FRESH PERSPECTIVE SERIES

The On-Demand Economy and Worker Benefits and Protections

By James C. Capretta
American Enterprise Institute
Resident Fellow
THE FUTURE OF WORK INITIATIVE is a nonpartisan effort to identify concrete ways to strengthen the social contract in the midst of sweeping changes in the workplace and workforce. The Initiative is focused on two key objectives: first, to advance and protect the economic interests of Americans in the independent workforce, including those in the rapidly growing on-demand economy; and second, to inspire a 21st-century capitalism which rewards work, fuels innovation, and promises a brighter future for businesses and workers alike. The Initiative is driven by the leadership of Honorary Co-Chairs Senator Mark Warner and Purdue University President Mitch Daniels with Co-Chairs John Bridgeland and Bruce Reed. For more information visit as.pn/futureofwork.

ABOUT THE FRESH PERSPECTIVE SERIES

THE FRESH PERSPECTIVE SERIES is a collection of independent works from expert authors across the ideological spectrum, each presenting new ideas for how various aspects of the social safety net could be updated to better meet the needs of our 21st century workforce. The economic landscape is changing far faster than our system of workplace protections and benefits has been able to keep pace – requiring fresh ideas for how to revitalize our social contract and restore the promise of work. The Future of Work Initiative is committed to the goals of promoting new and creative thinking, sparking bipartisan policy discussion, and working together to help create a healthier economic climate for all stakeholders. The ideas and proposals included are those of the authors, with editorial support from Future of Work Initiative staff.
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INTRODUCTION

THE GROWTH OF THE “ON-DEMAND” services sector has spurred a vigorous debate on the changing nature of the U.S. economy and the implications for American workers.

The “on-demand” economy refers to the growing number of businesses that connect service providers to customers through the assistance of information technology -- particularly “apps” accessible on smart phones. Uber and Lyft drivers are the most commonly-cited examples of the growing phenomenon, but there are others, including maid and handyman-type services, grocery and restaurant food delivery, data programming for academic research, and even short-term management consulting. Many other on-demand businesses are now in development and expected to emerge in the coming years.

Technology is what makes these new firms viable. Entrepreneurs and developers create internet software and “apps” that connect a service and a customer, making it much easier and more convenient than ever before.

This technology isn’t just breaking new ground with customer service – it’s also pioneering new ways to organize, manage, and deploy workers. Many of the people who work in the on-demand economy are not employees, but rather self-employed independent contractors. Consequently, they have fewer obligations than typical workers do, but also get much less in terms of the social protections that have been extended to workers in various federal and state laws.

The on-demand economy is still nascent and its long-term trajectory is far from clear. But there is an expectation that it will grow as technology improves and customers find its convenience more and more attractive. It is therefore appropriate to consider at this time what the effects of the on-demand economy might mean for workers, and whether adjustments in public policies are warranted.

A useful starting point for considering this subject is the proposal by Harris and Krueger to create a new category of worker, the “independent worker,” to address the growing number of people working in the on-demand economy.1 A discussion of that proposal follows, along with a description of an alternative approach that would be more consistent with existing law and less disruptive to the dynamic growth of this new sector of the national economy.

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A PROPOSAL FOR “INDEPENDENT WORKERS” IN THE ON-DEMAND ECONOMY

Much of the discussion about the on-demand economy comes from a perspective of concern that the firms connecting customers and service providers may also be undermining social protections that have been extended to employees in more traditional work. In particular, there is a concern that these firms are using large numbers of independent contractors even though the relationship between these companies and the service providers has some characteristics of an employer-employee relationship.

In the United States, several laws have extended protections for workers covering minimum wages, overtime pay, non-discrimination, family and medical leave, workers’ compensation, unemployment insurance, health insurance, and pension benefits. Some worry that newly emerging firms in the on-demand economy are avoiding the requirements these laws impose by classifying the people who work for and with them as independent contractors rather than employees.

