to change.

Maximizing the productivity of our workforce and the potential of the Gig Economy means updating labor laws to include and support everyone who works, not just employees. It's a monumental undertaking, but one that is necessary to sustain a productive, efficient, and equitable labor market. To start, there are three key steps we need to take to create a labor market for the Gig Economy.

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1.
Eliminate the Worker Classification System

The most fundamental, important and structural change is to eliminate the outdated two-category worker classification system that exists in so many labor markets globally. It no longer makes sense to force today's workers into a classification system that doesn't recognize the multi-faceted ways people work. There are numerous problems with this binary distinction:

- **The classification systems are vague and subjective.** Even though labor markets distinguish between employees and all other workers, there isn't one that offers a clear, objective definition of which workers are employees and which are independent contractors. These unclear categories leave many workers and the companies who hire them unnecessarily exposed to the legal and economic risks of misclassification, including potential lawsuits and tax penalties.

  In the U.S., for example, the IRS, Department of Labor and National Labor Relations Board each have their own unique and subjective definitions for classifying workers. Adding to the confusion, federal and state definitions also vary and often conflict. For example, the U.S. Department of Labor released a letter this year stating that independent workers who find work on online platforms are independent contractors, while California recently passed legislation that classifies them as employees. At the state level, it is possible to be considered an employee by one government agency and an independent contractor by another.

  This persistent lack of clarity creates a confusing, unworkable system, provides incentives for companies to misclassify employees as independent contractors, leaves workers on unsure footing when negotiating their status, and leads to ongoing lawsuits about worker classification.

- **The classification systems distort the labor market by creating a "classification kink".** A "kink," as economists use the term, is an economic inflection point created by policies. The most familiar example of a kink is an income tax bracket. The point at which one tax bracket ends and a higher one begins is the kink. People who have discretion over their income — or over how they report their income — try to stay at the upper limit of a lower tax bracket and avoid moving into the next higher bracket. The main problem with kinks, as the income tax bracket example illustrates, is that people try to game them. Behavioral economists have found that people "bunch," or cluster, at kinks in order to maximize their economic benefit.

  Worker classification introduces a kink in the labor market that causes both companies and workers to "bunch" around it in an attempt to maximize their economics. Companies have incentives to hire independent workers, and workers have incentives to get hired as employees. Changing the worker classification policy that creates the kink would eliminate the inefficiencies and distortions it causes in our labor market.

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The most common proposal to fix the worker classification system is to add a third category of workers called "independent worker" or "dependent contractor." Members of this new category would receive more benefits than independent contractors but fewer than those offered to traditional employees. This option fails to solve the exisiting problems of the classification system. It doesn't offer a clear, objective definition of an independent worker, it would introduce an additional kink into the labor market, and it would continue to distort the behavior of companies and workers.

An alternative solution is to eliminate classification entirely and have one type of worker called "worker." The fundamental belief underlying this solution is that our labor market should support everyone who works, not just traditional employees. It would require extending to all workers the benefits, subsidies, and protections that are now available only to employees.

2.
Extend Critical Employee Benefits to All Workers

Our labor laws and regulations create a two-tier workforce because there is one set of benefits and protections for employees and a second, consistently lesser, set for all other workers. The most critical benefit for all workers is access to health insurance.

In the U.S., benefits such as health insurance are provided primarily through employers only to their employees. This leaves independent workers on their own to create a personal safety net. In theory, it's possible to replicate an employer-provided benefits package on the private market, but it is much more time-consuming, complex, and expensive to do so.

One reason it's more expensive is that employer-provided health insurance in the U.S. is massively subsidized by the federal government through a series of tax breaks that are unavailable to independent workers. These tax breaks add up to about $300 billion annually. For example, employers don't have to pay payroll taxes on the value of the health insurance they provide, and their employees receive that health insurance coverage as a tax-free benefit.

