

Punching the Clock on a Smartphone App?

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of Work in America
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Executive Summary

Should your boss tell you how to vote? To even ask the question is absurd today, but it was not always so. Prior to the Industrial Revolution, workers were long looked down upon in both law and society. Early English attempts at republican democracy explicitly excluded employees from being able to vote, because employees were deemed to be servants to their masters, and were presumed to do his bidding in all matters, including voting. Things have improved immeasurably for working people since then, but the master/servant framework of labor relations is still with us today, in the form of obsolete labor and employment laws and regulations.

Is there a way forward for the modern economy? Yes, and ironically, it requires a look back to 1776, and Adam Smith's system of natural liberty. In *An Inquiry into the Nature and Causes of the Wealth of Nations*, Smith described how government policies intended to promote certain industries, notably agriculture, were in fact destructive of the overall wealth of the nation. He came to the conclusion that the sovereign power should step back from such policies, and let another system take over:

All systems either of preference or of restraint, therefore, being thus completely taken away, the obvious and simple system of natural liberty establishes itself of its own accord. Every man, as long as he does not violate the laws of justice, is left perfectly free to pursue his own interest his own way, and to bring both his industry and capital into competition with those of any other man, or order of men. The sovereign is completely discharged from a duty, in the attempting to perform which he must always be exposed to

innumerable delusions, and for the proper performance of which no human wisdom or knowledge could ever be sufficient; the duty of superintending the industry of private people, and of directing it towards the employments most suitable to the interest of the society.

Under this system of natural liberty, independent businessmen traded with one another to mutual advantage. The system relied on three factors:

- The division of labor, based on the recognition that not everyone can do everything he or she needs to prosper, and its corollaries;
- Specialization, which allows for innovation in working methods (encouraging further division of labor); and
- Exchange, whereby wealth is created by the exchange of goods valuable to all parties involved in a trade.

In Smith's system, employment of workers was rare (he uses the term more for employment of capital), and treated as the medieval employment of a servant by a master. Yet, he famously uses the example of a pin factory to illustrate the division of labor:

[I]n the way in which this business is now carried on, not only the whole work is a peculiar trade, but it is divided into a number of branches, of which the greater part are likewise peculiar trades. ... [A]nd the important business of making a pin is, in this manner, divided into about eighteen distinct operations, which, in some manufactories, are all performed by distinct hands, though in others the same man will sometimes perform two or three of them.

However, the example of the pin factory came with a caveat that was to have a significant effect on the way the system developed. Smith recognized the drudgery that factory work entailed and worried about its demoralizing effects:

The man whose whole life is spent in performing a few simple operations, of which the effects are perhaps always the same, or very nearly the same, has no occasion to exert his understanding or to exercise his invention in finding out expedients for removing difficulties which never occur. He naturally loses, therefore, the habit of such exertion, and generally becomes as stupid and ignorant as it is possible for a human creature to become. ... But in every improved and civilized society this is the state into which the labouring poor, that is, the great body of the people, must necessarily fall, unless government takes some pains to prevent it.

Governments around the world did take pains to prevent such a downfall in living and working conditions, though the enactment of labor regulations. However, those rules were based on the master/servant relationship, which increased in scope with the growth of large enterprises during the Industrial Revolution. Today, developed economies are moving away from that industrial model to more cooperative arrangements, such as contracting and the “sharing economy.” Thus, today’s economy is bound by laws designed for an earlier industrial era. Yet, to devise a roadmap for updating employment law, it is necessary to know how the large-scale industrial economy arose in the first place.

One major factor was the need of firms to lower transaction costs. While there are costs to every market transaction—not just monetary, but also the costs of time and effort—in some instances finding a party willing to provide a needed good or service to a business enterprise on a consistent, cost-effective basis may prove prohibitive. In such instances, it makes more sense to hire someone directly to do the work instead. In short, the division of labor creates costs that can make employment more attractive than market transactions. For clarity, this discussion refers

to the costs of commercial, market exchanges of goods and services as “transaction costs” and the costs of securing those goods or services through employment as “organizing costs.”

The Industrial Revolution, the era of mass production, and the early information technology revolution all made organizing costs generally lower than transaction costs. This helped create the era of the large corporation and mass employment, and the master/servant dynamic led to a system of regulation of work designed for the corporation and employees.

More recently, the IT revolution has reduced transaction costs to unprecedented levels in many areas. That is likely to continue. As it does, the system of natural liberty shows signs of reasserting itself over the corporate employment system. However, regulations designed for the corporate era are being wrongly applied to what are actually commercial market transactions. That could thwart the rebirth of a system that promises to bring significant benefits and solve the problems of employment that regulation seeks to address.

It is time to rethink how we regulate work. This paper recommends a series of regulatory reforms, based on the common law, to secure the benefits of the system of natural liberty for generations to come.

In order to enable the system of natural liberty to reemerge on terms set by individuals acting in markets rather than be strangled at birth by regulation designed for a bygone era, legislators and regulators will need to make certain policy changes.

First, lawmakers should reconsider all laws that tie non-economic social goals to the employment contract. In particular, Congress should reform the Fair Labor Standards Act to narrow the definition of employment in order to exempt volunteers and contract staff from it. No other employment law has such a broad standard. Therefore, harmonizing the FLSA’s standard with those of other laws—such as the NLRA, which uses the common law master/servant definition of employment—would be welcome. In order to address legitimate concerns about potential loss of benefits, legislators should consider policies such as neutral tax treatment to facilitate the development of private alternatives.

Legislators should also consider reforms to the National Labor Relations Act, in keeping with the stated purpose of the Act, to reduce conflict between employers and workers. Furthermore, removing the adjudicative function from the National Labor Relations Board could lead to a depoliticization of the Board's regulatory function and a reduction in regulation by enforcement. Adjudication of NLRA actions should be transferred to the Article III Courts, which are more insulated from politics than the membership of the NLRB.

Employment regulators should return to the common law tests of employment versus contracting, based primarily on control rather than the “economic

realities” tests rejected by Congress in the 1940s. This would reduce the risks of legitimate contracting being unfairly designated as employment. In addition, regulators and courts should consider whether a platform creates a two-sided market, using the criteria outlined in this essay, before stepping in to regulate business platforms as employers.

Legislators should also resist demands to create a new category of “dependent contractors” or “independent workers.” Rather than creating a government-mandated portable benefits vehicle, legislators should reform laws that create penalties on associations and businesses that attempt to provide such services.

Introduction

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bring significant benefits and solve the problems of employment that regulation seeks to address.

It is time to rethink how we regulate work. We need to reflect what people actually want from work and how the institution is evolving.

This paper recommends a series of regulatory reforms, based on the common law, to secure the benefits of the system of natural liberty for generations to come.

The Master/Servant Relationship and the Common Law Definition of Employment

As noted, the concept of employment was once bound with the idea that employees were mere servants to their employers.⁵ Workers were not expected to think for themselves, and were therefore not solely liable for harm to others inflicted in the course of their employment; the employers are as well (this is still largely the case).⁶ The common law, the basis of law in the United States, United Kingdom, and other countries with legal systems derived from the English legal tradition, evolved a series of tests to determine whether a worker is employed by someone in a master/servant relationship, or acts as an independent agent. Those workers who meet the tests, and their employers, are subject to employment law. Those who do not are subject to commercial contract

law. This determination is known as worker classification.

The tests are multiple, vary from location to location and case by case, and generally must take all the relevant facts into consideration when making the determination. Nevertheless, all common law countries rely on some version of this collection of tests.

