Insight

Setting the Record Straight on the Minimum Wage for Tipped Employees

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Washington, DC has been at the center of a vigorous debate about the minimum wage for tipped workers. This month the DC council approved a measure that by 2020 will raise the District's minimum wage to $15 per hour and the minimum cash wage for tipped workers from $2.77 to $5. From that point forward both minimum wage and the minimum cash wage for tipped workers will increase with inflation. While the bill mandates a dramatic increase in both wage rates, the measure is still not enough for some. In particular, the Restaurant Opportunities Center (ROC) announced a ballot initiative to raise the minimum cash wage for tipped workers to $15 per hour as well. What the leaders of the "One Fair Wage" campaign neglect to tell you, however, is that under all labor laws between cash wages and tips, tipped workers are already guaranteed *at least* the same minimum wage as everyone else. Moreover, such a change would do little to help those most in need and would only compound the negative labor market consequences of an already dramatic increase in the Districts minimum wage.

First, let's get the facts straight on how the minimum wage applies to tipped workers. Nationally, under the Fair Labor and Standards Act (FLSA), all workers must earn at least $7.25 per hour. Businesses are able to classify workers who receive more than $30 per month in tips as tipped employees. The law recognizes that tips are both a significant portion of the earnings these workers receive and a substantial additional cost to consumers who utilize these workers' services. Accordingly, FLSA allows an employer to claim a portion of a worker's tips as a "tip credit" and count those tips towards the minimum wage. Table 1 displays the tip credit and minimum cash wage for tipped workers under federal law, the previous DC law, the new DC law, and ROC's proposal.

Table 1: Minimum Wage for Tipped Workers

Wage Law	Minimum Wage	Tip Credit	Minimum Cash Wage
Federal Law	$7.25	$5.12	$2.13
DC Previous Law (effective July 2016)	$11.50	$8.73	$2.77
DC New Law (effective July 2020)	$15.00	$10.00	$5.00
ROC Proposal	$15.00	$0.00	$15.00

Federally, the maximum tip credit is $5.12 per hour, which means that employers are responsible to pay workers at least $2.13 per hour in cash wages. If at any given point the combination of the workers tips and the $2.13

cash wage falls short of the entire $7.25 per hour minimum wage, then the employer must make up the difference with a higher cash wage. As a result, under federal law all tipped workers are entitled to at least the same minimum wage as everyone else, and in many cases they have opportunity to make far more.

The law approved by the DC council works exactly the same way. Except by 2020 the minimum wage in the District will be $15 per hour, not $7.25. For tipped workers, the maximum tip credit will be $10 per hour, as employers will be responsible to pay at least $5 per hour in cash wages. Again, if the combination of the workers tips and the $5 cash wage is short of the entire $15, the employer must make up the difference, guaranteeing that all tipped workers make at least $15 per hour. ROC's proposal, meanwhile, would eliminate the tip credit all together and force employers to pay tipped workers at least $15 per hour in cash wages, regardless of how much the workers make in tips.

So under this minimum wage system, tipped workers are indeed guaranteed the same minimum hourly pay rate as all other workers and even have opportunities to make much more. Consider examples of two different tipped workers in DC under the $15 minimum wage bill just approved by the DC council. Indeed, the $5 per hour minimum cash wage requirement does not mean that tipped workers only earn $5 per hour.

Tipped Worker A

Tipped worker A works for a low-cost diner and only makes $5 per hour in tips. Combining her tips with the minimum required cash wage of $5 per hour, she would end up making $10 per hour total. This would leave her short of the $15 minimum wage guaranteed by the law. Consequently, her employer must make up the difference by increasing her cash wage by $5 per hour, so she still ends up making $15 per hour.

Tipped Worker B

Tipped worker B works in a high end restaurant and makes $15 per hour just in tips. As required by law, her employer must still pay her an additional $5 per hour to meet the minimum cash wage requirement. As a result, tipped worker B ends up making $20 per hour, 33 percent more than the minimum wage everyone else receives.

Tipped worker A is the anecdotal vulnerable worker that labor advocates want to protect by raising the minimum cash wage for tipped employees. But clearly regardless if the minimum cash wage for tipped workers were $2.77 as in the previous DC law, $5 as in the newly approved law, or $7.50 as in Mayor Bowser's initial proposal, tipped worker A still makes at least $15 per hour. Since adjusting the minimum cash wage for tipped workers has no impact on the well-being of vulnerable workers, it does little to help those most in need and only mandates an additional cost on businesses for employing those workers.

Moreover, raising the minimum cash wage for tipped workers can perversely benefit workers who do not require assistance. This is the case for tipped worker B who earns $15 per hour just in tips. Yet the DC government will still require her employer to compensate her with an additional $5 per hour.

The perverse effects of raising the minimum cash wage for tipped workers become even worse when considering both workers under ROC's proposal, which would eliminate the tip credit and require that employers compensate tipped workers with at least $15 per hour in cash wages. With $5 in tips and a $15 minimum cash wage from her employer, the vulnerable tipped worker A would make $20 per hour. Meanwhile, with $15 in tips and a $15 minimum cash wage, tipped worker B would end up making $30 per hour. In tipped worker B's case, the government would require an already self-sufficient worker to receive an additional $15 per hour.

