The "Gig Economy" and Independent Contracting: Evidence from California Tax Data on Prevalence and Incomes

By Annette Bernhardt (UC Berkeley), Allen Prohofsky (California Franchise Tax Board), and Jesse Rothstein (UC Berkeley)

Most labor market policy in the United States is designed for long-term employment relationships. Self-employed workers, including independent contractors and on-demand platform ("gig") workers, are excluded from many labor market protections, such as wage and hour laws, occupational safety and health regulations, unemployment insurance, and employer-provided health insurance and retirement programs.

These exclusions may contribute to reduced economic security and chronic instability in incomes and work lives. In order to develop solutions that will address workers' needs, policymakers need to understand whether gig work and other forms of independent contracting have actually grown, and if they have, how rapid that growth has been and where it has been concentrated. Especially important will be to understand the industries where independent contracting is most prevalent or has been growing rapidly, potentially signaling misclassification and the need for stronger enforcement. Equally important will be to understand how workers at different points of the income distribution are using independent contracting (as a main job or as supplemental income) and how these strategies change over the life cycle, including into retirement.

The problem is that we have very little consistent, rigorous evidence about the prevalence and nature of independent contracting, its growth in recent years, or its consequences for workers' economic security. Commonly-used labor market datasets are based on worker surveys, which contain significant reporting error on employment status. Employer surveys and many administrative data sources are often oriented toward traditional jobs. Individual tax data can therefore be critical to answering many of the outstanding empirical questions about independent contracting and gig work in particular.

Individual tax data have two clear advantages: (a) the clear distinction between W-2 income, on the one hand, and independent contracting (measured by sole proprietorship income) on the other; and (b) the ability to measure both traditional and non-traditional earnings for a given tax filer, both within a year and over time. For these reasons, tax data are crucial to advancing our understanding of the new world of work. But these data are very difficult to access and research to date has either been conducted by the U.S. Treasury and has focused on implications for tax collection, or by research teams focused on important measurement questions that arise from differences in workers' self-reported employment status compared to that suggested by tax data.

We use individual income tax return data, including information returns, collected by the California Franchise Tax Board (FTB), to study the prevalence and nature of independent contracting work in California. California is the birthplace of on-demand platforms and adoption in the state occurred earlier and at higher rates than in other parts of the country, yielding richer information on this emerging form of work. California is also the world's fifth largest economy (if viewed as a nation) and is home to roughly 40 million people, a larger population than the smallest 21 states combined.

Our study uses the FTB data to investigate six related research questions:

1. How prevalent is independent contracting in the California labor market?
2. How many workers use independent contracting for their main source of earnings and how many use it for supplemental income (and how important is that supplemental income to their total earnings)?
3. How prevalent are the different types of work categorized as sole proprietorships, such as independent contracting leading to a 1099-MISC, on-demand platform work leading to a 1099-K, and non-1099 self-employment income?

In order to answer these questions, we develop categorization of workers based on whether and how they mix W-2 jobs and sole proprietor income. This has important implications for public policy responses. Workers who are supplementing W-2 jobs with side gigs likely have very different needs than those for whom independent contracting is the main source of income, so effective labor market policy requires knowing how many of each there are.