Employment Policies INSTITUTE

POLICY BRIEF

NOVEMBER 2019

The Impact of Tip Credit Elimination on Servers' Share of Employment

Technical Analysis By:
David Macpherson | E.M. Stevens Professor of Economics | Trinity University
Dr. Bill Even | Raymond E. Glos Professor of Business | Miami University

KEY FINDING

When full-service restaurants open in states without a tip credit, they hire fewer tipped workers relative to states with a robust tip credit, and tipped employees are working fewer hours in those restaurants.

BACKGROUND

Over five million Americans currently work in restaurants as tipped servers or bartenders in restaurants.[1] By one estimate, nearly one in three American workers worked in the restaurant industry as their first job.[2] Despite the industry's popularity as a place of employment, it has been the subject in recent years of a well-funded attack by a labor group called the Restaurant Opportunities Center (ROC).

ROC dedicates a large amount of its annual budget of approximately $10 million to attacking the current tipping system; in particular, ROC advocates for the elimination of the tip credit.[3] (See side bar.) A bill in Congress called the "Raise the Wage Act of 2019" would eliminate this credit at the federal level.[4] ROC has pursued similar legislation in state capitols and at the ballot box, with few instances of success thus far. As an alternative to the current system, ROC has praised restaurateurs such as Danny Meyer who have pursued a no-tipping approach.[5] ROC's founder Saru Jayaraman described the group's position thusly: "Ultimately, this system of tipping needs to go."[6]

ROC's proposal has proved unpopular with the individuals it's supposedly supposed to help: Tipped employees. According to a 2018 survey from industry publication Upserve, 97 percent of tipped employees prefer the current tipped system to an alternative where they earn a much-higher base minimum wage but tips are not included.[7] In numerous states, tipped employees have organized against changes to the tipping system, which they argue will put their incomes and jobs at risk.[8]

WHAT IS THE TIP CREDIT?

Under the Fair Labor Standards Act (FLSA), the tipped minimum wage is the required base wage paid to employees who customarily receive tips. Tipped employees are subject to the same minimum wage ($7.25 at the federal level) as all other employees; employers are legally-required to make up the difference in pay should an employee's tips plus base wage not equal the standard minimum wage.[9] Almost all states (43) follow this standard, consistent with the Internal Revenue Service, of treating tips as income earned on the job. However, seven states—California, Nevada, Oregon, Washington, Minnesota, Alaska, Montana—do not count tips as income for the purposes of an employee's wage.

RESEARCH AND CURRENT EVIDENCE

ROC has supported its rhetorical case for changing the current tipping system by pointing to the seven states that have abandoned it. In particular, ROC has argued that the continued existence and growth of restaurants in those states supports its case that changing the tipping system has no negative repercussions for the restaurant industry.[10]

However, recent evidence out of California shows that states that do not allow a tip credit are suffering under higher wage mandates. To absorb the higher labor costs, restaurants and bars have increased prices, laid off employees, or closed down entirely.

In 2016, the San Francisco Chronicle stated that rising labor costs were one of the biggest contributors of why it was so expensive to dine out in the city.[11] More recently, a survey out of Emeryville, California identifies that "the restaurant industry is clearly struggling" due to the city's rising wage mandates.[12] The survey also includes excerpts from local restaurant owners that address the desire to implement a tip credit: "Apply the tips (gratuity) towards hourly wage. There is a huge difference between the front of the house and kitchen staff."

> The restaurant industry is clearly struggling.

Other restaurants have transitioned from the full-service model to quick service in order to reduce labor costs. The *New York Times* reports that restaurants are opting to replace service staff with customers to pick up meals and bus tables since staff in the kitchen can't be cut and burgers that go for $20-$25 will turn away customers.[13] As one owner explained, "Something has to give."