They are, briefly:

- **How much control does the supervisor exercise over the worker?** An employee will generally be supervised and directed, while a contractor will generally be free to determine the nature of his or her work.
- **Is the worker obliged to work?** If a worker is expected to arrive at a workplace at certain times or for certain hours, she is probably an employee. If she sets her own hours, she will probably be a contractor. Is the worker's time being bought rather than his or her skills?
- **Is the work integral to the corporation's business?** If the business could not survive without the work, then the person doing the work is probably an employee. If it is peripheral, the worker may be a contractor.
- **Does the worker manage his or her own financial risk?** If the work involves the opportunity for personal profit or loss, that is indicative of a contractual relationship. If the work does not involve such financial skills, it is probably an employment relationship.
- **Does the worker provide his or her own tools, facilities, and equipment?** The level of personal investment in these factors is indicative of the relationship. A chef providing his own knives is not necessarily an indication of independence, but providing his own knives and kitchen equipment and facilities may be.
- **How much initiative does the worker show?** Competing with others in an open market creates a presumption of independence, while the lack of capacity to exercise independent business judgment suggests employment.
- **Is the appointment permanent, open-ended, or for a fixed term?** Permanency or indefinite work is generally an indication of employment. Shorter term appointments may be an indication of independence, but may not be if they are routinely renewed.
- **Is there opportunity for delegation to others outside the organization?** An independent contractor will generally be able to subcontract with others to delegate the

completion of tasks. Employees will tend to be more constrained.

- **Are business expenses born by the organization or by the individual?** If business expenses are paid for by the organization outside of salary or wages, that is indicative of employment, whereas contractors will normally be paid a higher sum to account for business expenses they incur.⁷

This list is not exhaustive. Some jurisdictions will apply several tests to one or more of these aspects. And the relative importance of the tests has varied over time depending on the policy aims of the regulators.⁸ In the United States, lawmakers often have linked other policy aims to the employment contract. These include, but are not limited to:

- Taxation;
- Provision of health insurance;
- Anti-discrimination measures;
- Occupational health and safety;
- Social well-being instructions such as provision of leave or limitation of hours; and
- Union organizing and collective bargaining.

The statutory measures that were adopted in order to pursue these aims have often blurred the common law definition of employment and threaten to do so again. However, the common

law is clear as to the difference between a contractor and an employee.

Of these aims and measures, only the last two strictly regulate the nature of the employment contract as regards the relationship between the employer and employee. The others mostly concern relationships between the employer and government (or society in general), pre-contractual measures, or the worker and the environment.

Nevertheless, the essence of employment remains control of the employee. In law, the employee surrenders a considerable amount of his or her personal liberty and discretion to both the employer and employment regulators in return for the financial security the employment relationship provides.

Two major employment principles derive from this presumption of control.⁹

Vicarious liability. Employers are deemed to be responsible for the actions of someone under their control. For example, if someone driving a company car hits you while on work time, the employer is responsible for your damages and medical bills. The common law allows for action against the employee solely and directly in the case of wanton disregard of what he or she is supposed to be doing, but in most cases the employee simply makes a mistake while carrying out

a superior's instructions, meaning the employer is liable.¹⁰

Fiduciary duty of the employee to the employer. The voluntary assumption of the burden of control by another implies that one will not do anything to harm the other party's interests. This is why courts have regularly found that using an employer's commercial knowledge to set up a competing firm is a breach of that duty.

The assumption of control has special relevance to the evolution of the corporation and the regulatory reactions to that development.

The Corporation and the Coaseian/Hayekian Framework

As noted, the concept of division of labor really began to take hold around Adam Smith's time. Between then and the 1850s, there was a gradual movement in common law jurisdictions from the corporation being primarily a family business to one based on joint stock ownership. The adoption of laws that significantly reduced a major element of organizing costs by introducing the principles of limited liability¹¹ and the corporate veil increased the advantage of organizing over transaction.¹² The corporation became a dominant major form of commercial organization, and the predominant one for businesses that made larger profits.¹³ However, other

factors were at play in the creation of the firm as we know it today. The most important of these is transaction costs.

In his 1937 essay, "The Nature of the Firm," Nobel laureate economist Ronald Coase noted that firms exist because of the costs associated with market transactions.¹⁴ Whereas the natural arrangement for any transaction is to use the market, costs in finding a party willing to provide the goods or service may prove prohibitive. The transaction may not take place, or, as Coase observed, a party might hire someone directly to do the work instead. Therefore, the market inefficiencies of transaction costs led to the creation of firms as preferable to individuals trading with each other on ad hoc basis. The costs of using market transactions came to be known as "transaction costs." Although they are also transaction costs of a sort, for simplicity's sake this paper will refer to the costs of employing people as "organizing costs."

Transaction costs come in many forms. For instance, if I want to find a carpenter to make a table leg, I will need to research the local market for carpenters, find one, research to make sure she is reputable, negotiate a price and delivery date, arrange for delivery and payment, and (potentially) incur legal costs if the job is done in a subpar manner or not completed. That is a long list of considerations for one

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transaction. Each represents a cost, and the carpenter has to go through a similar set of considerations on her end of the transaction.

Another important factor in market transactions is opportunity cost, the value of alternatives foregone when one course of action is taken. For example, if I spend an hour washing dishes, I give up an hour I could have spent exercising. Opportunity costs are largely dictated by time. A longer task generally has more opportunity cost than a shorter one. This means that considerations such as time and effort also factor into transaction cost measurements.

The employment contract reduces the uncertainties involved in organizing an enterprise. Transaction costs push entrepreneurs toward hiring others to do the service for which they would otherwise transact. A business that needs a steady supply of table legs may find it advantageous to hire one or more carpenters for that purpose, thereby reducing transaction costs. At the same time, potential market actors are pushed toward employment, which reduces the transaction costs for selling their skills.

The classical corporation exists because of its advantage in the transaction costs calculation. It depends in large part upon the control inherent in the employment contract, as Coase acknowledged:

We can best approach the question of what constitutes a firm in practice ... by considering the legal relationship normally called that of master and servant or employer and employee. ... The master must have the right to control the servant's work. We can thus see that it is the fact of direction which is the essence of the legal concept of employer and employee just as it was in the economic concept (of the firm).¹⁵

In this Coaseian framework, the firm would lose its advantage in transaction costs without control and direction of its employees. For example, a large bakery that supplies supermarkets with fresh bread every morning would not be able to compete with independent bakers if it could not guarantee, via the employment contract, that its bakers would turn up for work very early in the day.

Yet it is in this very concept of control that the problems for the corporation begin to form. The first is what is known as the principal-agent problem. The entrepreneur (the principal) has theoretical control of his or her employees (the agents), but cannot hope to direct every single one of their actions. There will come times when the agent is acting out of different motives from the principal, with results that go against the principal's intent.

For example, the production department might be so concerned with cutting costs that it produces a product not up to the quality expectations of the entrepreneur, resulting in lost sales. Or the marketing department might demand product diversity while the production department prefers product uniformity, resulting in internal conflict the entrepreneur must resolve. Fred Smith draws attention to a newer form of the problem, where government affairs professionals benefit in career terms from expanded regulation that otherwise burdens the business.¹⁶

This problem is magnified when the entrepreneur is joined by other owners in the form of shareholders, who are even more removed from the conduct of the business, and delegate management responsibility to managers or supervisors. The problem then becomes the principal-supervisor-agent problem, with three different sets of motives involved, and the possibility for collusion by two parties against the interests of the other.

The initial reaction to this problem was “Taylorism,” a philosophy of “scientific management” propounded by the engineer Frederick Winslow Taylor in the early 20th century. Taylorism held that the activities of agents could be controlled through scientific principles, directing workers like cogs in a machine, reducing each task to a set of efficiency-based principles. While often denounced as

dehumanizing, Taylor actually propounded such ideas as giving workers rest breaks to improve output and even performance-related pay. Nevertheless, the concept relied on the idea that processes could be perfected and imposed by rule. It allows no room for independent thinking. Taylorism ultimately failed because it did not appreciate the nature of knowledge in an organization.

In his seminal article, “The Use of Knowledge in Society,” Nobel economics laureate Friedrich Hayek introduced us to the “knowledge problem,” which states that knowledge about any process or question is dispersed around society—or a firm—and any attempt to compile all of it is doomed to failure.¹⁷ For instance, different individuals place different values on various goods and services, which results in different prices. Hayek’s classic example is the price of tin. When more people need it, the price rises, which sends a signal to everyone that they should seek ways to economize in their use of tin. No one needs to plan the allocation of tin, centrally set a price for it, or promote laws on how it may be used.

