Labor Standards, the Fissured Workplace, and the On-Demand Economy

David Weil and Tanya Goldman

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Weil and Goldman discuss labor standards in the gig economy

- A business pays more for a person it employs directly than for a person paid by a contractor hired by the business to perform tasks; these tasks range from landscaping to software coding.
- The existing structure of U.S. labor standards is an effective tool in determining worker status in the gig economy.
- Existing U.S. labor laws are not an impediment to "growing an innovative on-demand company while providing workers with basic labor standards, decent wages, and core benefits."

If one attended one of the many Future of Work conferences and events in the past year, it would be easy to conclude that the majority of workers now and in the future will work for tech companies like Uber, Lyft, and TaskRabbit. There is no question that the on-demand sector is in a period of rapid growth and innovation.

The market capitalization of several well-known on-demand companies indicates that investors anticipate that they will create significant value in the future. Uber, for example, is currently valued at $62.5 billion (Isaac 2016). They may also provide new opportunities for people to work in flexible ways that may address some long-standing concerns of work/family balance.

But the preoccupation with the on-demand sector and its depiction as the embodiment of the future of work is empirically inaccurate. Best estimates today put total employment in on-demand companies at less than 1 percent of the workforce (Katz and Krueger 2016). Even with anticipated rapid growth of the sector, it is highly unlikely that a significant proportion of the workforce will be engaged on these platforms.

A myopic focus on the on-demand world obfuscates more fundamental changes that have become pervasive across a wider spectrum of industries. In this article, we discuss the importance of these larger-scale changes in framing policies in the on-demand sector and evaluate the issues related to the employment relationship arising in on-demand businesses.

The On-Demand Versus Fissured Economy

Workplace changes arising from digital technologies are part of a much broader context of profound changes that have and will continue to transform the workplace for millions of workers. In the past three decades, leading companies in a wide variety of sectors have sought ways to shed activities and shift them to other businesses while continuing to focus on providing the products and services consumers identify with—and that investors value in terms of their financial returns.

The hotel worker who cleans your room, the cable installer who shows up to your house, or the driver who provides same-day delivery of your package are not necessarily employees of the company whose name adorns their uniform or from which you placed your online order. They may very likely be employed by a staffing firm or subcontractor that has been hired by the company you're paying for the product or service.

Capital markets drove this evolution as major companies sought to improve their financial performance for private and public investors by focusing their businesses on core competencies—that

is, what provides greatest value to their consumers and investors (for example, Apple's competency in developing and marketing new products). A natural complement of this approach was to "shed" activities not essential to the organization's core competency. Typically, this started with activities such as payroll, publications, accounting, and human resource functions. It spread to outsourcing activities such as janitorial services, facilities maintenance, and security. But then, the shedding went deeper—in many cases, into employment activities that would be regarded as core to the company, such as the cable installer in our example.

This changing business model, the "fissured workplace," means that in more and more workplaces, the employment relationship has been broken into pieces, often shifted to subcontractors, third-party companies, or, more troubling, to individuals who are treated as independent contractors (Weil 2014). Fissuring is accomplished through a variety of business models: subcontracting, use of temporary agencies and labor brokers, franchising, licensing, and third-party management. Many business models in the on-demand sector represent a deepening fissuring of the workplace, as technology and software algorithms enable companies to further outsource significant proportions of the work.

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Although the fissured workplace arises in part from an effort to thwart the attributes of a traditional employment relationship (such as responsibility for compliance with basic labor standards and health and safety requirements, as well as payments into workers compensation and unemployment insurance systems), it is mistaken to view that as the sole driving force.

But whether the fissured workplace is associated with legitimate or illegitimate practices or motives, employment relationships are more tenuous, responsibility for legal compliance is shifted, and the workforce becomes vulnerable to violations of even the most basic protections of our laws. Workers at the bottom of fissured business models too often receive low wages, no benefits, and insecure employment and face violations of labor standards and health and safety protections.

The expansion of the fissured workplace probably plays a critical role in another unfortunate feature of the past few decades: the growth of earnings inequality. Increasing inequality can arise from growing differences in earnings *within* firms (rising dispersion of earnings of the workers "inside" the walls) versus growing earnings differences *between* firms (more dispersion in earnings "outside" the walls of a firm).

The fissured workplace can lead to growing inequality from the latter (that is, increased variation of earnings across firms). Lead businesses capture the lion's share of profits as a result of their core competency. Those companies continue to share some of those gains with the workers who remain inside their walls. At the same time, the outside companies competing to perform the services shed by lead businesses have lower profitability and therefore less to share with their workforce.