There are numerous ways to modify this system to support independent workers. One strategy is to reduce the tax breaks awarded to employers by, for example, collecting payroll taxes on the value of the insurance coverage they provide to employees. Those additional tax revenues could be used to extend subsidies for health insurance to independent workers. Another option is to cap the tax breaks that companies receive for providing health insurance and extend tax breaks to independent workers who purchase health insurance on the private market. ➲

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The European approach of relying more heavily on governments to offer key safety-net benefits such as health insurance is a proven, viable model. It's unlikely to be politically appealing in the U.S. currently, but it is a system that gives independent workers the ability to access affordable healthcare benefits without the need to hold a traditional job.

Another critical benefit is creating a safe working environment by protecting workers against discrimination and sexual harassment. The right to work in an environment free from harassment and discrimination is only awarded to employees and is not currently extended to independent workers. Existing regulations allow employers to discriminate against or harass independent workers for any reason (including gender, age, sexual orientation, and race). Changes in federal policy are needed to extend these protections to independent workers. In a promising first step in the U.S., Representative Eleanor Holmes Norton (D-D.C.) introduced a bill in Congress to what would do just that.

3. Rethink Income Protection

An essential goal of labor markets in the U.S. and the EU is to protect worker income. Current income protection policies, including unemployment insurance, the minimum wage, and preferred retirements savings plans, currently apply to employees in traditional jobs. There are no similar policies to protect the income of independent workers. The Gig Economy offers us a chance to revisit the intent and structure of existing policies and rethink the type of income protection we want to offer to all workers. There are several ways we can consider changing existing policies to include everyone who works.

Replace Unemployment Insurance with Income Insurance

Unemployment insurance protects employees' incomes if they lose their jobs. But a growing percentage of today's workforce don't need unemployment insurance, because they don't have a traditional job. They need income insurance if they lose a significant amount of work. The basic idea of income insurance is the same as unemployment insurance: to provide a minimum level of financial stability without creating incentives to stop working.

To create a system that provides income protection for everyone who works, companies would make prorated income insurance payments for all workers they hire. Since companies already have systems and mechanisms for making unemployment insurance payments, those processes could be extended to make prorated income insurance payments for all workers.

Reconsider the Minimum Wage

Lower skilled employees in entry-level jobs are protected by hourly minimum wage laws. In the U.S., nearly 60% of the workforce is paid hourly, and although just 2% of them earn the minimum wage or less, they are some of the most vulnerable workers.

Yet, minimum wage laws offer limited protections to those workers. Earning the minimum wage, even as a full-time worker, doesn't guarantee a life above the poverty line. Minimum wages don't come with minimum benefits. And the minimum wage isn't a promise of a minimum income, since employers usually control the number of hours someone can work.

The changes in the way we work encourage us to consider whether an hourly minimum wage still makes sense if it only offers a life of poverty. Should workers instead be guaranteed a minimum income? Should a minimum wage or income include the cost of basic benefits such as health, disability, and life insurance and some retirement savings? After all, how much protection does a minimum wage really offer, without an accompanying safety net of benefits?

It's also important to recognize that the minimum wage doesn't apply to all types of work. In our traditional economy, freelance writers, along with many other creative professions, have not been subject to minimum wages. Most freelancers are paid on a project or deliverable basis, with no calculation at the end to determine how many hours it took. As more workers take on project-based work, it raises the question of whether we should extend wage protections to workers who can set their own rates and control their own effort? If so, what would that look like?

Reform Retirement Savings

Pensions have traditionally provided income protection for employees after they stop working, but the pension system is facing numerous challenges. Government pension funds are in trouble. They are underfunded and struggling to meet their obligations to beneficiaries who are living longer. Corporate pension funds face the same pressures of increasing costs and longer beneficiary lives. Companies are responding by opting out of the retirement savings game by phasing out or eliminating their pension plans for new workers (who aren't likely to have a long corporate career anyways).

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Governments and companies are no longer taking responsibility to provide income to workers once they stop working. That leaves individual workers to save for their own retirement, which, if relied upon, is a public policy disaster in the making. In the U.S., where the responsibility for retirement savings has already been largely shifted to individuals, the results are terrifying. Nearly half of Americans have not saved enough to replace even one year of income in retirement, and the same percent have saved insufficiently for retirement under normal scenarios of health and longevity. This lack of savings is persistent across income levels. Both high- and low-earning workers, including many employees, fail to save sufficiently – or at all – for retirement.