In this world of dispersed knowledge, prices are the mechanism by which we signal information to each other. As economist Steve Horwitz puts it: “Prices serve as knowledge surrogates to enable people’s individual knowledge and ‘fields of vision’ to sufficiently

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overlap so that our plans get coordinated.”¹⁸ Yet, this poses a challenge to the way the firm is organized.

The firm relies on employment contracts, which suppress knowledge signals that commercial contracts transmit through prices. It relies on the assumption that the firm’s managers, and its workers, can interpret limited information well enough for its organizational cost advantage to be brought to bear. Nobel laureate economist Oliver Williamson called this the “bounded rationality” of the firm.¹⁹ Or as Coase himself put it, “It can, I think, be assumed that the distinguishing mark of the firm is the suppression of the price mechanism.”²⁰

Another issue firms often face is opportunism, a more pernicious manifestation of the principal-agent problem, in which the agent not only acts out of self-interest, but does so against the interests of the principal. This can be compounded in a principal-supervisor-agent situation, where the supervisors and agents collude to their own benefit. That can lead to the creation of stifling bureaucracy, loss of competitive market discipline, loss of accountability, and even outright corruption.²¹

A final problem is that a firm has to invest in assets that can become very specific to one task and cannot be repurposed. This goes as much for a highly skilled employee as for machines

that can only make buggy whips. Williamson called this problem “asset specificity.”²²

Together, these problems can cause seemingly dominant corporations to come tumbling down in the process that economist Joseph Schumpeter called “creative destruction,” whereby an old firm is replaced by a newer firm with more innovative capabilities.²³ Kodak could not see the change in market preferences away from film, owing to its bounded rationality and asset specificity. Barings Bank collapsed overnight because of the opportunism of one trader.

Despite the existence of these constraints, the employment contract provided a significant commercial advantage in the first half of the 20th century.

The Heyday of the Corporation and Regulatory Responses

The emergence of the corporation in the early 20th century brought with it several problems. The most obvious was domestic strife between management and organized groups of employees, with government often taking the side of management.²⁴ The cause of strife was a belief that individual workers lacked bargaining power over the employment contract, and that employers would refuse to meet with workers organized under union representation, calling on the power

of the state to enforce that refusal.²⁵ This was a legitimate concern. As classical liberal philosopher Jacob Levy noted:

The fact that workers have so often and in so many places sought to organize, and the fact that firms have so often and in so many places resorted to illiberal restrictions on freedom of association if not outright violence to prevent them from doing so, itself looks like prima facie evidence from the world in unions' favor. Whatever one's complaints against the regime of employment relations created by ... legislation such as the Wagner Act, unionization comes first, before the state action and initially in spite of state action.²⁶

Collective action by workers can be seen as a reaction to these problems. As Levy notes, many union demands can be seen as reactions to the principal-supervisor-agent problem, helping to discipline managers who are acting opportunistically. Yet, unionization represents an imperfect solution to a genuine problem. Collective bargaining often imposes rigid work rules that can make a firm uncompetitive and may not be suitable to individual workers' particular circumstances.

This was exacerbated during the New Deal era, with the passage of the

National Labor Relations Act (NLRA) and Fair Labor Standards Act (FLSA).²⁷ These two laws have come to dominate much of the employment relationship in the eight decades since their enactment.

The National Labor Relations Act curtailed the power of management within the firm. It guaranteed the rights of workers to form unions and bargain collectively, granted exclusive bargaining power to a union that won an organizing election in a bargaining unit, defined "unfair labor practices" by management, permitted the negotiation of contracts requiring compulsory dues, and set up an enforcement body, the National Labor Relations Board (NLRB).²⁸

The purpose of the NLRA is set out in its first section:

[T]o promote the full flow of commerce, to prescribe the legitimate rights of both employees and employers in their relations affecting commerce, to provide orderly and peaceful procedures for preventing the interference by either with the legitimate rights of the other, to protect the rights of individual employees in their relations with labor organizations whose activities affect commerce, to define and proscribe practices on the part of labor and management which affect commerce and are inimical to the general welfare,

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NLRB policy making shifts wildly with changes in administration.

and to protect the rights of the public in connection with labor disputes affecting commerce.²⁹

Set up as an adjudicatory as well as a regulatory agency, the NLRB has become highly politicized because of its structure. It is made up of five members: two Republicans and two Democrats, with a chair from the President's party. As a result, NLRB policy making shifts wildly with changes in administration, as Republican administrations tend to favor the management side, while Democrats lean heavily toward organized labor. This makes for a less stable legal climate compared to disputes settled in Article III Courts.

The Fair Labor Standards Act places significant constraints on the employment contract. It established a standard 40-hour workweek, time-and-a-half overtime pay for employees earning below a certain amount, a federal minimum wage, requirements for record-keeping, and restrictions on the employment of children. Other restrictions include a ban on volunteers working for commercial companies.

Moreover, the FLSA very broadly defines employment as "to suffer or permit to work." This is why volunteers are categorized as employees under the Act. At the same time, courts have exempted independent contractors from coverage under the Act on the

basis of tests derived from the common law tradition described above. The Act provides for exemptions from wage and overtime requirements for workers "employed in a bona fide executive, administrative, or professional capacity."³⁰

As is the case with all regulation, however, interpretation and enforcement of the law have varied considerably depending on the leanings of the administration in power at the time.

After a period of little industrial action during World War II, the pendulum had swung so far in the unions' favor that activities such as union shops, secondary picketing, and wildcat strikes were severely hampering the legitimate rights of employers. This led Congress in 1947 to pass the Taft-Hartley Labor Management Relations Act, which bans such practices and allows states to adopt right-to-work laws that bar unions from requiring workers to pay dues as a condition of employment.³¹

Nevertheless, collective bargaining remained an important form of employment negotiation in most states. That put the corporation's control of the employee under severe constraint. Yet, with no more than one third of the workforce ever members of labor unions, the corporation retained its dominance in the market.³²

To understand why, we can turn again to Coase, who pointed out that:

“Inventions like the telephone and the telegraph which tend to reduce the cost of organising spatially will tend to increase the size of the firm.”³³

Advances in telecommunications that were happening at the same time as the labor regulations were enacted did not just offset the rise in organizing costs, they enabled firms to grow in size.

Coase points out other factors that pushed the firm to becoming ever larger:

Other things being equal, a firm will tend to be larger:

- (a) the less the costs of organising and the slower these costs rise with an increase in the transactions organised.
- (b) the less likely the entrepreneur is to make mistakes and the smaller the increase in mistakes with an increase in the transactions organised.
- (c) the greater the lowering (or the less the rise) in the supply price of factors of production to firms of larger size.³⁴

All these factors came into play during the 1940s and 1950s. Taft-Hartley settled the regulatory landscape, preventing any further rise in regulatory organizing costs. Telecommunications and increased understanding of business administration reduced the incidence of mistakes by entrepreneurs and their surrogates. Together, these forces led to a settled structure for work. Large firms, with a highly regulated

employment contract, strong union influence, and internal hierarchies dominated the market for the next three decades.

Corporate and Worker Responses to the Regulated Firm

Despite this settled environment, corporations seeking competitive advantage looked for new ways of organizing that in many cases improved efficiency by accessing the extra information contained in market transactions and their prices. Others realized that using market transactions could reduce the problem of asset specificity by hiring contractors with specialized expertise or equipment when needed to perform non-core business activities. In turn, workers with specific skill sets looked for ways to sell those skills or knowledge to several businesses rather than having to adapt to the needs of one employer.

One example is contracting out support services to staffing companies. Staffing companies offer the services of receptionists, bookkeepers, or office cleaners, who previously would have been direct employees of the corporation. Some staffing company employees are seeking temporary work, while others use it as a stopgap while they look for permanent employment. Corporations that utilize staffing companies are freed from the costs of training several types of employees, as

Ray Kroc, the man who made McDonald's famous, started out as the McDonald brothers' franchising agent.

well as from some long-term costs, such as pensions, that may come with permanent employees.

These costs distort the true worth of the position, which is more accurately reflected by the price negotiated in a commercial contract with the staffing company. For example, the value of having an office cleaned once a day may be worth less to a company than the cost of hiring, training, providing equipment for, and accommodating a full- or even part-time employee to do the work, never mind the extra cost of complying with employment regulations and providing benefits.

