

The employment divide: is it possible to simplify the distinction between self-employment and employment?

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SUMMARY

- The distinction between self-employment and employment is becoming harder to sustain. Even on 2012/13 tax data from HMRC, a third of those reporting income from self-employment also report income from employment.
- Those two categories themselves simplify and often distort a much more complex labour market in which people are working and being paid in a range of different ways, including limited company contractors and workers employed through an umbrella company.
- The challenge this variation poses is that our tax system and the rights and protections offered through employment law may no longer fit the reality of the labour market.
- At the very least, people may look and behave very much like employees and yet lack the rights and protections of employees.
- Equally, they may in fact be self-employed – without a single employer responsible for giving them tasks or paying them – and yet fail to benefit from the tax treatment of other self-employed people.
- The aim of our project is to examine how widespread these mismatches are, what issues they raise, and how they might be tackled.

EARLY HIGHLIGHTS FROM THE ANALYSIS

- When we look for differences in the data, aside from employment status, between self-employed workers and employees, they can be difficult to find. The variation within each employment status may be more significant than the difference between them.
- There are nevertheless some important differences we do observe. Self-employed are less likely to be paid for overtime: 71% of self-employed who work overtime do so unpaid.
- Self-employed are less likely to receive training: only half as likely as employees.
- They take fewer days off sick: half as likely to take sick days.
- They are less able to save money from their earnings: 11 percentage point gap between self-employed and employees.
- We might assume that self-employed experience higher levels of autonomy at work as part of the trade-off for being self-employed. But, while broadly true, 1 in 5 self-employed do not report a lot of autonomy over their job tasks; and 1 in 3 do not report a lot of autonomy over working hours.

- The nub of the challenge may be that a significant proportion of self-employed do not enjoy the autonomy associated with self-employment; and yet also fail to enjoy some of the rights and protections that those in employment, with similar levels of autonomy, have access to.

POLICY OPTIONS TO EXPLORE

- Tackling this may require reducing the financial incentive for firms of treating workers as self-employed rather than employees. This could be done over time by equalising the level of National Insurance Contributions.
- Another approach could be to limit the option of self-employment to higher-paid workers, where we might more confidently assume that they have the bargaining power to access the benefits of self-employment while trading off rights and protections. This too would have to be a gradual change.
- Thinking about such options, and we will develop others during the project, is likely to be appropriate as the distinction between self-employment and employment will come under further pressure in the years ahead.

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INTRODUCTION

Self-employment as a share of all employment has risen from around 10% in the mid-1980s to 15% in the latest figures. This rise in self-employment, together with the public profile of new companies in the gig economy, has focused debate about whether the distinction between self-employment and employment is sound. At the very least, there is a popular perception that the distinction provides firms with the opportunity when taking on workers to arbitrage between the two statuses to obtain a tax or regulatory advantage.

Even the binary divide in employment status though understates the level of complexity that exists in practice. Data from HM Revenue and Customs suggests that more than 5.5 million people report income from self-employment; and that almost 1.8 million of them – close to a third – also report income from employment. In other words, a large number of people are both employed and self-employed.

On top of this, there are many different forms of self-employment: running your own business, working for yourself, or acting as a limited company contractor. Self-employed workers identify with different forms, or may identify with more than one at the same time.

Finally, many employees are not paid directly by their employer. They are paid through a payment intermediary or agency. They may demonstrate some of the characteristics of an employee while also demonstrating those of the self-employed, for example, having flexible hours or no fixed place of work.

It is worth adding that, while relatively new gig economy firms are the ones that have been the focus of public and media attention, the challenges thrown up by the distinction between self-employment and employment are longstanding. Gig working has been a characteristic of our labour market for a long time, across a wide range of sectors including public administration, education and financial services, as well as the more obvious ones of construction and transport. The largest increases in self-employment since 2009 have actually been in administrative and support service activities; information and communication; and health and social work.