As a last resort, many restaurants have opted to close down altogether. In San Francisco, where the minimum wage is $15 without an allotted tip credit, restaurant closures are at an all-time high. Food publication Eater even labeled the exodus of restaurants as the "death march."[14] Researchers with Harvard University and Mathematica Policy Research examined the effects of San Francisco's rising minimum wage on the restaurant industry. They found that each one-dollar increase in the minimum wage leads to a 10 percent increase in the likelihood of restaurant closures for 3.5 star rated restaurants as well as a four to six percent reduction in restaurants entering the market.[15]

Another contemporaneous example comes from New York, where the tipped minimum wage has increased rapidly from $5 to as high as $10 over the past four years. The impact on the state's full-service restaurant industry has been severe, particularly in its largest city. An article titled "The new minimum wage is killing NYC's once-thriving restaurant scene" described how the city suffered its first year-over-year loss of full-service restaurant employment in two decades.[16] A recent survey of hospitality industry employers in the city found that 36 percent had eliminated jobs in 2018.[17]

NEW ANALYSIS: TIPPED WORKERS' SHARE OF EMPLOYMENT

Some impacts of a higher tipped minimum wage are obvious; restaurants that close because of rising labor costs is one clear example of a negative impact. Other consequences—such as restaurants adopting staffing models where fewer employees are required—may be more difficult to see. Drs. David MacPherson from Trinity University and Bill Even from Miami University examined these impacts using Census Bureau data on the employment and hours of tipped workers by state.

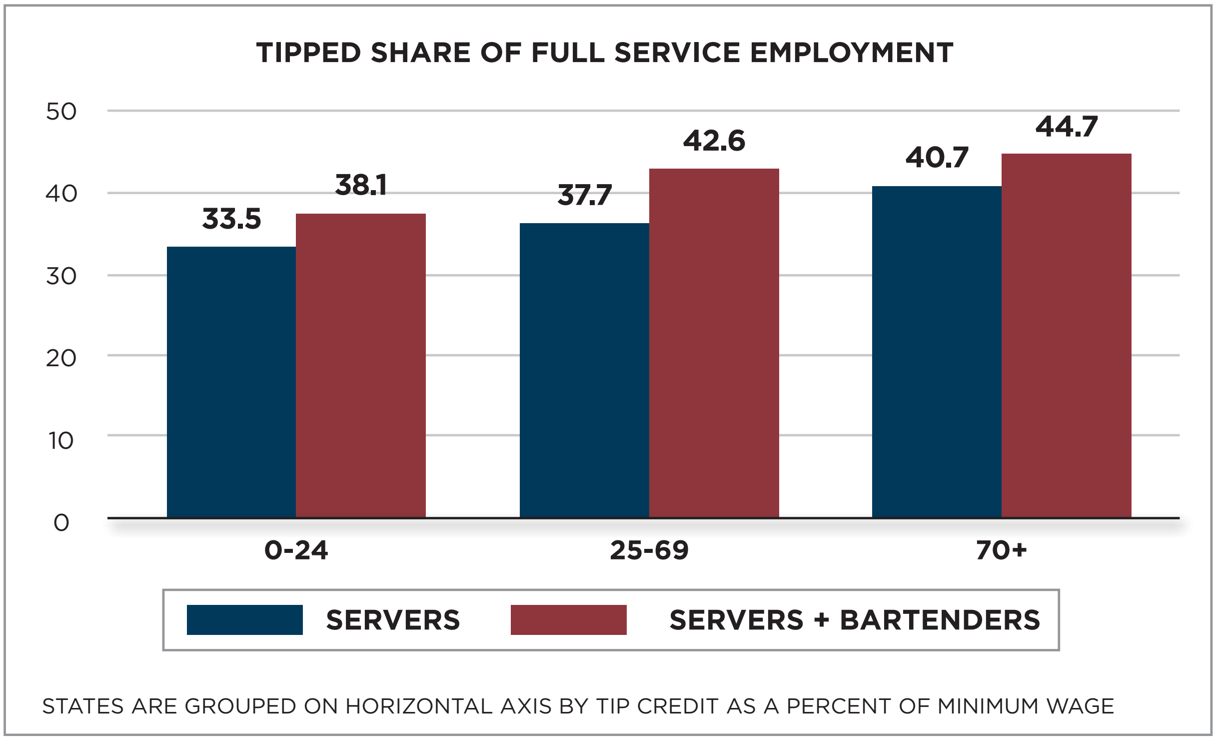
The researchers found that as the tip credit rises in states, the tipped worker share of employment and hours worked rises; conversely, states with a smaller or non-existent tip credit have a correspondingly smaller share of tipped employment.