Various laws such as the NLRA, FLSA, and the Family and Medical Leave Act anticipated such arrangements under the concept of “joint employment,” in which two or more employers are equally responsible for the legal requirements associated with the employment contract. In 1984, the National Labor Relations Board led the way in interpreting the definition of joint employer status by establishing a “bright line” standard that required *direct and immediate* control over an employee for an employer to qualify as a joint employer.³⁵ The lack of direct control removed the threat of joint employer liability from the firm that contracted or outsourced the service and enabled businesses to make greater use of contract services.

Another form of business organization developed to exploit the price system

in a commercial contract beginning in the 1950s—franchising. In a franchise business, an independent entrepreneur buys most of the components necessary for a successful business from the franchisor. This can include production methods, marketing, branding, reputation, a supply chain, and much more. The cost of these elements is set by the commercial contract. However, the franchisee entrepreneur runs the business as the sole employer of workers in the restaurant, store, or other establishment. The franchise can experiment as much as it desires within the constraints of the contract, up to and including innovations that the franchisor may adopt for all its franchises. A famous example is the Big Mac, which was invented in a McDonald's franchise restaurant.³⁶ Ray Kroc, the man who made McDonald's famous, started out as the McDonald brothers' franchising agent, opening its first franchised store in Des Plaines, Illinois, in 1955.³⁷

As Ken Phillips, Executive Director of Independent Contractors of Australia, put it in his 2005 book, *Independence and the Death of Employment*, regarding Australian franchise bread businesses:

To a casual observer, hot bread franchises look like large conglomerates. ... But they are very different. They are, in truth, a new model of the firm in which the conglomerate is deconstructed into integrated small firms, but

which, as a whole, still have recognizable features of a large firm. Rather than being controlled by employment contracts, the franchise operation functions internally through commercial contracts. Each hot bread franchise owner has commercial contracts with his or her customers and the franchise. In one instance, a hot bread franchiser went broke and the franchisees pooled their resources and purchased the franchiser's business. In this instance, the franchisees have commercial contracts with a franchiser in which they are all shareholders.³⁸

The creation of such a business model would have been difficult in an environment where the franchisor is regarded as a joint employer of the franchise's employees. The value and information created by the commercial contract arrangement likely would be drowned out by the exercise of control through the employment contract. However, the NLRB took no steps to impose joint employer status on franchise businesses, which meant that franchise transaction costs could be lowered to a point where they were lower than the organizing costs of a large conglomerate.

Other businesses less suited to the franchise model sought ways to introduce market arrangements into the firm.³⁹ Some, like the German

engineering giant Siemens, have contracted out even essential services like research, while retaining research divisions that were effectively in competition with outside contractors.⁴⁰ It has also dedicated over €100 million (\$113 million at this writing) to allow employees to pursue their own research projects.⁴¹ Others, like the robotics firm ABB Group, split into many semi-independent units in order to promote entrepreneurship.⁴² Taiwanese computer giant Acer split into a network of businesses that charged each other market prices, and were not restricted to buying from other firms in the network.⁴³ Even large state-run enterprises like the British National Health Service introduced internal market structures during the 1980s and 1990s. In each case, the aim was to reduce the problems of the command structure imposed by the employment contract via the introduction of information contained in a commercial contract into the structure of the firm.

A good example is Hewlett Packard, which introduced a form of internal venture capitalism for projects called VC Café.⁴⁴ Anyone could propose an idea to a board of senior managers, who would fund the projects it found the most promising. The projects were posted online and project managers could find staff to work on them from those who expressed an interest, matching projects to those with the necessary skills and passion to make the project a success, without need for

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reorganization. Moreover, in an excellent example of the market providing information that management lacks, on occasion the board found no employee interest in a project it had approved, leading to cancellation of the project.

Another innovative HP experiment involved compiling sales projections from an internal predictions trading market, where employees were given an allocation of shares and allowed to trade them based on their sense of how printer sales would turn out. In 15 out of 16 experiments, the consensus of the traded projections was significantly closer to actual sales than the company’s official estimates. As Thomas W. Malone and Patrick J. McGovern of MIT’s Sloan School of Management note:

[I]n the market, salespeople are motivated to trade based on what they actually think will happen—not what they want to happen or what they want others to think will happen. Even more important, the traders can see the current consensus of all their colleagues reflected in the prices. Then they can use whatever other data they have (even if it’s just their instincts) to judge whether a given prediction at a given price is a good buy or not.⁴⁵

To be sure, internal markets can suffer from principal-agent problems, where

heads of competing divisions treat their competitors as enemies rather than colleagues, but in general the principle of internal markets increasing information flows has been proven over time.⁴⁶

At the same time as corporations were developing these new business models, workers were making new demands of employers. A combination of social and cultural changes led to a rejection of the idea that the state and other institutions could determine or control people’s thoughts, actions, or aspirations in the way they had in the past.⁴⁷ This rise of individualism was reflected in how people reacted to the employment contract.

Union membership declined steadily, particularly in the private sector.⁴⁸ Yet management’s reaction to this change did not reflect a decrease of workers’ bargaining power. Rather, employees went from being viewed as “cogs in the machine” to important assets whose creativity and potential could be sources of competitive advantage.⁴⁹ As a result, workers were able to leverage their increased value to the firm to demand greater flexibility in employment contracts.

This was reflected in the transition from employees being regarded as “personnel” to being viewed as “human resources.” Human resource theory regarded an employee not just as one set of skills plugged into one job, but a

bundle of skills and other assets that could be just as much a resource to the company as any expensive capital asset. Leadership, talent, and creativity were all assets that could be developed and utilized by a company that regarded its employees in that way.

The idea can even be traced back to Adam Smith, who noted that there were four forms of fixed capital, the fourth of which was:

[T]he acquired and useful abilities of all the inhabitants or members of the society. The acquisition of such talents, by the maintenance of the acquirer during his education, study, or apprenticeship, always costs a real expense, which is a capital fixed and realized, as it were, in his person. Those talents, as they make a part of his fortune, so do they likewise that of the society to which he belongs. The improved dexterity of a workman may be considered in the same light as a machine or instrument of trade which facilitates and abridges labor, and which, though it costs a certain expense, repays that expense with a profit.⁵⁰

It was work by Columbia's Jacob Mincer and Chicago's Gary Becker that led to the widespread recognition of the potential of a firm's human capital in the 1960s. With human resource management focusing more on the

relationship between the firm and the individual employees, the relationship between the firm and the collective representatives of employees began to take a back seat. The individual worker began to have more control over his or her employment contract.

One example of this is the growth of salaried junior management within the firm. Firms were able to select hourly employees with potential, promote them to junior management positions, and allow them to work longer hours in order to use their talents and abilities to the firm's advantage in exchange for accelerated promotion. They were able to do this as the Department of Labor did not raise the wage threshold for exempting workers from the FLSA's overtime pay requirements for several years. This meant that workers who previously might otherwise be needed to be hours-limited for overtime pay by means such as clock-punching were now able to be regarded as junior managers, with extended hours and responsibilities.⁵¹

Other examples of increased worker control over the employment contract came in the form of flexible working hours, telecommuting, performance-related pay and bonus schemes, employee stock options, and other management innovations, beginning in the 1980s. Of course, not all workers benefited from such developments, notably those with fewer or less

marketable skills—those in possession of less human capital—but firms with significant investment in human capital experienced a significant shift in the worker-management power balance toward the worker. This was despite, or perhaps because of, the decline in union representation.

Yet, unionization has persisted to varying extents around the U.S., and there is evidence that collective bargaining held back this power shift. In a 2014 study conducted for the Competitive Enterprise Institute, Ohio University economist Lowell E. Gallaway and Jonathan Robe found that states with higher union membership showed lower growth in household income between 1965 and 2011.⁵² Collective bargaining may have been restricting the use of more worker-friendly, higher compensated employment contracts. Indeed, they concluded that, “the decision to officially encourage collective bargaining through public policy, which was the primary thrust of the National Labor Relations Act of 1935 (the Wagner Act), was rife with unintended negative consequences.”⁵³

Labor regulations have yet to catch up with these developments, in particular the rise of what Ken Phillips calls “the independent employee”:

They want to do and think for themselves. They are decision-makers. They are self-managers.