The question of what constitutes an employer-employee relationship is a subtle one. Harris and Krueger make the point that workers in the on-demand economy do not fit the definition of a traditional employee because these workers are not making the kind of commitment that employees typically have to make to become “employed,” particularly in terms of giving up some of their freedom over the allocation of their time. Typically, employees are required as a condition of employment to work at times and in places that are most convenient and profitable for the employer. The employees’ obligations to their employers also often mean that they have less ability to earn income in other ways. Consequently, there is a dependent relationship between employees and employers, which is the primary reason for numerous public policies protecting these workers in various ways and requiring their employers to make available various benefits associated with employment.

At the same time, Harris and Krueger also state that workers in the on-demand economy do not fit the definition of independent contractors either, because these workers typically do not have the power to negotiate the terms of their compensa-
tion from their customers or the intermediary firms. In the on-demand economy, the compensation is generally set by the technology firms, and is non-negotiable. This is different from the typical independent contractor – like a painter – who sets his own price when bidding for work from various customers.

Based on this assessment, Harris and Krueger conclude that it is time to create a third category -- the “independent worker.” Workers in this new category would not be employees, but they also wouldn’t be “on their own” independent contractors either. Rather, Harris and Krueger propose to give independent workers some additional rights and protections:

- Independent workers would have the freedom to organize and collectively bargain, as employees do today, by granting workers in this new category exemptions from anti-trust law statutes that might prevent them from jointly setting conditions for their compensation from firms competing in the on-demand economy.

- Firms in the on-demand economy would be granted the authority to voluntarily pool resources on behalf of independent workers -- for purchases such as group health and disability insurance – without opening up the firms to the contention that the workers are employees.

- Independent workers would be granted the same non-discrimination protections that apply to employees and prospective employees.

- Firms would be required to pay the employer share and withhold the employee share of Federal Insurance Contribution Act (FICA) tax payments from the compensation paid to independent workers. In addition, these firms would be required to withhold income tax payments from this compensation.

- States would be allowed to grant firms employing independent workers the ability to opt into workers’ compensation systems in return for protection from lawsuits brought by the independent workers based on workplace accidents and injuries.

- Firms would be permitted to facilitate the pooling of voluntary unemployment insurance arrangements among independent workers, although the workers would be ineligible for the federal-state unemployment compensation system based on their earnings as independent workers.

“The question of what constitutes and employer-employee relationship is a subtle one. Harris and Krueger make the point that workers in the on-demand economy do not fit the definition of a traditional employee because these workers are not making the kind of commitment that employees typically have to make to become “employed,” particularly in terms of giving up some of their freedom over the allocation of their time.”
Firms would be required to make payments of 5 percent of the net compensation they pay to independent workers to support their enrollment in health insurance offered through the Affordable Care Act’s exchanges. The independent workers would not get employer-sponsored insurance but would get employer support for their premium payments.

**A MARKET INNOVATION FOR CONSUMERS AND WORKERS ALIKE**

Harris and Krueger’s proposal for independent workers hinges on the view that these workers need some assistance from public policy because they are not like independent contractors, who are said to have more ability to negotiate the terms of the financial relationship with their customers than on-demand workers are today. And it is certainly true that the big on-demand firms – particularly Uber – set the compensation they provide for their service providers on a take it or leave it basis. Uber drivers do not have the ability to set their own rates.

But it is important to realize that labor markets are, when functioning properly, two-way streets. The firm seeks the assistance of workers or service providers by offering them compensation; it is up to the workers and potential employees to decide if the compensation is satisfactory for the work they will be asked to perform. If the compensation seems inadequate to draw a sufficient and qualified pool of workers, then the firm must adjust what it is offering to make it more attractive so that it can meet the needs of its customers.

What is notable about the technology now disrupting so many service sectors in the on-demand economy is that the opportunity to use the technology to satisfy a consumer need is highly attractive to both the customers and to the service providers. The new technology makes it easier and more convenient for people with an asset – a car or a skill requiring some training and experience – to earn an income on that asset. For many people, this is a highly attractive prospect, freeing up an underutilized source of income. This is the key to making the successful on-demand firms work – they are able to unlock a labor supply that was previously largely dormant.