At the bottom of fissured workplaces, where firms compete to provide more homogeneous products and services for lead businesses, in more competitive markets with lower barriers to entry, one finds businesses with lower profitability, paying wages closer to marginal productivity.[1]

There is growing empirical evidence of these effects. As decisions about wages are pushed out by leading companies to subcontractors and other parties, the value they created moves away from being shared with the workforce and toward investors. A business will pay considerably more for a person it pays directly—whether a janitor, security guard, or software coder—than to a person who is paid by a contractor to that business.[2]

As work is increasingly shifted out, the chances of "working up from the mailroom" evaporate, as do opportunities for training, mentoring, and skill development—concerns we also see in the on-demand sector. As a result, growing dispersion of earnings can be thought of as a "big bang" that is leading firms to rush away from one another, with lead businesses and their set of workers moving upward and subordinate firms and their associated distribution of earnings moving downward.[3]

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It is the expansion of all of these types of employment relationships, and not just of jobs in the on-demand sector, that best characterizes the future of work. A recent study by Katz and Krueger (2016) suggests that from 2005 through 2015 somewhere between 80 percent and 100 percent of net employment growth occurred in workplace arrangements that can be characterized as fissured.

The scale of these changes can also be seen in segments of the workforce where fissuring has become widespread. Contrasted with the estimated 600,000 workers in the on-demand sector (Harris and Krueger 2015), we estimate that there are more than 29 million workers in just ten industries affected by the fissured workplace.

As we think about the future of work, it is critical to concentrate on these more fundamental and pervasive changes and not become distracted by the bright, shiny objects that appear on our smartphones. If we do not focus on policies that address the consequences of the fissured workplace, millions of workers will bear greater risks and further erosion of basic labor standards—not to mention additional growth in earnings inequality.

Economic Realities of On-Demand Business Models

But what of the on-demand sector? Even if it remains a smaller part of the economy, how should we think about the adequacy of existing policies to address it? In particular, there have been a number of recent proposals about how to protect workers in the on-demand sector while preserving innovation.

These proposals address the perceived lack of fit between emerging digitally based business models and existing approaches to the workplace (in particular, the definition of who is an employee). To quote one of the more extreme views, "Internet platforms also have turned a bright spotlight on the country's labor laws, which are showing themselves to be hopelessly outdated as they impose rigid divisions between employees and independent contractors" (Kennedy 2016). Calls for new worker classifications, regulatory safe harbors, and other policies aimed at on-demand companies would also ripple over to the wider brick-and-mortar economy.

Emerging business models always encounter tension with existing approaches to defining employment.

Emerging business models always encounter tension with existing approaches to defining employment. As Liebman and Lyubarsky note in their article, "Crowdwork, the Law, and the Future of Work," in this issue of *Perspectives on Work*, the Supreme Court has recognized long-standing conflicts regarding "the borderland between what is clearly an employer–employee relationship and what is clearly one of independent entrepreneurial dealing" (*NLRB v. Hearst Publications* 1944).

Nonetheless, our existing structure of labor standards embodied in the Fair Labor Standards Act (FLSA) is remarkably well-suited for analyzing worker status in these new arrangements.[4] To see why, it is useful to examine the underlying nature of on-demand platforms.

At the risk of oversimplification, the on-demand world can be usefully broken into two broad business models. In one model, *digitally enabled market platforms*, a digital app connects potential users of services with providers. Similar to Etsy or eBay, except they are markets for services, not goods, the app serves as a method of linking markets by providing potential users nuanced information about providers (such as other customer evaluations of the service and information on provider expertise) in a low-cost way to transact business between the parties.

Those suppliers are more likely to be acting as true independent contractors, at least as defined by the FLSA. Among other factors, suppliers typically set their own prices, compete on the basis of their individual reputations, make decisions that will affect their individual profit or loss, and provide services that are not integral to the app itself.

In contrast, *digitally enabled branded platforms* connect potential users with a service that has been carefully crafted to have certain qualities, characteristics, and benefits. In that system, the app provides users with a service that has a specific quality standard—characteristics that are ensured by the provider, and in most cases a pre-specified price for services set by the platform and not the individual providers. In general, branded platforms specify to their providers the type of service, the prices that will be allowed, the timing, and in some cases the place where services will be delivered, as well as other central attributes of the service.

For digitally enabled branded services like these, the business model requires service providers to be integrated into the platform, limiting the ability of those providers to earn profit or sustain losses on the basis of their individual decision making. These providers typically make a relatively low investment in their provision of the service and do not have unique skills that provide them an independence from the platform by which they are connected (such as a person who delivers packages to a pre-specified list of addresses). Although every case needs to be evaluated based on specific facts, the economic realities test used under the FLSA might characterize relationships under these circumstances as indicative of employment.

The recent history of several on-demand companies illustrates how many businesses in the digital space are recognizing the value of a digitally enabled branded platform model. Companies like Hello Alfred, Bridj, and Luxe have embraced employment for their businesses. Companies like Instacart, Honor, and HomeHero have moved some or all of their workforce into employee status. Public accounts of these businesses suggest that the choice of business model drives the decision to treat their workforce in this manner.

For example, Hello Alfred provides services that require its workforce to have access to their clients' personal information and homes (Sapone 2016). Given the potential stakes of this relationship, it is not hard to see why Hello Alfred has strong incentives to carefully select, train, manage, retain, and if necessary, terminate people who provide those services because the company's value proposition depends on trust between the client and the provider. Similarly, Honor, a provider of home care services, understands that the value of its business model stems from the standards, capabilities, and trust that customers have in the company's caregivers.

