

Should Tipping Be Abolished?

Policy Report No. 382

by Richard McKenzie

March 2016

The practice of tipping restaurant servers and bartenders is under attack. Some academics and pundits want to abolish tipping and replace the practice with a higher minimum hourly wage or a so-called “living wage,” generally described as the wage rate required to lift the living standards of a household or family with only one worker above the poverty line.



Dallas Headquarters:
14180 Dallas Parkway, Suite 350
Dallas, TX 75254
972.386.6272

www.ncpa.org

Washington Office:
202.830.0177
governmentrelations@ncpa.org



Executive Summary

Yet tipping opponents do not seem to appreciate the economics of tipping. Servers at many moderately priced or casual restaurants with table service earn far more than the abolitionists realize. Tipping has economic advantages for everyone concerned: restaurant owners, their customers, servers and other workers.

Tipping abolitionist Saru Jayaraman has argued in the *New York Times* that tipped restaurant servers have historically “suffered” under state and federal mandated minimum and subminimum wage rates. The federal minimum wage for nontipped workers has remained at \$7.25 an hour since late July 2009, whereas the federal subminimum wage for tipped workers has remained at \$2.13 an hour. Note that \$2.13 is the required hourly pay for restaurants so long as servers’ reported total hourly pay — tips reported per hour plus \$2.13 an hour — is at or above \$7.25 an hour. If servers’ total hourly pay is less than \$7.25, restaurants must make up the difference. Jayaraman’s 2015 column reported that “median pay for a tipped worker in New York [State], including [reported] tips, stands at just \$9.43 an hour,” which, she argued, is significantly below a living wage in most parts of the state, especially in high-cost New York City. However, the *median hourly pay* of tipped workers includes workers who receive very few tips, such as at coffee shops and fast-food restaurants. Moreover, Jayaraman’s reference to the *median* hourly pay for servers is the hourly pay rate *reported* by the servers exactly halfway up the *reported* income ladder. If the survey includes fast-food workers, there could be many servers heavily reliant on tips who make far more than \$9.53 an hour.

The most notable concern over the imposition of a broad-based mandatory wage rate is that costs of living vary by

Should Tipping Be Abolished?

state and locality, and that types of restaurants (fast food, coffee shops, sit-down) vary within a locality. Thus, it would not make sense to mandate the same wage level.

Servers' Attitudes toward Tipping. An informal survey of 40 servers in moderately priced sit-down restaurants (on par with Applebee's) was conducted in Orange County, California. The servers were asked what hourly wage rate would they need to voluntarily forgo their current minimum wage and all tips. The hourly pay rate given ranged from \$18 to \$50, with a median hourly rate of \$30. All the servers were quick to assert that if tipping were replaced by a fixed hourly rate of pay, service would suffer significantly, at least on average.

Restaurants' Experience with No Tipping Policies. In late 2015, New York City-based Union Square Hospitality Group began instituting a no-tipping policy for its 1,800 employees at 13 Danny Meyer's restaurants. Smaller restaurant companies in the Los Angeles area have also adopted no-tipping policies. Locally, the Bel Air Bar + Grill announced that it will eliminate tipping, increase employee wages and increase menu prices accordingly.

The experience of a two-restaurant firm in San Francisco provides a case study in what many restaurants might find in eliminating tipping. In 2015, the owner of Bar Agricole and Trou Normand eliminated tipping and raised prices by 20 percent to provide higher hourly wages across servers and kitchen staffers. During its 10-month experiment, the restaurants

lost 70 percent of their servers. The reason was clear on reflection: Servers experienced an hourly wage drop from a range of \$35-\$45 to \$20-\$35.

The Principal/Agent Problem. Many restaurants face a serious managerial problem that economists dub the "principal/agent problem." Many owners and corporate executives of restaurants may know a lot about the restaurant industry and their locations' performances at the macro level — such as sales, costs, trends and industry fads. They may have demographic information about their customer bases that servers do not. But remote owners know little about individual customers in different locations across the diverse microeconomies of their restaurant locations.

The economics of tipping can be understood in this framework. Tipping is a pay mechanism that incentivizes servers to use their localized information for their own and their company's benefit. Tipping aligns the incentives of servers and managers and owners for a common objective — to make people's restaurant experiences a win for everyone. Through tipping, servers effectively become commissioned salespeople, enticed to add to customers' experience and company sales.

Richard B. McKenzie is the Gerken Professor of Economics and Management Emeritus in the Merage School of Business at the University of California, Irvine and a senior fellow with the National Center for Policy Analysis.

Introduction¹

The practice of tipping restaurant servers and bartenders is under attack. Some academics and pundits, ostensibly speaking for servers, want to abolish tipping, calling it an ineffective form of compensation, as well as a form of oppression by restaurant owners and customers. They want to replace the practice with a higher minimum hourly wage or a so-called “living wage,” generally described as the wage rate required to lift the living standards of a household or family with only one worker above the poverty line.