They seek to control their own destinies and careers and not to have the firm decide either their current or future place in the world. And the more educated they are, the more they want to exercise self-control. These people, working in firms, are the greatest challenge so far to the idea, structure and operations of firms.⁵⁴

We can see just such a desire for independence in the popularity of the new workplace culture entrepreneur Tim Ferriss outlines in his 2007 bestseller, *The 4-Hour Workweek*. Ferriss advises a four-step framework for rethinking your work life, which goes by the acronym DEAL, for Define, Eliminate, Automate, Liberate. The steps are as follows:

- Work out what you really want from life (“What excites you?”) and what it will take to get you there.
- Eliminate tasks that take up time for little result; be effective rather than efficient.
- Automate not just tasks but income streams as well.
- Work when and where you want to by liberating yourself from the 9-to-5 routine and the physical office location through remote working arrangements and flexible scheduling.⁵⁵

Workers who pursue these goals are almost by definition independent employees. They look for multiple income streams and freedom from the most restricting constraint of the employment contract—control by others.

There are other workers to whom independence may not necessarily be terribly important, but for whom flexibility is key, such as single mothers. They may not care whether they are employees or contractors, but desire flexible work arrangements to ensure they can take care of non-work responsibilities. Such demands often lead firms to offer things like telecommuting or flexible work hour options. Yet not all firms can do so, which means that independent contracting is often the best way to achieve flexibility in work, even if the worker does not value independence that highly.

By the start of this decade, the work landscape had changed considerably from the settled environment of the past 40 years. New business models took advantage of changes in transaction costs and sought to introduce the benefits of the price system into the firm. Meanwhile, a new breed of employee was forcing changes to the employment contract without using regulation. The system of natural liberty was beginning to reassert itself.

The Return of Regulation and Advent of Platform Technology

Around 2010, two new forces began to assert themselves in the area of employment. The first was an effort by the Obama administration aimed at reasserting government regulatory authority over the employment contract. The second was the development of platform technology that promises to fundamentally restructure much of the world of work.

In a 2007 law review article, David Weil, then a Professor at Boston University School of Management, now the head of the Department of Labor's Wage and Hour Division, challenged the idea that the commercial contract could secure benefits for workers. Weil wrote:

A regulatory strategy ... is based on the idea that private actors—individuals, employers, institutions—left to their own devices will not necessarily select policies that are consonant with the public aims related to the five principles. Regulatory systems provide the government with tools to *change private behavior*, and those tools are usually related to enforcement activities: conducting of inspections, finding and citing violations with laws (procedural or substantive), assessing penalties, and ensuring compliance. [Emphasis added]

By the start of this decade, the work landscape had changed considerably from the settled environment of the past 40 years.

Weil defined five principles to achieve his policy goals:

- Assuring basic labor standards: hours of work, overtime compensation, child labor restrictions.
- Ensuring a safe and healthy work environment.
- Protecting against workplace discrimination in hiring, promotion, and dismissal and equal treatment of employees regardless of race, sex, age, or disability.
- Providing mechanisms for worker representation and voice at the workplace
- Protecting against major downside risks associated with employment: loss of pensions or health care benefits, loss of job from plant closure, or major family emergencies.⁵⁶

Weil's aim was to reverse the move toward greater commodification of work—that is, suppress the system of natural liberty—in favor of a single set of planned principles set by government and enforced by the employment contract. His strategy was to leverage the power of the regulatory system to force changes in private behavior, under threat of punishment, in order to achieve “public aims.”

Of particular concern to Weil was what he termed (and named a later book after) “the fissured workplace”—the

growth of more and smaller business units. Weil regarded the introduction of markets and commercial contracts within a formerly monolithic corporation as a threat to workers and the “public aims” of employment regulation. His agenda pays no regard to the need for more information that the growth of new business models was intended to fulfill, or to the increasing demand for flexibility and independence expressed by modern workers.

Such a strategy has been adopted by U.S. labor regulators—of which Weil is now one—since the election of President Obama in 2008. Both the Department of Labor and the National Labor Relations Board have embarked on a steady stream of regulatory interpretations, rulemakings, and enforcement actions with the intention of restricting business and worker options. These include the following:

- The Department of Labor followed up with its own “economic realities” test for joint employer classification under the Fair Labor Standards Act (January 2016).
- The Department of Labor nearly doubled the wage level at which employers are required to pay overtime (rule proposed May 2016).
- The National Labor Relations Board dropped its “bright line” standard for joint employer classification in favor of an

“economic realities” test that allows for much more discretion on the part of the NLRB and much less clarity for businesses. It has already enforced this new standard on staffing companies and its General Counsel has started action to extend joint employment status to franchise businesses by launching litigation against McDonald’s (August 2015).

- The Department of Labor has significantly revised its tests for independent contractor status under the FLSA, making it much more difficult to classify as one. As with the joint employer classifications, the most significant move was to lessen the importance of direct control over the employee, allowing other tests to signify employment even in the absence of control (July 2015).
- The Department of Labor and state labor departments cracked down on volunteers working for such industries as consignment sales and wineries (2014-2015).
- The NLRB introduced new rules to make it easier for unions to call quick elections in companies, which gives management less time to make its case, leading to an increased likelihood of collective bargaining being imposed on the company (December 2014).

- The Occupational Safety and Health Administration reversed policy and allowed union representatives to accompany federal safety inspectors on inspections of nonunion worksites, giving unions a role to play in making arguments over workplace safety even where the union has not been elected by the workforce (February 2013).⁵⁷

Taken together, these actions represent a direct attack on modern business models. Redefining joint employment could be fatal for some companies that rely on outsourcing and smaller franchise businesses.

It is worth looking at the NLRB’s joint employer ruling on staffing companies in more detail.⁵⁸ The majority, in its lengthy opinion, is explicit in its aims—to rein in the developments of the past three decades in American employment practices. Time and again, the majority refers to Board decisions and Supreme Court opinions from the 1970s or earlier, ignoring subsequent rulings.

This decision makes contracting much less attractive to companies, as it raises the transaction costs associated with hiring. More functions will be brought in-house, and as a result of the raised costs, people will lose their jobs. People will lose the flexibility working for staffing companies rather than one

Redefining joint employment could be fatal for some companies that rely on outsourcing and smaller franchise businesses.

particular employer—a flexibility some workers value.⁵⁹

Worse, the majority’s stretching of the definition of “joint employment” shows a disregard for Congressional intent, by essentially reviving a definition of joint employment that Congress firmly rejected in the 1947 Taft-Hartley Act.

As Board Members Philip Miscimarra and Harry I. Johnson III note in their dissent, the majority’s opinion seems to rely on the overly broad definition rejected by Congress.

In this case, our colleagues abandon the attempt to strain extant joint-employer law, which had already been strained beyond its rational breaking point in *CNN*. Instead, similar to what was done in *FedEx* for the definition of a statutory employee, they have announced a new test of joint-employer status that, notwithstanding their adamant disclaimers, effectively resurrects and relies, at least in substantial part, on intertwined theories of “economic realities” and “statutory purpose” endorsed by the Supreme Court in *NLRB v. Hearst Publications*, 322 U.S. 111 (1944), which Congress expressly rejected in the Taft-Hartley Amendments of 1947.⁶⁰

The majority is also explicit in why it wants to do this—to make it easier for labor unions to organize new members.

The NLRB aims to use the joint employer decision to reverse the trend toward independent employees, by making it easier for unions to play the two sides of a potential joint employer against one another.

Joint employer status is the gift that keeps on giving to employment regulators. For example, Microsoft and other large companies have imposed codes of conduct on their contractors specifying that the contractors should adhere to certain employment standards. It is ironic to note that the presence of these codes, many of them once cheered on by the Obama administration, may be viewed as evidence of joint employment status.⁶¹

Similar motives are in play in the other regulatory initiatives. The overtime rule could cause companies to restrict the hours of employees who might want to work more for personal career advancement, reducing the role of aspirational junior managers in companies.