Pay in some of these sectors is often low and prospects for progression are limited. This highlights the other challenge thrown up the divide between self-employment and employment in addition to the potential for arbitrage by firms: individuals, who may have many of the characteristics of being employed nevertheless lack the rights and protections of employed workers. Improving those rights and protections in a sustainable way – i.e. without creating new opportunities for arbitrage or damaging the viability of work opportunities - is an important objective.

Cracking these issues is difficult; and this paper is an initial briefing based on early analysis as part of a longer project that will report in Spring 2017. The Office for Tax Simplification (OTS) has already examined many of the issues mentioned here, commenting that “employment status is a complex and wide-ranging subject that many have said has no real

solution – and that if we [OTS] did manage to ‘solve it’, we should immediately move on to world peace as we’d clearly be on a roll.”

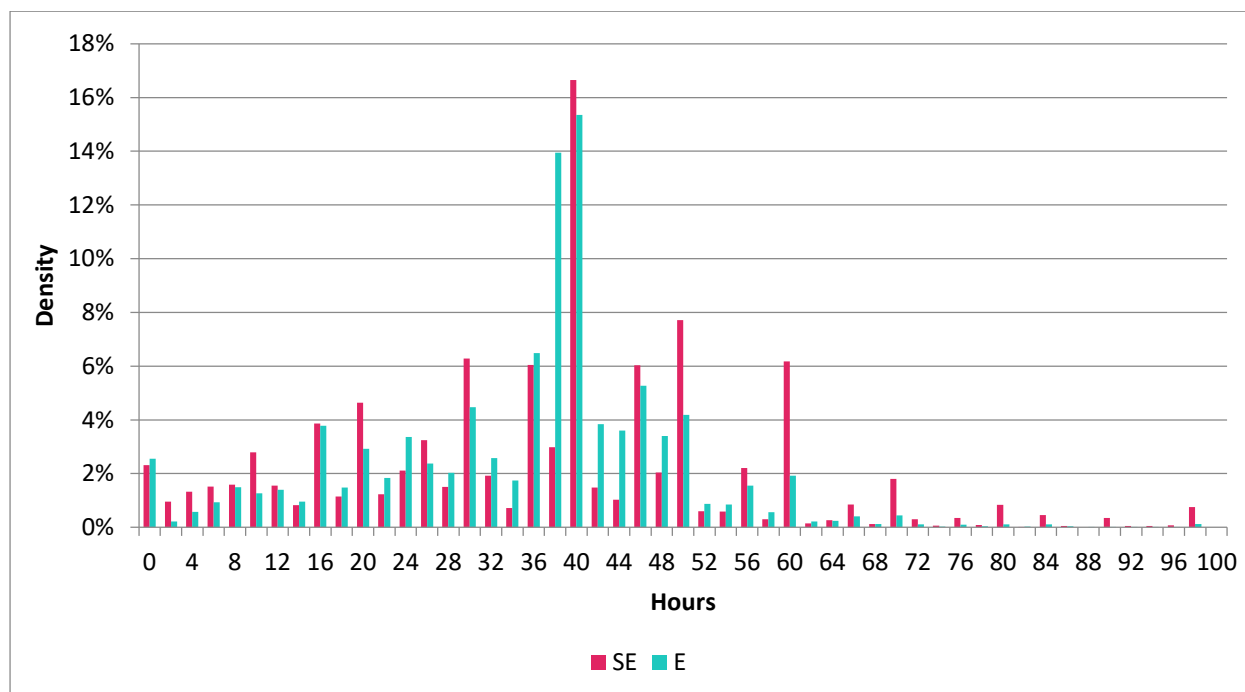
What we attempt in this paper is more modest: to describe the initial results from analysis which aims to disentangle self-employment from employment; identify some of the vulnerabilities that those in self-employment may experience compared to employed workers; and begin to suggest some policy options for how those vulnerabilities can be tackled, including potentially through managing the distinction between self-employment and employment differently in the future.