Additionally, tipping abolitionists argue that tips are an uncertain benefit, and vary across both customers and servers; and that servers need, want and deserve higher and more stable incomes. Finally, they contend that restaurant owners have the market power to impose tipping policies because there is an ample supply of qualified servers. According to antitipping advocates, restaurants use tips only to reduce labor costs and pad their own pockets at the expense of servers and other restaurant workers.

Yet tipping opponents err on many of the facts about servers’ pay, and they do not seem to appreciate the economics of tipping. Servers at many moderately priced or casual restaurants with table service earn far more than the abolitionists realize. While servers at such restaurants hardly reach the top income group, they are not the menial, low-income workers the tipping abolitionists suggest.

Moreover, tipping is prevalent within the restaurant industry for a good, old-fashioned economic reason: for most restaurants, tipping has survival value. After all, the practice of tipping has lasted for more than a century in the United States. Why? Because tipping has economic advantages for everyone concerned: restaurant owners, their customers, servers and other workers.²

The “Tipping Is Wrong” Case

Tipping abolitionist Saru Jayaraman is codirector of the labor advocacy group Restaurant Opportunities Centers United, and director of the Food Labor Research Institute at the University of California, Berkeley. She has argued in the *New York Times* that tipped restaurant servers have historically “suffered” under state and federal mandated minimum and subminimum wage rates. Jayaraman’s 2015 column reported that “median pay for a tipped worker in New York [State], including [reported] tips, stands at just

\$9.43 an hour,” which, she argued, is significantly below a living wage in most parts of the state, especially in high-cost New York City. She also argued that:

“the racialized element of the practice [of tipping, which started in the post-Civil War years] continues to this day: 53 percent of tipped workers in New York State are minorities, and 21 percent live at or below the poverty line. And most tipped workers are not fancy steakhouse servers; they are women working at places like IHOP, Applebee’s and Olive Garden. Based on American Community Survey data, the Restaurant Opportunities Centers United estimates that nearly 70 percent of tipped restaurant workers are women, 40 percent of whom are mothers.”³

Note how Jayaraman shifts from discussing the *median hourly pay* of tipped workers — which includes workers who receive very few tips, such as at coffee shops and fast-food restaurants — to talking about casual restaurants, where servers take and deliver orders to tables. Notice also that she reports the *median* hourly pay for servers, which is the hourly pay rate *reported* by the servers exactly halfway up the *reported* income ladder. If the survey includes fast-food workers, there could be many servers heavily reliant on tips who make far more than \$9.53 an hour. Her median includes the hourly pay of runners and bussers, who make substantially less per hour than servers.

Jayaraman claims that subminimum wage rates for tipped workers “enshrine” discrimination against women and the gender pay gap, because so many servers are female. “Worse still,” she atones, “this two-tiered system is the reason the restaurant industry is the single largest source of sexual harassment claims in the United States. Women forced to live on tips are compelled to tolerate inappropriate and degrading behavior from customers, co-workers, and managers in order to make a living.”⁴

Similarly, writing for the *Huffington Post* in 2014, journalist Hunter Stuart made many of the same arguments for abolishing tipping everywhere in the restaurant industry, concluding, “Tipping brings with it a welter of problems: It’s costly for taxpayers, it’s often arbitrary (and even discriminatory) and it contributes to poverty among the waiters and waitresses who must grovel for our change to earn their living.”⁵

Finally, noting that many states banned tipping after

Should Tipping Be Abolished?

the custom was introduced in the United States in the late 1800s, Brian Palmer, a regular contributor to *Slate* and *Earthwire* online magazines, laments its return over the past century, concluding that “We had it right the first time.” He claims, “Tipping is a repugnant custom. It’s bad for consumers and terrible for workers. It perpetuates racism. Tipping isn’t even good for restaurants, because the legal morass surrounding gratuities results in scores of expensive lawsuits.”⁶

Tipping Income and Minimum Wages

The arguments for replacing tipping with a higher minimum wage fail on both factual and theoretical grounds, at least for casual, sit-down restaurants, which have been identified as a target of laws that abolish tipping.

The most notable objection to the imposition of a broad-based mandatory compensation policy is that working, cultural and social conditions vary widely across restaurants and the country — and even across servers. Washington policymakers are unlikely to abolish tipping everywhere and set an unvarying minimum server wage, especially if it is set at a level substantially above the federal or even the New York and California minimum wage rates. Should servers in relatively low-living-cost states, such as Mississippi or Alabama, receive the same “living wage” as those in high-cost areas such as New York and California? Indeed, should all parts of California and New York have the same living wage?