Moreover, the compensation that is provided to drivers for Uber and other on-demand workers must be understood both as the dollar compensation and the ease with which it is earned. For many Uber drivers, the compensation is perfectly fine, even attractive, at the levels set by the firm because they can earn it when they want to, and there is no obligation to work on a fixed schedule.

As of the end of 2015, Uber had more than 400,000 active drivers, 69 percent of

“The compensation that is provided to drivers for Uber and other on-demand workers must be understood both as the dollar compensation and the ease with which it is earned…. [Uber] drivers generally report being satisfied with their experience with Uber because of the flexibility the firm offers to them.”
whom had other full-time or part-time work. These drivers generally report being satisfied with their experience with Uber because of the flexibility the firm offers to them. They drive when they have the time to do so. The success of the firms in the on-demand economy in attracting the service suppliers that make their businesses viable is direct evidence that the compensation these firms are offering is attractive enough for their business plan.

Many workers in the on-demand economy also have other employment that is not in any way restricted by their participation in this new and emerging slice of the economy. These workers often get health care and other benefits from one employer and then supplement their income in the on-demand economy.

Some may argue that Uber and other on-demand firms, by not offering health and other benefits to their independent contractors, are “free riding” on companies that provide more traditional benefits to their employees. But this perspective is off-base. In competitive labor markets, employer-provided fringe benefits come out of the total compensation paid to employees, so it is the workers, not the firms, who ultimately pay for health insurance and other protections. Moreover, firms that hire employees do so because that approach to deploying labor is consistent with their business plan. More than likely, these firms could not survive by working only with independent contractors. Uber and other on-demand firms are different. They have built business models – centered on information technology – that explicitly allow them to rely on a loosely affiliated group of independent contractors who only work when they want to.

Absent evidence to the contrary, the labor market should be trusted to properly match workers and firms to maximize efficiency. At the moment, there is very little evidence of any market failure.

**UNINTENDED CONSEQUENCES**

An important reason for exercising some caution in public policy regarding worker protections is the very real prospect of unintended consequences from steps intended to help workers. In particular, the proposal to create a new third category of worker – the “independent worker” – could inadvertently result in a loss of income and social protection for the people the policy is intended to help.

Today, employers must choose to either hire workers as employees or engage with independent contractors to get the services they need to run their businesses. If employers are given a third choice that entails less expense, less long-term commitment, and fewer risks, it would seem possible that the main effect would be to

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encourage more employers to redefine their workforce to fit within the new model. This could mean a larger migration of people out of employed status and into independent worker status than from independent contractor to independent worker. After all, there are far more people who are currently employees of firms than who are working as independent contractors, and thus far more potential for migration out of employment than out of independent contracting.

In addition, the combination of proposed benefits for independent workers would raise costs on employers well above what they are today. Harris and Krueger’s proposed requirement to pay a 5 percent fee for health insurance on all compensation earned by independent workers would be the equivalent of a new tax on this sector of the economy. Employers will be unlikely to pay much of this tax, as they will adjust the compensation levels of their workers and also raise their prices. The net effect, however, will be to squeeze the ability of the new firms to run their businesses as they can today, which means these firms will contract or grow less rapidly than they would without the new costs and restrictions associated with independent workers. This will mean reduced incomes for those people who would have been willing to engage with these firms without the added protections of independent worker status.
A BETTER APPROACH

Instead of creating a new category of worker, with new obligations on the employers who hire them, it would be better to examine what can be done to improve the social protections of these workers by working with the current classification system and making adjustments as necessary.

The goal of any adjustments should be to improve the social protection available to workers in the on-demand economy without misallocating resources in ways that are contrary to the wishes and interests of these workers. In general, this means not imposing expensive new burdens on the firms -- which will inevitably lead to lower incomes for the workers -- but to facilitate improved protection for workers who prefer and desire more flexible working arrangements.