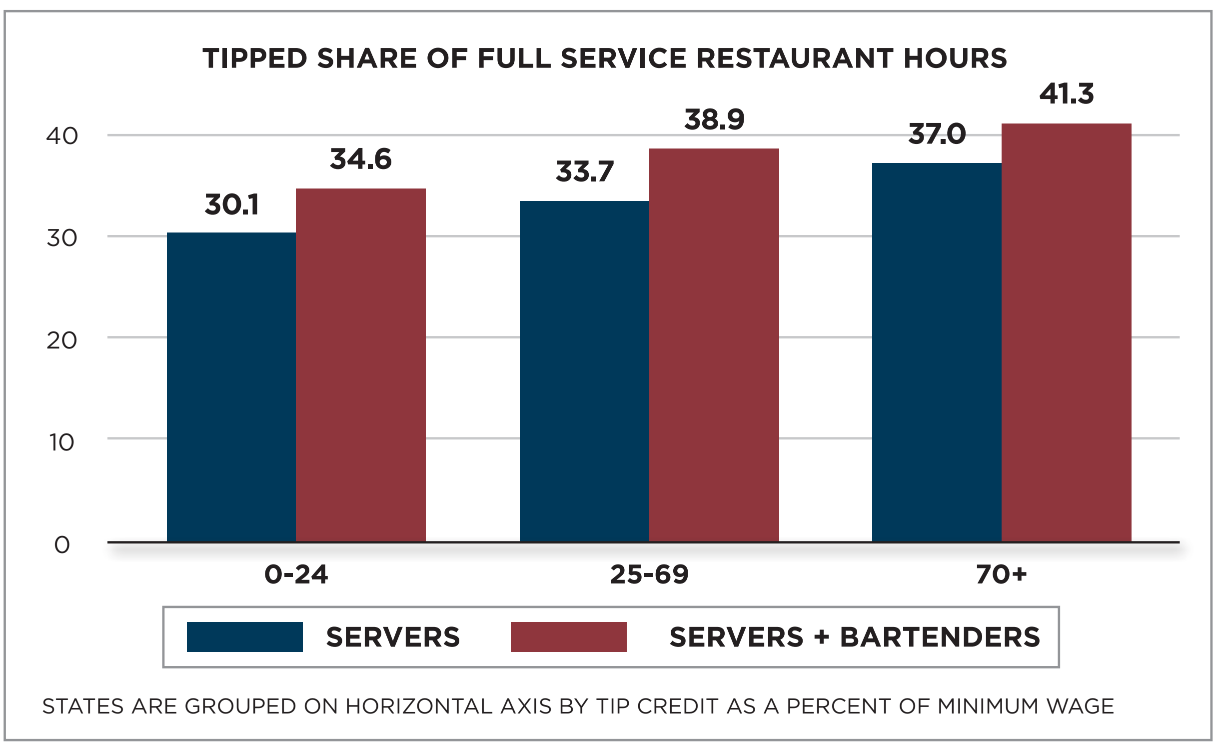
The key findings are as follows. (Full details are in a technical analysis at the end.)

- In states with a severely compromised tip credit, tipped servers represent a nearly 18 percent lower share of employment in full-service restaurants, compared to states with a more-robust tip credit;

- The difference is similar when looking at tipped employees' hours: Tipped employees represent nearly 19 percent fewer hours worked in full-service restaurants, relative to states with a more-robust tip credit;
- The conclusion is clear: Even as full-service restaurants open in states without a tip credit, they hire fewer tipped workers relative to states with a robust tip credit, and tipped employees are working fewer hours in those restaurants.