Minimum and Subminimum Wages. The federal minimum wage for nontipped workers has remained at \$7.25 an hour since late July 2009, whereas the federal subminimum wage for tipped workers has remained at \$2.13 an hour. Both wage rates have lost 11 percent of their purchasing power since 2009. However, note that \$2.13 is the required hourly pay for restaurants so long as servers’ reported total hourly pay — tips reported per hour plus \$2.13 an hour — is at or above \$7.25 an hour. If servers’ total hourly pay is less than \$7.25, restaurants must make up the difference.

State and municipal minimum wage rates vary across jurisdictions:

- In New York, the state minimum wage is \$9 an hour. Beginning in 2016, the subminimum for tipped workers is \$7.50 an hour.⁷
- In 2015, California servers received the state minimum wage of \$9 an hour, plus their tip income.⁸
- Beginning in 2016, California’s minimum wage increased to \$10 an hour.

A bill is making its way through the California state legislature seeking to raise that wage to \$13 an hour by 2017. If passed, this legislation would give California the highest state minimum wage in the country.⁹

An Informal Survey of Servers on Compensation.

Granted that workers at some restaurants in low cost-of-living areas may earn very low tips and total compensation per hour, is that the case at mid-level restaurants such as IHOP, Applebee’s and Olive Garden? The claim is worthy of serious investigation.

Some first-hand research in Orange County, California, at several casual, moderately priced, sit-down restaurants, held several surprises. The fixed criteria for selecting restaurants was that they had to serve at least wine and beer, and have a strong menu focus on

hamburgers. More specifically, their cheeseburgers with a side of fries had to range between \$8 to \$12.¹⁰

The interviews were conducted between 2:00 and 4:00 p.m. — generally slow hours — and the servers were informed they were contributing to a survey examining the economics of tipping, focusing on a proposal to replace tipping income with a fixed hourly wage. Almost all had a fairly firm idea of their *average* hourly pay with tips included. I asked, “What minimum hourly rate of pay would you need to voluntarily give up your current compensation package, including your tips and the minimum hourly wage rate paid by your restaurant, assuming all other conditions of your job — hours of work, benefits, and schedule flexibility — would remain the same?”¹¹

After revealing the minimum hourly wage rate they would require, the servers were asked, “Does this mean that if your manager offered you that hourly wage rate with no tipping income allowed, you would voluntarily

“Working conditions vary widely across restaurants and across the country.”

accept the offer?” Most immediately said they would. About 20 percent however, said that the first wage rate they gave would not make them better off, usually because their average hourly tip rate was higher. Those servers were asked, “If you would not accept the offer of your initial wage rate, what hourly wage would you accept?” At that point, they stated a higher wage that would induce them to accept the offer:¹²

- Remarkably, the required hourly wage given by the 40 surveyed servers — of which three-quarters were female — ranged from \$18 to \$50.
- The *average* required hourly wage for them to forgo tip income was \$29.30 an hour.
- The median hourly pay rate (the pay rate halfway up the distribution of pay rates given) and mode pay rate (the most frequent pay rate given) were both \$30 an hour, with 62 percent giving an hourly rate of \$30 or more.

Several servers who said they would accept a fixed hourly wage lower than their estimated average hourly tip income plus their restaurant-paid minimum wage gave two reasons for doing so: First, they explained that they preferred the lower mandated hourly pay rate to the variable hourly income from tips. They indicated they would be better able to budget with a fixed hourly wage. Second, five servers said they were willing to accept a lower hourly wage because they presumed they would no longer have to “tip out,” which involves handing over some of their tips to bussers and runners — and, at some restaurants, cooks and hostesses.

All servers were quick to assert that if tipping were replaced by a fixed hourly rate of pay, service would suffer significantly, at least on average. A few servers volunteered that they often had to put up with “unkind” or “arrogant” customers. The service for such customers would suffer substantially under a fixed hourly wage rate. All servers and managers interviewed indicated that restaurant sales would also suffer.

Tips and Menu Prices. Tips are surely related to the prices of menu items, given that tips are most often calculated as a percentage of the restaurant bills; thus, higher menu prices typically generate higher tips. The interviewees for this study worked at an Applebee’s

in Orange County, California, where wages are 12 percent higher than the national average, but the cost of living is 18 percent higher than average.¹³ The prices of cheeseburger/fries combinations at Applebee’s and Chili’s in Winston-Salem, North Carolina, and Dallas, Texas, are comparable to prices in Orange County, suggesting that if tips vary among the three locations, it probably is a function of income and maybe the cost of housing.