Of course, it is possible that myopia is at work here. Society has an interest in ensuring the general economic security of its workers, and some independent contractors may inappropriately undervalue these benefits and protections and thus forgo taking the steps necessary to secure them on their own. This may be particularly true for health insurance and retirement savings. But there are already other laws on the books addressing these questions (including the recent enactment of the Affordable Care Act, which penalizes taxpayers for failing to enroll in a health insurance plan). Instead of imposing new burdens on workers in the on-demand economy, it may be more beneficial to examine proposals advanced in recent years to improve the portability of job-based benefits for workers with lower wages, more self-employment, and less enduring connections to large, stable firms. These efforts point to an agenda that could be beneficial to the workers now engaged in the on-demand workforce without undermining the dynamism of this important new sector of the national economy.

SOCIAL SECURITY AND MEDICARE CONTRIBUTIONS

The Social Security and Medicare programs provide protections for workers. Workers make payroll contributions to the program based on their earnings and receive benefits if they become disabled or when they retire (or reach age 65 in the case of Medicare). The disability protections are particularly important to workers and generally beyond what could be purchased through private insurance options. It is therefore important that independent contractors make contributions to these pro-
grams and earn the protection they provide.

Under current tax law, there is no reason that independent contractors, including those working in the on-demand economy, would not earn credits toward Social Security and Medicare protection. Tax law requires self-employed individuals to make contributions to the programs at a rate that is equivalent to the total amount paid by employer and employees on the same level of income. Those taxes are collected as part of the income tax filing system, but independent workers are also required to make quarterly tax payments (instead of lump sum payments with their annual returns) to ensure federal receipts are spread throughout the year. Taxpayers that fail to make quarterly payments are potentially subject to penalties.

There is no clear evidence indicating that independent contractors in the on-demand economy are paying their taxes into the programs at a lower rate than is otherwise seen in the self-employed economy. However, there is emerging survey data indicating a serious lack of information among these workers regarding their tax obligations, with the potential that many of them will inadvertently run afoul of current tax law.3

The solution to this problem is to encourage the IRS to do a better job informing independent contractors in the emerging on-demand economy of their taxpaying obligations, along with the important protections that come with paying Social Security and Medicare taxes. A voluntary program of tax withholding, at the election of the employer, could also be explored. This would be a benefit to workers that on-demand firms could offer, but they would not be required to do so. If important to workers, such a benefit could become an additional selling point attracting workers to firms selecting this option.

**HEALTH INSURANCE**

Health insurance is arguably the most important job-based benefit provided in the United States. As of 2012, there were 170 million Americans with health benefits financed, at least in part, by employers.4

For many years, the market for health insurance for people outside of employer-sponsored coverage was feeble and inadequate. The federal government provided a large tax benefit for job-based insurance but no assistance for people purchasing coverage directly from insurance companies. Consequently, only people who had no other choice bought their insurance in the individual market.

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The 2010 Affordable Care Act (ACA) was aimed in many ways at making the individual market work better for people without the option of a job-based plan. The law provides substantial financial support to households with incomes above the eligibility level for Medicaid but below four times the poverty line. This assistance is especially generous for households with incomes in the range of 138 percent of poverty to about 250 percent of poverty. These households can use the federal financial support provided to them to purchase coverage on the ACA’s exchanges with reduced premiums for themselves. As of March 2016, there were 11.1 million Americans enrolled in health insurance on the ACA’s exchanges.5

Key Republicans in Congress also support providing assistance in purchasing insurance to households without access to employer-sponsored coverage. The GOP leadership in the House recently introduced a comprehensive plan to replace the ACA and make other changes in Medicare and Medicaid.6 Under the plan, any household without the offer of a job-based plan would get a refundable federal tax credit that could be used to purchase a state-approved insurance plan.