These results provide empirical support for the trend captured in the aforementioned *New York Times* article, where self-service restaurant models substitute for full-service in full-service restaurants. Technology makes some of these changes easier: Tabletop ordering devices





allow restaurants to staff fewer servers per section. For example, one tipped franchisee in New York shed one-third of his 3,000-person staff in response to the state's rising tipped minimum wage. Tabletop ordering devices made such a shift possible.[18]

The authors' analysis suggests that, while some restaurants may continue to grow in states with little or no tip credit, they will do so with a smaller share of tipped employees.

TECHNICAL ANALYSIS

Dr. David Macpherson, Trinity University
Dr. William Even, Miami University

The data for the analysis is drawn from two sources. The 2015 and 2016 American Community Survey (ACS) and the 2015 and 2016 Quarterly Census of Employment and Wages (QCEW). The ACS is used to compute the number of employees that are restaurant workers in each state, as well as the number of servers and bartenders. Total weekly hours for each type of worker is also estimated by state.

Since the ACS does not distinguish between full and limited service restaurants, the QCEW is used to estimate state-specific measures of full-service employment. A calculation is also used as an estimate of full-service hours in each state by multiplying full-service employment by the average weekly hours of a restaurant worker in that state.

The graphs show the server share of full-service restaurant employment, as well as the share held by servers and bartenders. The graphs illustrate that as the tip credit rises, the tipped worker share of employment (and hours) rises. This is to be expected since a decrease in the tip credit drives up the cost of tipped relative to non-tipped workers.

The regressions show a similar result and establish the statistical significance of this relationship. The regressions are described by the following model:

$$Tipped_i = \beta_0 + \beta_1 Full_i + \beta_2 Full_i * Tip\ Credit_i + u_i$$

Where Tipped_i is tipped employment or hours in state i, Full_i is full service employment or hours in state i, and Tip Credit_i is the tip credit as a percent of the minimum wage in state i (measured as a categorical variable).

The regression results mirror the patterns shown in the figures. In states with a tip credit of less than 25 percent of the minimum wage, a one-unit increase in full-service employment leads to 0.37 additional servers. The impact of full service employment on server employment is greater in states with a greater tip credit percentage. In states with a tip credit of 70 percent or more of the minimum wage, a one-unit increase in full-service employment leads to 0.42 additional servers. A similar pattern exists for the effect of the tip credit when using hours of employment, or the employment of servers and bartender.

---

1 https://www.bls.gov/ooh/food-preparation-and-serving/food-and-beverage-serving-and-related-workers.htm
2 https://www.americaworkshere.org/first-job
3 https://projects.propublica.org/nonprofits/organizations/10939141/201823119349300547/IRS990
4 https://www.congress.gov/bill/116th-congress/house-bill/582/text
5 https://rocunited.org/2017/09/danny-meyer-no-tipping/
6 https://www.foxnews.com/politics/restaurant-labor-group-targets-tips-in-next-phase-of-minimum-wage-fight
7 https://upserve.com/restaurant-insider/restaurant-industry-report-shares-everything-need-know-tipping/
8 https://totalfood.com/upstate-waitress-raczynski-nyc-tip-credit-elimination/
9 https://www.dol.gov/whd/regs/compliance/whdfs15.htm
10 https://rocunited.org/wp-content/uploads/2018/02/OneFairWage_W.pdf
11 https://www.sfchronicle.com/restaurants/article/Why-is-it-so-expensive-to-dine-out-in-San-6856554.php
12 https://evilleeye.com/news-commentary/council-considers-minimum-wage-pause-after-mills-study-reveals-struggling-local-emeryville-restaurants/
13 https://www.nytimes.com/2018/06/25/dining/san-francisco-restaurants-service.html
14 https://sf.eater.com/2016/12/9/13901596/restaurants-bars-closed-winter-2016-san-francisco-bay-area
15 https://www.nber.org/papers/w25806?utm_campaign=ntwh&utm_medium=email&utm_source=ntwg20
16 https://nypost.com/2019/03/30/the-new-minimum-wage-is-killing-nycs-once-thriving-restaurant-scene/
17 https://thenycalliance.org/information/survey-results-labor-costs
18 https://www.youtube.com/watch?v=S4P8Fq9Tal0
