Testimony to the 2014 New York State Wage Board

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Good afternoon and let me begin by thanking Chairman Grippen and Commissioners Briccetti and Ward for performing this valuable public service.

My name is Thomas Michl. I am a Professor of Economics at Colgate University in Hamilton New York. I have conducted research and written on the minimum wage, including one paper, "Can rescheduling explain the New Jersey minimum wage studies?" that won the Otto Eckstein award for the best paper published in the Eastern Economic Journal from 1998 to 2000. Owing to my teaching schedule I am unable to appear in person before you so I have arranged to have my testimony read into the record by Joanna Nadeau.

My overall recommendation is that the tip credit system is broken and that New York should join the seven states that have eliminated it altogether. According to a recent White House report on the tip credit prepared by the Council of Economic Advisors and other policy experts, while the tip credit system in principle is supposed to bring workers' pay up to the statutory minimum, fully "one in ten workers in predominantly tipped occupations report hourly wages below the Federal minimum wage, including tips. This fact highlights the challenges of ensuring compliance with minimum wage laws for tipped workers."[1] The problem is compounded by the confusing nature of the rules surrounding tip credit, both for employers and employees. From my own knowledge of tip credit gained through the experiences of family members, I know that employees do not always understand the information provided on their pay stubs and may not realize it when their compensation falls short of the mandated minimum wage. The confusing rules on the tipped credit can also make it easy for wage violations to occur, even for employers trying to do right by their workers. This is because when rules governing minimum wages are complex (as they are for the tipped subminimum wage), enforcement can be very difficult.

Tip credit is also confusing for consumers and citizens. Raising the minimum wage is widely regarded as a popular and effective policy to make work pay and alleviate poverty. Polls routinely show that a bipartisan majority of over 70 % of respondents support the policy. Yet many citizens are uninformed about the loophole in the minimum wage that allows employers to pay tipped workers a subminimum wage. This loophole effectively means that customers are covering a large fraction of employers' labor costs. The gratuity that once served as a way for customers to reward workers for services has become a subsidy to employers. It is difficult to see any economic rationale for this policy and the available evidence suggests that reducing or, even better, eliminating this subsidy would achieve the objective of raising the earnings of low-wage workers, particularly female workers who are disproportionately represented among tip credit workers, without significant negative unintended consequences.

Moreover, eliminating the tip credit would target wage policy towards the widely shared goal of alleviating working poverty. Tip credit workers have poverty rates more than double that of workers as a whole, and for wait-staff (who comprise around 60% of tip credit workers) the rates are nearly triple.

In states that have eliminated tip credits, poverty rates for tip credit occupations are noticeably lower than in states that have kept the Federal tip credit or that have reduced it as New York has.[2]

Opponents of eliminating the tip credit argue that removing the subsidy to employers will raise the cost of labor and result in the loss of jobs. They also sometimes argue that customers will tip less generously, causing workers to experience a decline in their pay. Both of these claims about negative unintended consequences are difficult to square with the evidence.

For example, consider the experience of tip credit workers across states that have different policies.[3] In states that observe the Federal tip credit minimum wage of $2.13 per hour in 2012, tipped workers make up about 3.1% of the workforce. In states with no tip credit (i.e., states in which tipped workers receive the regular minimum wage), they make up 3.5% of the workforce. There is no obvious evidence that tip credit occupations like wait-staff or bartenders have suffered job losses in states that have eliminated the credit altogether.

The same comparison shows that eliminating tip credit does not adversely affect workers' incomes. In the states that observe the Federal tip credit minimum wage, the median wage for tipped workers was $9.80 per hour in 2012. In the states with no tip credit, the median wage for tipped workers was $11.19 per hour. Evidently even if customers tip less generously when they know the tip credit has been eliminated (which itself seems problematic since tipping practices are as much the result of convention as calculation), the increased base wage in no-tip-credit states more than compensates workers.

These conclusions have been verified by the econometric research of Sylvia Allegretto at the University of California Berkeley, who used the variation across states as a kind of "natural experiment" to see what effect relaxing or eliminating the tip credit had on workers in the affected occupations. Her research shows that workers' earnings improved significantly in states that increased their tip credit minimum wages. She also found that once controls for spatial heterogeneity were included (different states have different underlying trends in employment unrelated to wage policies, for example) the effects of increasing the tip credit minimum on employment were "indistinguishable from zero."[4]

These results on the effects of the tip credit minimum wage are consistent with a growing body of research on the earnings and employment effects of the minimum wage itself that has accumulated over the last three decades. The central tendency of most studies has moved *away* from a finding that low-wage employment (particularly teen employment) is negatively affected by modest increases in the statutory minimum. The most recent generation of research has improved the power and sophistication of the research methodology, and generally corroborates the early work by David Card and Alan Krueger (then both at Princeton University) that first suggested that the employment effects were negligible or even in some cases positive. While it is true that there continue to be dissenting opinions, several meta-analyses (studies of studies) that try to systematically summarize the whole literature have supported this interpretation. The most recent such study done by Dale Belman from Michigan State University and Paul Wolfson from Dartmouth concluded that "it appears that if negative effects on employment are present, they are too small to be statistically detectable."[5]

Opponents of higher minimum wages almost always express incredulity at these findings based on the view that they violate some putative economic law that price and quantity are always inversely related. But in fact there is no economic law that says higher wages must always reduce employment. In models that incorporate the costs of hiring and training workers, sometimes called "dynamic monopsony" models, a higher minimum wage can in principle increase employment. Indeed, there are many plausible responses by employers to a higher minimum that do not result in employment losses, including reduced turnover costs (through lower hiring and training costs), improved organizational efficiency, reducing hours through rescheduling the existing workforce, and small price increases. The empirical results suggesting negligible employment effects are completely consistent with the best available modern economic theory that gets to grips with some of the complexities of actual economic behavior.

In summary, the case for bringing the tip credit wage up to the full statutory minimum is strong. The tip credit system is confusing for employers, employees, citizens, and customers; it is difficult to enforce; and it potentially frustrates the intent of minimum wage laws that have strong public support. Eliminating it will raise the earnings of workers who are disproportionately represented by women below the poverty level without creating negative unintended consequences.

Notes

[1] "The impact of raising the minimum wage on women and the importance of insuring a robust tipped minimum wage," White House Report, March 2014.

[2] See Sylvia A. Allegretto and David Cooper, "Twenty-three years and still waiting for change," Economic Policy Institute and Institute for Research on Labor and Employment, University of California, Berkeley, July 2014.

[3] The data in this paragraph and the next paragraph are taken from Allegretto and Cooper, *op. cit.*

[4] Sylvia A. Allegretto, "Waiting for change: is it time to increase the $2.13 subminimum wage?" Institute for Research on Labor and Employment Working Paper 155-13, December 2013, University of California, Berkeley.

[5] Dale Belman and Paul J. Wolfson, "The new minimum wage research," Employment Research Newsletter, Volume 21, Number 2, 2014, W.E. Upjohn Institute for Employment Research.