DISENTANGLING SELF-EMPLOYMENT FROM EMPLOYMENT

The challenge in disentangling self-employment from employment is that there is very wide variation in the characteristics of the self-employed; and the same is true for the characteristics of the employed.

At a first glance, looking for example at numbers of hours worked (Figure 1) we can observe that the largest proportion of workers in either category is working 40 hours per week. The proportions working 36 hours per week are also broadly the same. There are some self-employed who work exceptionally long hours, more so than is the case for employees, though for the most part, across shorter working hours and the still fairly conventional band of 36-40 hours, the distribution is largely similar; and the differences across employment status are smaller than those we observe when comparing different sectors.

Figure 1: total hours worked including overtime



We tested this idea a little further. Specifically we examined whether it is possible to set aside how people identify themselves – whether as self-employed, employed or both – and instead study the characteristics of how they work. It may be that analysing those characteristics without the filter of employment status will help us to see the underlying reality of different working patterns.

We attempted to do this using the Labour Force Survey (LFS). LFS is a study of the employment circumstances of the UK population. It is the largest household study in the UK and provides, among other data, the official measures of employment and unemployment. We carried out a cluster analysis of responses to LFS based on the following variables:

- Whether hours vary
- Whether the respondent has second job
- Whether does shift work
- Type of working hours arrangement (e.g. flexitime, zero hours contract)
- Whether more than one client
- Whether works at home
- Whether works overtime
- Whether has employees

For this purpose we pooled the responses from all respondents, regardless of how they reported their employment status. Our thought was that we could then look at the clusters we got from the initial analysis and compare the characteristics of the clusters – for example, there may be a cluster where hours vary by much more than the average, or one where a much larger proportion have more than one client. These clusters could provide an alternative way of thinking about the different conditions or status of workers in the labour market.

No such luck. Analysing the responses referred to in the LFS reveals no clusters. The level of variation in the responses is so large that they scatter across any grid that we tried to create. Any hope that, by putting employment status to one side, we might observe underlying clusters of working patterns in the data was dashed. This leads us back to where we started: employment status does not always help us to differentiate between how people are working; but there is no readily available alternative.

For that reason, we plan to embark on a new survey of workers, focusing on those who we think may be most likely to be tangled up in the distinction between self-employment and employment. Using networks of workers' associations and business representative organisations we hope to uncover more information about the modern reality of working at this interface.

We tried one other approach using data that already exists. Through the Understanding Society dataset – Understanding Society is an academic study capturing information every year about the social and economic circumstances of people living in the UK – we were able to look at whether workers of different types experience autonomy in their work.

We looked at this because, after all, underlying the concept of self-employment is the idea that self-employed workers have a looser or freer relationship with the person or firm paying for their labour than employees do. One way to test the distinction between self-employment and employment is to examine whether it is indeed true that self-employed report autonomy in doing the tasks they are set, or the hours they work.

We find that, on the whole, higher proportions of self-employed do report autonomy compared to employees. As shown in Table 1, 80% of self-employed report 'a lot' of autonomy over job tasks compared to 39% of employees. The same pattern is apparent in autonomy over hours. As shown in Table 2, 68% of self-employed have 'a lot' of autonomy over work hours compared to 22% of employees. These are much more substantial differences than we observed, for

example, on the number of working hours. This is revealing, though perhaps unsurprising; after all, the test of employment status is based on something very close to a definition of autonomy, and so we should expect that self-employed workers are autonomous.

That said there is nevertheless a significant proportion of self-employed experiencing 'some', 'a little' or no autonomy over either job tasks or work hours. The proportion is 1 in 5 for job tasks; and 1 in 3 for work hours. Their experience may therefore be much more akin to that of the employed, again suggesting that their employment status may not convey so much useful information about their actual conditions of work; and that the test of employment status may be failing as a way to reflect the underlying nature of the working relationship.