Instead of saving, workers are working, or planning to work, beyond traditional retirement age. That strategy is reasonable as long as the later years are healthy ones, but in many cases they are not. More than 40% of workers leave the workforce involuntarily, due to their own, or their spouse's, poor health or disability. Many others leave due to mandatory retirement ages, age discrimination against older workers, or changes at their company that result in involuntary job loss.

Any realistic solution for paying for retirement will include more than one payor and will continue to rely at least partially on the corporate contributions that have traditionally funded retirement. Today, many companies provide contributions to retirement savings for their employees. One approach is to require companies to contribute prorated retirement savings for all their workers, not just employees. An option for helping individuals save more is to implement more automatic savings plans. These plans have proven to be successful at increasing savings rates.

Going Beyond Labor Market Reforms to Support the Gig Economy

Governments can support the changing workforce and the Gig Economy through policies and initiatives that go beyond transforming labor laws. Two important areas to focus are preparing the workforce to successfully compete for work globally and recognizing the role of innovative startups in supporting independent work.

Prepare the Workforce to Compete Globally

Governments have long exercised control over their national workforces via immigration policy. The rise of both independent and remote work does an end-run around these traditional controls. Companies seeking knowledge workers with particular expertise or skills no longer have to bring workers to a physical location to employ them. They can find and recruit skilled workers from around the world and hire them in their current locations, without the need for work visas.

As remote work becomes more common, so too will globally distributed workforces, particularly among the most highly skilled knowledge workers. This trend benefits companies who can more easily access the precise talent they need. It also benefits the workers who are hired for better work and compensation than their local alternatives. The negative impact is on workers who may not have the skills, work ethic, or knowledge to successfully compete in a global market.

Governments are so far ignoring this trend. They have yet to respond to this technology-enabled work drain and remain myopically focused on preventing foreigners who are physically in the country from working in traditional jobs. It's an increasingly ineffective approach. The knowledge workforce now competes for work across borders and around the world. Countries that focus on offering the best education and training systems to their citizens will be best positioned to create the most competitive workforces globally.

A New Labor Market for All Workers

Labor and tax policies that support only employees in traditional jobs make less and less sense in a workforce that is increasingly made up of independent and Gig Economy workers. Creating a labor market that supports everyone who works requires a new way of thinking about worker classification and extending the benefits, rights, and income protections awarded to full-time employees to all workers. It's a monumental political undertaking but a necessary one if we want to maximize the potential of the Gig Economy and our increasingly independent workforce. ■

Recognize the Role of Startups

Innovative startups have a critical role to play in supporting independent workers and the growth of the Gig Economy. They can create products and services that make it easier and more efficient for people to find work, and for companies to recruit and hire independent workers. They can also help companies provide benefits to workers and manage compliance with labor regulations, as well as make it easier for workers to pay taxes, save for retirement, manage their income, and access benefits. For example, technology platforms such as Catalant, TopTal, and Upwork efficiently match independent workers and companies with projects and assignments: They are the new recruiters of the Gig Economy. Companies like Stride Health are making it more efficient and increasingly automatic for independent workers to save for and pay taxes, purchase health insurance, and manage the back office and administrative functions of being self-employed. EdX, Coursera, Udemy, and NovoEd and other online learning platforms make it possible for workers to acquire skills and knowledge when, where, and as quickly as they want at low or no cost. These companies are disrupting traditional education, as well as corporate learning and development.

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About the Author

Diane Mulcahy is the author of *The Gig Economy: The Complete Guide to Getting Better Work, Taking More Time Off, and Financing the Life You Want* (Harper Collins), a best-selling book on Amazon that has been translated into five languages.

Ms. Mulcahy is an Adjunct Lecturer at Babson College where she created and teaches the first MBA course on the Gig Economy.