The two business models illustrate a larger principle. Rather than requiring new types of employment designations, as have been advocated elsewhere (such as the Harris and Krueger "independent worker" classification), many of the issues raised by on-demand business models arise in both on-demand and traditional brick-and-mortar setups. While there may be some instances where on-demand companies have characteristics that do not match neatly with one or the other of the models we discuss, this ambiguity is not distinctive to the on-demand sector but can be found in the wider economy.

The employment relationship remains critical to the maintenance of labor standards. The erosion of labor standards leads to wage stagnation, dead-end jobs with no upward mobility, underinvestment

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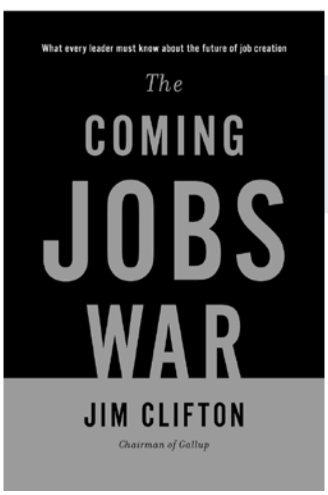

The Coming Jobs War: What Every Leader Must Know About the Future of Job Creation
Jim Clifton • Gallup Press, 2011

From the publisher's description …

What everyone in the world wants is a *good* job.

In a provocative book for business and government leaders, Gallup chairman Jim Clifton describes how this undeniable fact will affect all leadership decisions as countries wage war to produce the best jobs.

Leaders of countries and cities, Clifton says, should focus on creating good jobs because as jobs go, so does the fate of nations. Jobs bring prosperity, peace, and human development —but long-term unemployment ruins lives, cities, and countries.

Creating good jobs is tough, and many leaders are doing many things wrong. They're undercutting entrepreneurs instead of cultivating them. They're running companies with depressed workforces. They're letting the next generation of job creators rot in bad schools.

A global jobs war is coming, and there's no time to waste. Cities are crumbling for lack of good jobs. Nations are in revolt because their people can't get good jobs. The cities and countries that act first—that focus everything they have on creating good jobs—are the ones that will win.

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in training, lack of access to benefits and protections, and diminished workplace health and safety. We do not see impediments in the existing law to growing an innovative, on-demand company while providing workers with basic labor standards, decent wages, and core benefits.

Companies should start with a clear strategy for creating value for their customers and, based on that strategy, select an appropriate method for operationalizing it in the way they deploy their workforce. Those choices can be made within the context of existing workplace rules and framed by the worker protections arising from our laws. This strategy allows businesses in all sectors to innovate and find opportunities to compete and to earn profits for their investors while treating workers fairly.

Notes

1. See Chapter 4 in Weil (2014). This analysis is developed in greater depth in David Weil, "Income Inequality, Wage Determination, and the Fissured Workplace," in Bradford DeLong, Heather Boushey, and Marshall Steinbaum (eds.). *On Thomas Piketty's Capital*. Cambridge, MA: Harvard University Press, forthcoming.
2. See, for example, Arandajit Dube and Ethan Kaplan (2010), "Does Outsourcing Reduce Wages in the Low-Wage Service Occupations? Evidence from Janitors and Guards." *Industrial and Labor Relations Review*, 63(2): 287–306; and Deborah Goldschmidt and Johannes Schmieder (2015), "The Rise of Domestic Outsourcing and the Evolution of the German Wage Structure." Working Paper, Boston University. The authors of the latter study show that food, cleaning, security, and janitorial workers receive wage premiums comparable to those of the overall workforce prior to outsourcing.
3. See Erling Barth, Alex Bryson, James Davis, and Richard Freeman (2016), "It's Where You Work: Increases in Earnings Dispersion Across Establishments and Individuals in the U.S." *Journal of Labor Economics*, 34(2): S67–S97; Jae Song, David Price, Nicholas Bloom, Faith Guvenen, and Till von Wachter (2015), "Firming Up Inequality." Working Paper 21199, National Bureau of Economic Research; David Card, Jörg Heining, and Patrick Kline (2013), "Workplace Heterogeneity and the Rise of West German Wage Inequality." *The Quarterly Journal of Economics*, 128(3): 967–1015; and David Card, Ana Rute Cardoso, Jörg Heining, and Patrick Kline (2016), "Firms and Labor Market Inequality: Evidence and Some Theory." Working Paper, University of California, Berkeley.
4. Administrator's Interpretation 2015-1 (2015, Jul. 15), "The Application of the Fair Labor Standards Act's 'Suffer or Permit' Standard in the Identification of Employees Who Are Misclassified as Independent Contractors" (http://bit.ly/2bz4PdB), which discusses the "economic realities" analysis under the FLSA and uses multiple factors to determine whether a worker is truly in business for himself or herself (i.e., an independent contractor) or is economically dependent on an employer (i.e., an employee).

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