Table 1: autonomy over job tasks

Autonomy over job tasks				
	A lot	Some	A little	None
Self-employed	80%	13%	4%	3%
Employees	39%	32%	15%	14%

Table 2: autonomy over work hours

Autonomy over work hours				
	A lot	Some	A little	None
Self-employed	68%	17%	8%	7%
Employees	22%	21%	18%	40%

The nub of the challenge may be that a significant proportion of self-employed do not enjoy the autonomy associated with self-employment; and yet also fail to enjoy some of the rights and protections that those in employment, with similar levels of autonomy, have access to.

The focus of our next section is to uncover in more detail what these disadvantages or vulnerabilities may be.

HOW DO SELF-EMPLOYED DIFFER FROM EMPLOYEES

To consider this, we went back to employment status. While there may be no large differences between the spread of working hours, as observed in Figure 1, there may be other significant differences between self-employed and employees.

Using LFS, we observe a few. Starting with the disadvantages or vulnerabilities that the self-employed experience, we find that self-employed are less likely to be paid for overtime: 71% of self-employed working overtime do so unpaid, compared to 62% of employees. This is shown in Table 3.

The very fact that so many self-employed report working overtime at all – 13% on our analysis – is in itself surprising. Working overtime suggests more control by the person paying for work than we might assume in self-employment.

Table 3: likelihood of being paid for overtime

Paid vs unpaid overtime		
	Unpaid	Paid
Self-employed	71%	29%
Employees	62%	38%

Self-employed are also less likely to receive training: 4% of self-employed received training in the 4 weeks before the survey, compared to 8% of employees, as can be seen in Table 4. When self-employed do receive training, it is less likely to be on the job. In other words, they may be expected to train in their own time. This perhaps fits better with our traditional conception of self-employment – training on the job suggests more control by the person paying for work – though it is likely to diminish the time self-employed have to take on other work.

Table 4: likelihood of receiving training

Education and training on or off job (last 4 weeks)				
	On	Off	Both	% of total
Self-employed	26%	61%	13%	4%
Employees	44%	35%	20%	8%

We also find that self-employed are less likely to days off sick. When they do take days off sick, as can be seen in Table 5, on average they return to work quicker than employees. The reason for this is likely to be obvious: their sick days are unpaid.

Table 5: likelihood of taking days off sick

Days off sick in week of the survey		
	Mean number of days taken	% of total taking days off sick
Self-employed	2.29	1%
Employees	2.61	2%

Finally, on this theme, we find that self-employed are less likely to be saving: only 43% of self-employed are saving compared to 54 of employees. This can be seen in Table 6.

Table 6: likelihood of saving

Whether saving		
	Yes	No
Self-employed	43%	57%
Employees	54%	46%

Over the course of this project, especially using the new survey mentioned in the previous section, we hope to illustrate further some of the disadvantages or vulnerabilities that those in self-employment experience.

A striking corollary of our analysis so far is that the disadvantages or vulnerabilities we have identified exist even though the profile of self-employed workers does not obviously suggest they have weaker bargaining power.

As shown in Table 7, the occupation mix is skewed towards the higher skilled end, compared to employees: 16% of self-employed are managers, directors and senior officials compared to 10% of employees; and 26% are in skilled trades compared to 8% of employees. At the other end of the labour market, only 2% of self-employed are in sales and customer service compared to 9% of employees; and only 6% are in elementary occupations compared to 11% of employees.

Table 7: occupation grouping for main job

Major occupation group – Main job									
	Managers, Directors & Senior Officials	Professional	Associate Professional & Technical	Admin & Secretarial	Skilled Trades	Caring, Leisure & Service	Sales & Customer Service	Process, Plant & Machine	Elementary Occupations
Self-employed	16%	17%	15%	3%	26%	7%	2%	8%	6%
Employees	10%	21%	14%	12%	8%	10%	9%	6%	11%

On a similar theme, we find that there are higher concentrations of self-employed in London and South East, successful economic regions, compared to parts of the country where we might expect there to be on average a higher proportion of lower value added roles or poorer prospects for employment and progression.