In effect, the government has used regulation to convey different information from that conveyed via the price system. The price system conveys information about people’s needs and desires—in other words, what people really need and want. Regulation used in this fashion conveys information about what the government thinks people *should* want (as Weil takes pains to point out).⁶²

The price system would indicate no perceived need for the regulation. By seeking to fulfill utopian goals rather than allow people to pursue their individual preferences, it is likely to be viewed as unwanted or in many cases actively opposed by those on the receiving end of it. By raising transaction costs, it frustrates people's ability to fulfill their needs and wants as revealed through the price system.⁶³

However, at the same time as this regulatory agenda was being developed and implemented, technological innovation led to significant reductions in transaction costs for some industries. This development has variously been termed the "on-demand," "platform," "gig," or "sharing" economy. Its most common application has been the creation of new markets through online platform applications, which act as another source of information.

These markets are what economists call "two-sided markets," where a supplier of a good or service is linked up with a customer through the platform, much as a farmers' market helps buyers and sellers connect, reducing transaction costs, which in turn reduces the need for an employment contract.

A platform is not necessarily an active market maker. It could be a passive technology like the DVD, which makes it easier for the supply side to provide high quality video products and for the

demand side to get those products in an affordable, standard format.

Platform apps, on the other hand, are generally market makers. The two most prominent examples are ridesharing apps like Uber and Lyft and room sharing apps like AirBnB. In both cases, they link someone who is willing to provide a service with someone who wants that service. A person seeking an affordable ride has new options available in addition to taxis. Similarly, someone seeking lodging has access to new, more affordable alternatives to hotels.

Ridesharing provides a good example of lowered transaction costs. The existing taxicab market was already largely made up of independent contractors. What ridesharing did was attract more people into a contracting market by reducing transaction costs via an innovation to which old price-raising regulation did not apply.

Taxicab operators have traditionally been highly regulated, with the rationale of ensuring public safety. The justification was that entrusting one's travel to a stranger involved being able to trust that stranger to carry out the service without harm to the passenger. Regulation provided that trust. The genius of the ridesharing revolution was that the platform apps contain their own system of trust in the form of feedback mechanisms,

The genius of the ridesharing revolution was that the platform apps contain their own system of trust in the form of feedback mechanisms, such as ratings.

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such as ratings. For instance, Uber passengers rate their drivers on a basis of one to five stars, and any driver who drops below a certain threshold faces a review which could result in them losing access to the platform. Passengers see their driver's rating in advance, and can choose not to accept a ride offer from someone with a lower rating.

These feedback mechanisms also lower risks for drivers. Taxi drivers have no way of knowing whether a passenger is going to treat them well. They might stiff them, either by not having the cash to pay for the ride or presenting a fraudulent credit card. They might be drunk and throw up in the car. Using ridesharing feedback mechanisms, drivers rate their passengers. Passengers with low ratings will not be offered rides.

Platform apps attract new workers to independent contracting, which allows them to become their own boss. Surveys of ridesharing drivers show many drivers do it as a second job, many work fewer than 10 hours a week.⁶⁴ Similarly, room-sharing hosts almost by definition are setting up their own businesses.

If independent employees are turning more to "gig economy" work, we would expect that to show up in the Bureau of Labor Statistics' measures of self-employment or the number of people holding more than one job.

That is not the case. As Eli Dourado and Christopher Koopman of the Mercatus Center show, the first measure is at a 70-year low and the second has declined for two decades. However, as Dourado and Koopman suggest, the Current Population Survey relies on responses from workers who might think of gig economy work as being somehow different from self-employment.⁶⁵

To obtain a more objective measure, Dourado and Koopman examined Internal Revenue Service (IRS) data on the issuance of Form 1099-MISC "Miscellaneous Income" compared with issuances of Form W-2 that represent employment income. They found that, "there has been a significant increase in the total number of 1099-MISC forms issued by the IRS in the last 15 years, around a 22 percent increase since 2000. During the same period, W-2 forms have stagnated, falling by around 3.5 percent. Moreover, they note that this process was underway long before the arrival of the first sharing economy firms. This suggests that people were looking for sources of income other than employment even before the expansion of employment regulation and the parallel opening up of new opportunities. Absent further regulation, we should expect more people to look for more flexible forms of work. But regulation is not absent. It is the tension between these two forces that forms

the real policy challenge of coming years.⁶⁶

The Sharing Economy and its Regulatory Challenges

In many ways, the sharing economy is a good example of the rebirth of natural liberty. All sharing economy enterprises display one or more of the following characteristics. They:

- Serve unmet demand by tapping into underused capital via price signals;
- Provide a significant reduction in transaction costs;
- Use crowdsourced certification to build trust;
- Integrate payment systems to further reduce transaction costs and provide both enhanced customer experience and lowered risk for the supplier;
- Create or expand two-sided markets, thanks to apps' market-making capability.

As such, they pose a challenge for regulators. In the case of trust, they make regulators redundant. They also create new markets that regulators had never considered in the first place. Some highly regulated industries may find themselves wiped out by the creation of these new markets. For instance, the taxicab industry finds itself on the ropes in many cities in the face of competition from ridesharing services. As the value of taxi medallions

has plummeted, we have begun to see regulators attempt to convey the information that taxis are valuable by imposing a tax on ridesharing companies to subsidize taxi services, as happened recently in Boston and Victoria, Australia.⁶⁷

The most pressing problem that needs to be addressed is that of employment regulation, as new business models threaten to make the employment contract obsolete. As Duke University economist Michael Munger has noted:

[A] long-term contract of the sort we associate with firms may well become quite rare. Firms may rent capital equipment and labour for very short periods, increasing the productivity of the workers for the period that they are employed and dramatically reducing the fixed costs of the firm. In the limit, firms themselves might simply become individuals or small teams that hire out for specific projects. Workers in this system would be private contractors, not “employees” in the traditional sense.

Unsurprisingly, the counter-revolutionary fervour of those who wish to protect existing power structures of both firms and unions will call for attempts to control the sale of transaction cost reductions.⁶⁸

The sharing economy is a good example of the rebirth of natural liberty.

Much of the advantage of reduced transaction costs will vanish if regulators impose unneeded organizing costs on the platforms, by trying to force them into a New Deal-era regulatory scheme.

Munger’s concerns are on point. The reaction of regulators so far has been to double down on the employment contract through the proliferation of ever more intrusive worker classification determinations. There have been dozens of court cases alleging that Uber and Lyft drivers should be considered employees of the company providing the platform rather than independent contractors.⁶⁹ Unions have sought to apply the terms of the National Labor Relations Act to new types of companies as well.

So far, these actions have not caused any change in the status of independent workers in the sharing economy, at least at the federal level, as most court cases have been settled on the basis that workers remain independent contractors (although California-based cleaning app Homejoy closed as a result of state lawsuits).⁷⁰ However, the agenda described above, coupled with the broad definition of employment in the FLSA, means that threats to new forms of work will continue. For example, a California judge recently denied a proposed settlement of a lawsuit between Uber and certain drivers on the grounds that a jury should decide the question of whether Uber is an employer under state law.⁷¹ As platforms seek to make themselves more attractive to workers, they have steadily been offering incentives that may make them seem more like employers to regulators and courts.

Much of the advantage of reduced transaction costs will vanish if regulators impose unneeded organizing costs on the platforms, by trying to force them into a New Deal-era regulatory scheme.

To circumvent this problem, there have been proposals for a new, third classification for workers as “dependent contractors.” Such a category already exists in some developed countries, including Canada and Germany. Cutoff points for what proportion of their incomes workers must receive from one source to count as dependent varies—it is 80 percent in Canada, just 51 percent in Germany.⁷² As Hebrew University of Jerusalem law professor Guy Davidov notes:

The important point is that the more you rely on a single employer for your livelihood—the more the relationship is characterized by dependency, and this vulnerability, in turn, justifies some protection. The crucial aspect appears to be the ability of the worker to spread risks.⁷³

This points to a central problem with U.S. labor law. The various employment regulators, in pursuing their agenda by redefining such categories as joint employer and worker classification on the basis of “economic reality” have *already created this category and subsumed it under employment.* A

contractor who would qualify as a dependent contractor in Canada or Germany could easily qualify as a full employee under the current regulatory interpretations of employment in the U.S., although this is less likely in industries where independent contracting is the accepted method of doing business, such as construction contractors that do a majority of business with one client. It is in new industries such as sharing economy platforms where the dependent contractor is likely to be recognized as an employee according to current regulatory thinking.