So long as the ACA remains in effect, or is replaced by something similar to what the House GOP is proposing, there is little reason to propose other changes just for workers in the on-demand sector. If a worker earns all of his income as a driver for Uber, and his income is moderate, he is eligible to purchase coverage through an ACA exchange and receive federal subsidies. Proposals to force firms competing in the on-demand economy to make contributions on behalf of their workers to health insurance would only come at the expense of the earned income of those workers. The result would be lower incomes for workers and therefore higher premium subsidy costs (unless the schedule of subsidization were to be adjusted for employer contributions). There is no convincing reason to do this, as the workers already have access to this insurance today without further governmental intervention.

RETIREMENT SAVINGS

Employer-sponsored retirement savings is also an important component of the nation’s social welfare system. According to government statistics, about 80 percent of full-time workers in the U.S. have access to an employer-sponsored 401(k) retirement savings plan, and about 64 percent of all full-time workers contribute to such plans.7 These retirement plans are completely portable because they are owned by the workers.

Workers therefore take their savings with them when they switch jobs.

The contribution rate toward retirement savings is much lower among self-employed people. Current law provides some attractive options for self-employed workers, including the Self-Employed Pension IRA, which allows self-employed tax filers to set aside a substantial portion of their earnings in a tax deductible retirement savings account. But many studies have shown that inertia and the transaction costs of setting up a plan can be barriers to properly preparing for lost income in old age. And Social Security’s benefit levels are far below what is needed for most people to sustain the lifestyle they had while working into retirement.

Several proposals have been made to improve options for self-employed workers. One would be to allow firms, and workers, to make contributions to 401(k) plans sponsored jointly among firms. Another option would be to have states set up simplified 401(k) plans to which small firms and self-employed workers could contribute. The pooling effect of the plan would lower the transaction costs for everyone. States could also require firms engaged with independent contractors to withhold contributions from the compensation paid to their contractors if the contractor elected to participate in the plan. The requirement to withhold retirement contributions at the request of independent contractors could be limited to firms engaged with a sizeable number of such contractors so that the requirement doesn’t apply to firms for whom this would be a burden.

As the on-demand economy grows, and independent contractor work increases as a percentage of total compensation, it is important to make it simpler and more convenient for such workers to save for their retirement needs. Today’s approach works well for employees of mid to large firms, but not as well for others.

**WORKERS’ COMPENSATION**

The workers’ compensation system provides employers with immunity from some legal actions taken by injured workers in return for an experience-rated system of pre-determined payments to workers for such injuries. This system is generally only available to firms and their employees, not independent contractors.

It makes good sense to open up this system, on a voluntary basis, to firms who deploy a large number of independent contractors as part of their services for customers. The firms that opt in would be required to make premium payments to the state compensation system, which would be an added expense for these companies. It is therefore possible that these contributions would effectively lower the amount these firms make available as compensation for their independent con-
tractors. However, it is also possible that a firm’s payments to a state workers’ compensation program would be less, over time, than the payouts to plaintiffs bringing suits against the company for workplace injuries.

Moreover, because these programs charge experience-rated premiums, firms have a strong incentive to minimize the risk of injury for their workers. Applying that same incentive to large numbers of independent contractors who work closely with such firms could be an important step toward better safety in a number of areas, including on the roads. On-demand firms may be reluctant to exert control over the manner in which the work is conducted out of fear that control opens them up to more legal exposure. The voluntary workers’ compensation program needs to be designed carefully to ensure there is an overall incentive for firms to take on more responsibility for the safety of their associated contractors rather than less.

**UNEMPLOYMENT COMPENSATION**

The most difficult protection to extend to independent contractors is protection against lost income due to unemployment. Unemployment insurance makes sense when a worker is dependent on an employer, and is thus vulnerable to lost income when the employer goes out of business or lays off workers to cut costs. The worker is not responsible for the lost income in those instances.