One may ask, wouldn't tipped workers greatly benefit from such substantially higher wages and reduce poverty? Unfortunately, policymakers are not genies who can snap their fingers to grant workers higher wages and eliminate poverty without consequences. Rather evidence consistently demonstrates that raising the minimum wage often hurts those it is intended to help by increasing joblessness among vulnerable workers and failing to deliver income gains to those who need it most.

In Washington, DC, the council opted to increase in the minimum wage and the minimum cash wage for tipped workers despite evidence that the restaurant industry has been suffering in U.S. cities that recently raised the minimum wage. Last year, restaurant employment growth in cities that raised their minimum wages declined substantially. The council also ignored warnings right at home as local businesses and restaurants made it clear they will not be able to absorb the minimum wage hike without at least some workers losing their jobs. For instance, in response to Mayor Bowser's initial plan to raise DC's minimum wage to $15, the popular bar Capitol Lounge tweeted, "if this bill passes, we will be forced to make drastic changes or close entirely." Even worse, Walmart abandoned its plans to build two stores in DC and indicated their decision was in part due to the District's plan to raise the minimum wage to $15 per hour and to require employers to fund paid family leave for all workers. The evidence is clear that not only will workers lose their jobs or be unable to obtain a new one, but the vulnerable low-wage service workers in restaurants, bars, and retail that the measure is intended to help will be ones most burdened with the additional joblessness.

Raising the minimum cash wage for tipped workers to $15 per hour, as ROC is advocating, will only make matters much worse for service workers. In the industry that this measure would primarily impact, restaurants, customers are more sensitive to the increase in prices that would be necessary to offset the additional labor costs. Ironically, this is largely due to the custom of tipping: any increase in prices would also result in a larger tip, further increasing the cost of dining out. Let's say, for instance, that Washington, DC enacts a $15 minimum cash wage for tipped workers and the diner that employs tipped worker A must increase prices by a modest 2 percent. For a $10 meal, the price would increase by 20 cents to $10.20. But, for customers the total cost of the meal would increase by more than 20 cents because instead of tipping on a $10 bill, they would tip on a $10.20 bill. For a customer who usually compensates waiters and waitresses with a 20 percent tip, the total cost of the meal would increase by a total of 24 cents from $12 to $12.24. While this increase in prices may not seem huge to many, across all bars and restaurants, it would surely add up and residents in the District would likely respond simply by dining out less often. With fewer customers, the restaurant industry would be strained even further, perhaps leading to even more tipped workers their losing jobs.

Moreover, there is no guarantee that the tipped workers who keep their jobs would actually need assistance. Rather according to 2013 data from the Survey of Income and Program Participation (SIPP), it is clear that work is the most important factor for determining whether an individual is in poverty. In 2013, among prime age individuals (ages 18 to 64), only 9.4 percent of hourly workers and 13.6 percent of hourly waiters, waitresses, and bartenders were in poverty. So while traditionally tipped workers like restaurant servers were more likely to be in poverty than all hourly workers, the vast majority were not in poverty. Moreover, even among hourly restaurant servers whose self-reported cash wage was below the federal minimum wage, the vast majority were not in poverty. Only 19.4 percent of prime-age restaurant servers who received cash wages below $7.25 per hour were in poverty. Meanwhile, those most likely to be in poverty did not have a job. 27.8 percent of prime-age jobless individuals were in poverty. Indeed, raising the minimum wage and the minimum cash wage for tipped workers could make matters worse for the many workers who would become jobless and thus far more likely to be in poverty.

Finally, it is important to note that a principal concern that advocates like ROC have about the minimum cash wage for tipped workers is that it is potentially easier for employers to unlawfully underpay their workers. For instance, tipped worker A's employer may decide to ignore the law and not adjust her cash wage so that she ends up making $10 per hour instead of the $15 per hour she is guaranteed. However, the evidence that this issue consistently plagues tipped workers is merely anecdotal and lacks convincing data. For perspective, according to the SIPP data, 36.4 percent of restaurant servers in 2013 reported cash wages below $7.25 per hour. This means that nationally, only for about one-third of restaurant servers has a chance of being unlawfully underpaid by their employer. We do not know, however, how often after tips these workers still end up making below the federal minimum wage. Moreover, even if it turns out that this is indeed a problem that some workers face, then the solution clearly is not to eliminate the tip credit all together, which ROC is advocating. This would unnecessarily burden businesses and their workers for the actions of a few bad actors. Instead, the solution lies with policymakers enforcing the current law more effectively.

The DC council just passed a dramatic increase in the minimum wage to $15 per hour. While this creates several labor market problems in itself and does little to help those in poverty, raising the minimum cash wage required for tipped workers to $15 per hour as well would only make these problems worse. It is clear that raising the minimum cash wage earned by tipped workers would do nothing to help the most vulnerable workers and it would likely perversely benefit those who do not need assistance. In the end, it just creates an even larger burden on businesses and makes it harder to address the root cause of poverty: joblessness.