This begs the question: if we cannot explain the difference in working conditions by some underlying economic logic – e.g. self-employed workers are less productive or their labour is used by lower-performing firms and this is why they enjoy poorer working conditions – then we might ask if the distinction of employment status itself gets in the way of improving the conditions of self-employed workers?

We need to do a lot more analysis to consider that question fully. For the purposes of this initial briefing note, we suggest some high-level ideas in the final and concluding section which we will develop further by the end of the project.

SIMPLIFYING THE DISTINCTION BETWEEN SELF-EMPLOYMENT AND EMPLOYMENT

There are at least a couple of different ways in which the distinction between self-employment and employment might get in the way of improving the conditions of self-employed workers.

The first is that, if the firms using workers benefit from a significant financial advantage in deploying them as self-employed rather than as employees, then they are likely to seek that advantage. Plainly that advantage does exist. It is made up in a number of different ways: National Insurance Contributions overall are lower for self-employed workers; there is no auto-enrolment into making employers' pensions contributions; the costs of tax administration can be passed on from the firm to the worker; and there are savings on sick pay and other workers' rights as well.

In considering whether to address one or more of the specific disadvantages or vulnerabilities that self-employed workers experience, a firm may wish to do so and yet, by doing so, risk losing the remaining financial advantage that they have been enjoying.

For the purposes of considering this idea, we put to one side firms that may have no intention of improving conditions. These may be more numerous compared to firms who do want to make improvements – and the appropriate action for them may be to increase enforcement or make the employment status test more exacting. HM Revenue and Customs has recently announced the creation of a new Employment Status and Intermediaries Team as part of a drive to take, as Financial Secretary to the Treasury Jane Ellison has put it, “strong action where companies, to reduce their costs, force their staff down routes which deny them the employment rights and benefits they are entitled to.”

While enforcement action will be appropriate in some cases, we have also heard from firms who would wish to provide protection to their workers for days off sick, whether in the form of sick pay or insurance, but they do not do so because, while they judge that specific decision to be affordable and sustainable, they do not consider a wholesale transfer of workers from self-employment to employment to be so. By doing a little, they risk being on the hook for doing a lot; and so they hold back from doing a little as well.

We have heard the same point made about training. The gain in productivity from training, the firm judges, is worth having; but it is not large enough to risk putting the workers receiving training over the line into employment.

The most effective way to achieve a different result in these situations – and to address the disadvantages and vulnerabilities that we have observed self-employed workers as experiencing – may be to reduce the size of the financial advantage a firm achieves by using self-employed workers as opposed to employees.

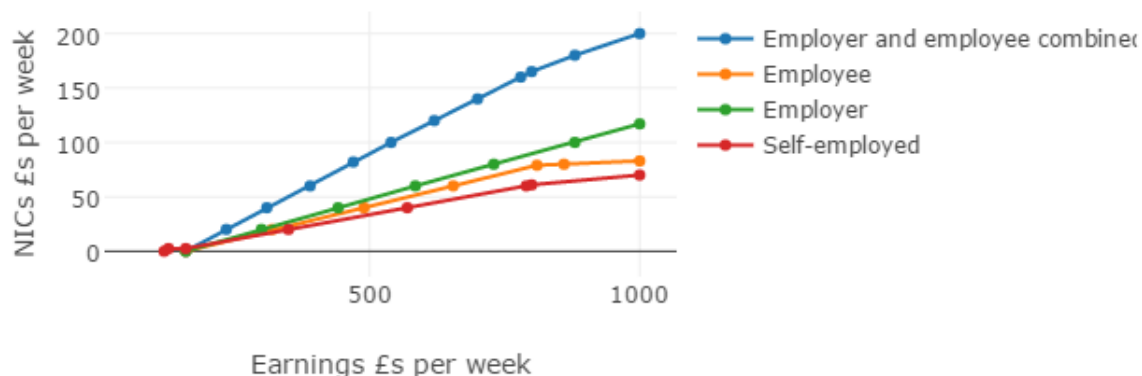
Thinking specifically about National Insurance Contributions, for example, policy could target broadly the same aggregate revenue – and hence leave the tax burden on workers and business broadly unchanged - while levelling the rate between self-employed and employees.