The idea of dependent contractors also creates problems for the putative employer in that their incomes are subject to significant variability. These problems are obvious when we look at the issue of withholding taxes. As Jared Meyer of the Manhattan Institute says, “This would create a burden on employers because participants in the sharing economy often have highly variable incomes, so their estimated tax obligations are unclear.”⁷⁴ For a business where large numbers of employees are working variable hours every day, the burden would become even greater.

There is also the question of marginal cases, where the worker has several sources of income and it is not clear whether one of her clients reaches the threshold for being designated as the

source of dependence. It is almost impossible for firms to predict for such a circumstance, which means the burden of proof resides with the worker. Firms would have to budget for disputes, raising the transaction costs of working with potential dependent contractors.

Moreover, the creation of such a category ignores the realities of independent employees and what they are looking for. In many cases, they are looking for multiple income streams in order to reduce dependence and the constraints of the employment contract. Bringing them back towards the constraints of employment would undermine that goal.

This debate at least shows that other countries have attempted to reconsider the early 20th century employment model, but have not yet been successful in catering to workers without overly burdening their potential employers and cutting off opportunities.

What about Benefits?

A major source of trepidation for individuals considering working as independent contractors is what they see as the loss of fringe benefits, especially health insurance. Yet, technology can offer solutions there as well. One proposal is the creation of a “portable benefits vehicle” to allow workers of whatever stripe to share in

the sort of policy goals normally attached to the employment contract. A consortium of CEOs, union leaders, and think tank researchers described the idea in a statement, “Common grounds for independent workers” in November 2015.⁷⁵ The signers agreed that: “Everyone, regardless of employment classification, should have access to the option of an affordable safety net that supports them when they’re injured, sick, in need of professional growth, or when it’s time to retire.”

The vehicle the consortium proposed would have the following characteristics (the following is taken verbatim from the proposal):

- **Independent.** Any worker should be able to access a certain basic set of protections as an individual regardless of where they source income opportunities.
- **Flexible and prorated.** People are pulling together income from a variety of sources, so any vehicle should support contributions that can be prorated by units of money earned, jobs done, or time worked, covering new ways of micro-working across different employers or platforms.
- **Portable.** A person should be able to take benefits and protections with them in and out of various work scenarios.

- **Universal.** All workers should have access to a basic set of benefits regardless of employment status.
- **Supportive of innovation:** Businesses should be empowered to explore and pilot safety net options regardless of the worker classification they utilize.⁷⁶

While the platform looks promising, pitfalls could arise in its development and implementation. The standardized benefit package and other features already guarantees that it would be a regulatory burden. If government were to administer the program, it would likely increase in size, scope, and number of rules, and become another bureaucratic burden as well. Relevant legislation would be needed to divest the various employment regulators of some of their current authority, in order to avoid them expanding their power to the detriment of the sharing economy as a whole.

Ideally, however, a program like this could be privately administered and adopted voluntarily by both workers and platforms. Competing programs could exist. The model for such programs already exists, in the form of 19th century fraternal organizations, which provided pooled insurance for workers in the form of sick pay and other protections before the emergence of the socialized versions in the 20th century.

As University of Alabama historian David Beito points out, it was the very legislative tying of benefits to the employment contract that doomed fraternal societies in the first place:

[A] reinvigoration of mutual aid (though not necessarily through fraternal societies) is not out of the question in the 21st century. One reform that would encourage such a trend is to repeal or revise laws that subsidize third-party insurance. Perhaps the leading example is legislation enacted during World War II, which exempts employer-provided fringe benefits, such as health insurance, from income tax. According to John C. Goodman, the annual value of this exemption adds up to an enormous \$130 billion. For a typical autoworker, for example, it is over \$1,200 per year. Federal tax policy has not only tied workers to their jobs but has undermined their incentives to purchase health insurance through non-governmental organizations such as fraternal societies. It has also created a perverse system where workers lose all their benefits when they change jobs or become unemployed. By contrast, if individuals had the same tax incentives to purchase insurance from associations, such as lodges, as they do now from their

employer they could still retain full coverage even if they changed jobs.⁷⁷

With the change Beito recommends, it is plausible to see platforms rather than associations springing up to provide such benefits. Whether the government would be prepared to countenance such a change is another matter. The Affordable Care Act retained the tie of health insurance to the employment contract while threatening to fine—or tax, as the Supreme Court interpreted it—independent workers who did not purchase health insurance through the government’s portal.

Another suggestion by Princeton University economist Alan Krueger and Cornell University economist Seth Harris for a category of “independent worker” contains just such a proposal. Their suggestion would guarantee workers many of the benefits attached to the employment contract but not hours-based benefits such as those under the FLSA or unemployment insurance. Being more extensive than the CEO consortium’s proposal, it suffers from many of the same problems.⁷⁸

For instance, the independent worker’s benefit package includes the right to bargain collectively. As noted, collective bargaining is a poor answer to the shift toward more flexible and entrepreneurial work arrangements that has been taking place for half a century, and to which

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the sharing economy is a market-discovered answer. As Jared Meyer says, “Of course these workers should be allowed to join a union, but it makes little sense to force them to adhere to collectively bargained agreements when they often work with more than one company and/or have another full-time job. Additionally, independent workers have diverse priorities and work arrangements, even when they work with the same intermediary.”⁷⁹

Instead, addressing the challenges facing traditional corporations, sharing economy platforms, independent workers, and regulators requires institutional reforms designed to strengthen contractors rather than burdening them and others with complex regulation. Australia’s solution was to pass an Unfair Contract Law in 2015 that significantly restricts what demands a company can make of a small business contractor. The law forbids unilateral changing of terms and conditions, and other terms that apply to one side but not the other to the smaller firm’s detriment.⁸⁰ While such a suggestion may seem attractive at first, it represents favoritism to small businesses and undue restrictions on the commercial contract. Microsoft should be able to demand that its contractors commit to its code of ethics. What should not happen is for this code to be enforced by any other law than the law of contract, or that

Microsoft be adjudged to have joint employer status with its contractor as a result of the code.

The true solution to these problems is to return to the principles of common law as a means of deciding what makes the difference between an employee and a contractor, and to let the market experiment with different forms of mutual aid packages that can present the contractor who wants to pay for them with equivalent benefits to those guaranteed by law to employees. With transaction costs falling, the market should be able to find acceptable solutions as long as government does not burden those solutions with utopian information.

Finally, to achieve a successful transition to a work environment more attuned to natural liberty, business leaders, whether they be corporate CEOs or individual independent contractors, need to explain to regulators, and to the public at large, the changes in the nature of work and why they have proved beneficial. They must do so in terms of the economy as a whole rather than their particular industry. In short, they must be prepared to stand up and advocate for the system of natural liberty.

Conclusion

In order to enable the system of natural liberty to reemerge on terms set by individuals acting in markets rather than be strangled at birth by regulation

designed for a bygone era, legislators and regulators will need to make certain policy changes.

First, lawmakers should reconsider all laws that tie non-economic social goals to the employment contract. In particular, Congress should reform the Fair Labor Standards Act to narrow the definition of employment in order to exempt volunteers and contract staff from it. No other employment law has such a broad standard. Therefore, harmonizing the FLSA's standard with those of other laws—such as the NLRA, which uses the common law master/servant definition of employment—would be welcome. In order to address legitimate concerns about potential loss of benefits, legislators should consider policies such as neutral tax treatment to facilitate the development of private alternatives.

Legislators should also consider reforms to the National Labor Relations Act, in keeping with the stated purpose of the Act, to reduce conflict between employers and workers. Furthermore, removing the adjudicative function from the National Labor Relations

Board could lead to a depoliticization of the Board's regulatory function and a reduction in regulation by enforcement. Adjudication of NLRA actions should be transferred to Article III Courts, which are more insulated from politics than the NLRB.