For independent contractors in the on-demand economy, it is often entirely up to the worker how much time they put into the enterprise. A driver for Uber can work as much or as little as he would like to. It is impossible to design a stable insurance system when the insured person has nearly complete control over when and how to trigger the event causing the insurance payout. This is the same conclusion Harris and Krueger reached in their assessment of the on-demand economy.

The best alternative approach to improving the financial security of workers in the on-demand economy is to allow them to set aside resources that they could later tap during a period of lower earned income. Firms could be asked to facilitate independent contractor contributions to a 401(k) plan that could also serve as a cushion during periods of lower earned income. Conditions could be established for withdrawing funds without penalty to allow individuals with a history (above some minimum) of independent contractor income to supplement their incomes during periods of lower incomes. Those who access funds in this manner could be required to repay the amounts when their incomes, as shown in tax filings, exceed a certain threshold.
CONCLUSION

New technology is opening up many new possibilities for earned income. The on-demand economy is allowing people with underutilized assets to begin generating income streams from those assets. This is a highly valuable change in their lives. The importance and popularity of this development is evident in the relatively large numbers of people who are participating in this new segment of the economy as suppliers of services.

It is of course a concern if large numbers of Americans are going without the social protections that have been built up around traditional employment. But there is little evidence at this point of such a development. It is more likely that the on-demand economy is serving as a supplement for many people to their traditional employment, not as a substitute.

Moreover, policy has been moving gradually over many years toward improving the ability of fully self-employed Americans to protect themselves, with health insurance, retirement savings, and disability protection. More can and should be done to facilitate the ability of persons with self-employment income to access programs and policies that put them on the same level as employees in terms of social protections.

But these steps, if done carefully, can be fully consistent with a thriving on-demand economy, which promises to be as helpful to those supplying the services as it is to the customers who use them.
James C. Capretta is a resident fellow and holds the Milton Friedman chair at the American Enterprise Institute, where he studies health care, entitlement, and US budgetary policy, as well as global trends in aging, health, and retirement programs. In 2015 and 2016, he directed two major studies: one on reforming US health care according to market principles and consumer choice, and the second on reforming major federal entitlement programs to promote greater personal responsibility, focus limited resources on those most in need, and lower long-term federal expenditures.

Mr. Capretta spent more than 16 years in public service before joining AEI. As an associate director at the White House’s Office of Management and Budget from 2001 to 2004, he was responsible for all health care, Social Security, welfare, and labor and education issues. Earlier, he served as a senior health policy analyst at the US Senate Budget Committee and at the US House Committee on Ways and Means. Mr. Capretta was also a fellow, later a senior fellow, at the Ethics and Public Policy Center.

Mr. Capretta’s essays and reports include “Improving Health and Health Care: An Agenda for Reform” (AEI, 2015); “The Budget Act at Forty: Time for Budget Process Reform” (Mercatus Center, 2015); and “Increasing the Effectiveness and Sustainability of the Nation’s Entitlement Programs” (AEI, 2016). His book chapters include “Health-Care Reform to Lower Costs and Improve Access and Quality” in “Room to Grow: Conservative Reforms for a Limited Government and a Thriving Middle Class” (YG Network, 2014); and “Reforming Medicaid” in “The Economics of Medicaid: Assessing the Costs and Consequences” (Mercatus Center, 2014).

He has been widely published in newspapers, magazines, and trade journals, including Health Affairs (where he is a member of the Editorial Board), The JAMA Forum, National Review, The Wall Street Journal, and The Weekly Standard. His television appearances include “PBS NewsHour,” Fox News, CNBC, and Bloomberg Television.

Mr. Capretta has an M.A. in public policy studies from Duke University and a B.A. in government from the University of Notre Dame.
The Aspen Institute is an educational and policy studies organization based in Washington, DC. Its mission is to foster leadership based on enduring values and to provide a nonpartisan venue for dealing with critical issues. The Institute is based in Washington, DC; Aspen, Colorado; and on the Wye River on Maryland’s Eastern Shore. It also has offices in New York City and an international network of partners. For more information, visit www.aspeninstitute.org.