The present differences are large, illustrated in Figure 2 below. This might suggest that levelling them out will have to be done on a gradual basis. Ultimately, the aim could be to treat National Insurance Contributions very much like income tax – a single, consistent rate regardless of the nature of employment and with no distinction between individual and employer contributions. A first step towards such a policy could be to push up the level of self-employed contributions while reducing employer contributions, cutting the incentives for both sides of the employment relationship to arbitrage the employment status distinction rather than reflect the underlying reality.

A first step in this direction, alongside a policy statement about the long-term ambition to achieve parity, would potentially begin to change the decision-making in firms and improve the working conditions of the self-employed, as well as reduce perhaps the enforcement challenges faced by HMRC in policing the distinction between self-employment and employment.

Figure 2: difference in National Insurance Contributions

NICs contributions for employed and self-employed people



The second way in which the distinction might be a stumbling block to the underlying objective of improving conditions for self-employed workers might be that some self-employed benefit from its use, even if others do not. If a significant proportion of workers in a firm, sector or occupation benefit from being treated as self-employed, then this may become the norm throughout the firm, sector or occupation, even if it is not to the benefit of everyone.

We see hints of this divide among self-employed workers in our analysis. For example, while we find that the proportion of self-employed who are saving is lower than employees, those who are saving are on average putting aside higher amounts per month.

If the population of self-employed is indeed bifurcated in this way - split for example between the well paid and highly skilled who genuinely enjoy autonomy in their work and are broadly satisfied with the trade off on rights and protections that they are making or can price the loss of rights and protections into their pay, versus those who have lower pay, less autonomy and on top of that are losing out on rights and protections – then it may be that the distinction between self-employment and employment could be clarified in new ways.

One option would be to stipulate that all workers earning below a threshold amount are employees, regardless of the other characteristics of their work. The question of whether a worker is self-employed or employed would therefore only arise for higher-paid workers, where we might feel more confident in assuming that their bargaining power is such that they will only be classified by the firm paying for their work as self-employed if that is a fair description of their working conditions. We recognise that this might cause issues for start-up entrepreneurs and that this would need to be addressed.

Once again, making a change like this suddenly would be hugely disruptive and drive additional costs, including those of change itself, on to new and small firms, as well as those with narrow profit margins. There would be challenging policy design questions over how to set the threshold, whether it is annual earnings or hourly earnings for example.

However, if we take the view that the distinction between self-employment and employment is already fraying, and likely to come under further pressure in the years ahead, then we may be wise to work through such issues and then set a date 3-5 years in advance when a change like this will come into effect.

NEXT STEPS IN THE PROJECT

This briefing reports on some early analysis from the project and begins to explore some policy options for the future. We have already noted that there are significant data gaps and there is a wider question around whether the characteristics of employment or self-employment that we can observe in the data are distorted by how workers identify themselves.

For example, limited company contractors may identify as employees, because of the level of control they experience in their work contracts, though they are treated as self-employed by the firms for whom they work. The high proportion of self-employed who identify as managers and directors may also mislead us as to their bargaining position – for example, they may be managers or directors of one person firms in low-paid or low-skilled sectors of the economy.

To tackle some of these issues, SMF will work with a broad range of business organisations over the next three months to survey workers who are at the crossroads of employment and self-employment. We hope that this will provide a better basis on which to base policy recommendations. Those recommendations will feature as part of a final report from this project in Spring 2017.