Employment regulators should return to the common law tests of employment versus contracting, based primarily on control rather than the “economic realities” tests rejected by Congress in the 1940s. This would reduce the risks of legitimate contracting being unfairly designated as employment. In addition, regulators and courts should consider whether a platform creates a two-sided market, using the criteria outlined in this essay, before stepping in to regulate business platforms as employers.

Legislators should also resist demands to create a new category of “dependent contractors” or “independent workers.” Rather than creating a government-mandated portable benefits vehicle, legislators should reform laws that create penalties on associations and businesses that attempt to provide such services.

NOTES

- 1 The Agreement of the Free People of England, 1649, a draft constitution for England following the English Civil War, contained a revolutionary provision guaranteeing the right to vote for all men over the age of 21 except servants (i.e. employees), beggars and Royalists, <http://www.constitution.org/eng/agreepeo.htm>.
- 2 Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, Book IV.9.51, London 1776.
- 3 Smith, I.1.3.
- 4 Smith, V.1.178.
- 5 The United Kingdom's Master and Servant Act 1823, which was extremely influential in the development of labor law in the United States and other common law jurisdictions, was primarily concerned with codifying penal sanctions for breach of contract by employees. Such breaches were punishable by hard labor, or even jail sentence. Separate acts, such as the Combination Acts, punished workers attempting to organize for bargaining purposes.
- 6 See, for example, *Burlington Industries, Inc. v. Ellerth* (No. 97-569), Supreme Court of the United States, decided June 26, 1998. While vicarious liability is the general rule, not all actions by an employee can be placed at the foot of the employer. In *Dee v. Marriott International, Inc.*, 1999 WL 975125 (E.D.Pa. 1999), for example, the Supreme Court of Pennsylvania found that Marriott was not responsible for the sexual assault of one employee by another as such an act "is excessive and so dangerous as to be totally without responsibility or reason."
- 7 This list is inspired by a similar list in Ken Phillips, *Independence and the Death of Employment*, (Brisbane Connor Court, 2005), but takes into account American interpretations of the common law.
- 8 In the United States, regulatory agencies such as the Department of Labor and the Internal Revenue Service also apply their own, similar tests when interpreting employment law statutes or determining worker classification for the purposes of withholding income taxes. These statutory interpretation tests are largely similar to the tests of the common law.
- 9 Phillips.
- 10 See note 6.
- 11 Limited liability limits the liability of an owner or investor in a corporation to the amount of his or her investment.
- 12 Closely connected with limited liability, the corporate veil means that when a lawsuit is filed, it is against the corporation, not the owner or investor. It is a serious matter to "pierce" the corporate veil and find an owner or investor personally liable beyond his or her investment.
- 13 In 2008, before the financial crash, there were 22.5 million sole proprietorships, with a total profit of \$265 billion. Adrian Duggan, "Sole Proprietorship Returns 2008," Statistics of Income Bulletin, Summer 2010, Internal Revenue Service. There were 3 million partnerships and 5.8 million corporations that year, reporting annual profits of \$1.2 billion in Q1 2008, FRED economic data, Federal Reserve Bank of St Louis, <https://fred.stlouisfed.org/series/CP>.
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- 15 Ronald H. Coase, *The Firm, The Market, and the Law* (Chicago: University of Chicago Press, 1988), p.53.
- 16 Fred Smith, "The Political Principal/Agent Problem," *Forbes*, April 28, 2011, <http://www.forbes.com/sites/fredsmith/2011/04/28/the-political-principal-agent-problem/#7a6d9cf05799>.
- 17 Friedrich A. Hayek, "The Use of Knowledge in Society," *American Economic Review*, Vol. XXXV, No. 4. (1945), pp. 519-530. American Economic Association, <http://www.econlib.org/library/Essays/hykKnw1.html>.
- 18 Steve Horwitz, "Hayek's 'The Use of Knowledge in Society—A Summary,'" Coordination Problem, May 9 2016, <http://www.coordinationproblem.org/2016/05/hayeks-the-use-of-knowledge-in-society-a-summary.html>.
- 19 Oliver Williamson, *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting* (New York: The Free Press, 1985).
- 20 Coase, 1937t.
- 21 Jean Tirole, "Hierarchies and Bureaucracies: On the Role of Collusion in Organizations," *Journal of Law, Economics and Organization*, 1986, Vol. 2, Issue 2, pp. 181-214.
- 22 Williamson.
- 23 Joseph A. Schumpeter, *Capitalism, Socialism and Democracy* (London: Routledge, 1942), pp. 82–83.
- 24 Federal and National Guard troops were used against strikers during the Great Steel Strike of 1919, while state police were used to disarm strikers and their allies after the "Battle of Matewan" in West Virginia in 1920. As late as 1937, police forces battled union members in the Little Steel strike in Ohio. David Brody, *Steelworkers in America: The Nonunion Era* (Urbana, Ill.: University of Illinois Press; Illini Book Edition, 1998).
- 25 Adam Smith recognized this problem: "It is not, however, difficult to foresee which of the two parties must, upon all ordinary occasions, have the advantage in the dispute, and force the other into a compliance with their terms. The masters, being fewer in number, can combine much more easily; and the law, besides, authorizes, or at least does not prohibit their combinations, while it prohibits those of the workmen. We have no acts of parliament against combining to lower the price of work; but many against combining to raise it. In all such disputes the masters can hold out much longer. A landlord, a farmer, a master manufacturer, a merchant, though they did not employ a single workman, could generally live a year or two upon the stocks which they have already acquired. Many workmen could not subsist a week, few could subsist a month, and scarce any a year without employment. In the long run the workman may be as necessary to his master as his master is to him; but the necessity is not so immediate." Smith, I.8.12.

- 26 Jacob T. Levy, “Thoughts on Unions,” *Bleeding Heart Libertarians*, June 6 2012, <http://bleedingheartlibertarians.com/2012/06/3087/>.
- 27 An earlier law, the Railway Labor Act, had similar effects on transportation industries.
- 28 The Taft-Hartley of 1947 amended the NLRA to allow states to pass right-to-work laws.
- 29 29 U.S.C. § 141.
- 30 For the regulations around this, see 29 CFR, part 541
- 31 However, this did not become clear until *Algoma Plywood v. Wisconsin Board*, which went to the Supreme Court in 1949. *Algoma Plywood v. Wisconsin Board* 336 U.S. 301 (1949).
- 32 Bureau of Labor Statistics, Historical data for the tables of union membership, <http://www.bls.gov/cps/cpslutabs.htm>.
- 33 Coase 1937.
- 34 *Ibid.*
- 35 *TLI, Incorporated and Crown Zellerbach Corporation and General Teamsters Local Union No.326 a/w International Brotherhood of Teamsters, Chauffeurs, Warehousemen and Helpers of America*, Case 4-CA-13033, National Labor Relations Board, July 31, 1984, <http://www.laborrelationsupdate.com/files/2014/07/TLI-Inc.pdf>. See also *Laerco Transportation*, 269 NLRB 324 (1984).
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- 38 Phillips.
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- 43 “A survey of Business in Asia”, *The Economist*, March 9, 1996, p. 27.
- 44 Thomas W. Malone, “Bringing The Market Inside,” *Harvard Business Review*, Vol. 82, No. 4 (May 2004), pp. 106-114.
- 45 *Ibid.*
- 46 Steve Denning, “Do Internal Markets Nourish Innovation? The Case of Sears,” *Forbes*, July 16 2013, <http://www.forbes.com/sites/stevedenning/2013/07/16/do-internal-markets-nourish-innovation-the-case-of-sears/#c8f08f44d43e>.
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- 51 William G. Whittaker, “The Fair Labor Standards Act: A Historical Sketch of the Overtime Pay Requirements of Section 13(a)(1),” Congressional Research Service, May 9 2005, http://digitalcommons.ilr.cornell.edu/cgi/viewcontent.cgi?article=1240&context=key_workplace.
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- 65 Eli Dourado and Christopher Koopman, “Evaluating the Growth of the 1099 Workforce,” Mercatus Center, December 10 2015.
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