When asked what nontipped wage they would accept, three servers at a casual restaurant in Winston-Salem responded thusly: one server said \$20; the other two, \$30 — for an average of \$26.67. That is, less than 10 percent lower than the average given by Orange County servers, despite the fact the North Carolina restaurant paid a minimum wage of \$2.13 an hour while California restaurants paid \$9 an hour. These comparative responses raise the question of whether the relatively high wage-rate responses for the Orange County servers would compensate them for the cost-of-living gap between Orange County and Winston-Salem.

However, a North Carolina server confessed, “I made \$60,000 last year, reported \$40,000, giving me a before-tax income equivalent of \$80,000, which explains why I dropped my teaching job.” His hourly wage rate for the total income actually received (\$60,000) was \$40 an hour. His hourly wage rate before taxes, or after adjusting for tax avoidance, was \$53 an hour.

“Tipped servers would accept a \$30 an hour nontipped wage.”

The Economic Function of Tipping

Tipping abolitionists insist that the practice has no redeeming economic justification in the restaurant industry, with the possible exception of upscale restaurants. They insist tipping is a win-lose compensation arrangement, with servers losing income and job security, and risking sexual harassment.

Clearly, tipping is not used everywhere, which suggests it is hardly a universal win-win pay scheme, given that no single compensation arrangement could work for diverse labor-market conditions. The particulars of individual labor markets usually define compensation packages, which is reason enough for policymakers to shun blanket compensation mandates. For Subway workers, tips are an incidental source of compensation. At Starbucks, tipping

Should Tipping Be Abolished?

is more common but hardly a major source of baristas' compensation.

Restaurants with “No Tipping” Policies. In 2016, Joe’s Crab Shack, a chain of 130 restaurants nationwide, will experiment with a no-tipping policy at 18 locations. The owner, Houston-based Ignite Restaurants, notes that its menu prices will rise to cover the added wage bill, but management expects prices will rise by less than 20 percent, which it says is the usual percentage tip.¹⁴ Ignite has followed in the footsteps of New York City-based Union Square Hospitality Group, which in late 2015 began instituting a no-tipping policy for its 1,800 employees at 13 Danny Meyer’s restaurants.¹⁵

Smaller restaurant companies in the Los Angeles area have also adopted no-tipping policies. Locally, the Bel Air Bar + Grill announced that it will eliminate tipping, increase employee wages and increase menu prices accordingly. The decision, the restaurant says, “allows us to offer our entire staff a fair, living wage.” Similarly, Bar Nine, a coffee shop and roaster in Culver City, eliminated tipping at its café as of January 1, 2016, and increased the price of most of its drinks by about 50 cents. The shop says this modest increase is actually less than the average tip left at its shop, so customers probably will spend less than they did before they eliminated tips.¹⁶

While Joe’s Crab Shack and Danny Meyer’s restaurants may indeed find that a fixed hourly pay rate will work better for its workers, customers and owners than a minimum — or subminimum — wage-plus-tips compensation package, they might find the opposite is the case. Restaurant chains will surely be watching their experiences with no-tip policies. Firms seeking to maximize their returns on their investments certainly have a long-run interest in finding the best compensation package for their servers, customers and owners, to everyone’s mutual benefit.

The experience of a two-restaurant firm in San Francisco provides a case study in what many restaurants might find in eliminating tipping. In 2015, the owner of Bar Agricole and Trou Normand eliminated tipping and raised prices by 20 percent to provide higher hourly wages across servers and kitchen staffers. During its

10-month experiment, the restaurants lost 70 percent of their servers. Owner Thad Ogler told a *USA Today* reporter, “They [servers] became more and more disgruntled, and we started to experience turnover. We were spending a lot of time and energy hiring and training, and rehiring and training.” The reason was clear on reflection: Servers experienced an hourly wage drop from a range of \$35-\$45 to \$20-\$35.¹⁷

The Principal/Agent Problem. Many restaurants face a serious managerial problem that economists dub the “principal/agent problem.” Many owners and corporate executives of restaurants work at a distance from their locations, visiting in person only occasionally. They may know a lot about the restaurant industry and their locations’ performances at the macrolevel — such as sales, costs, trends and industry fads. They may have demographic information about their customer bases that servers do not. But remote owners know little about individual customers in different locations across the diverse microeconomies of their restaurant locations. Unlike their local managers and servers, they don’t know who the “regulars” are or how they can be best treated.

How can owners, executives and managers encourage servers to do what they are hired to do, boost sales and profits? One way is to monitor the servers closely, using incentives to encourage them to do their jobs properly. However, close monitoring of workers is time consuming and costly, and assessments made at a distance can be seriously flawed. Attempts to improve owners’ assessments of servers with ever-closer and more detailed monitoring can become intrusive, and costlier to restaurants. And monitoring methods such as performance reviews, bonuses or even firings can be clumsy instruments with which to assess a restaurant worker’s abilities.

An alternative way of inspiring servers to use their localized information is to give them some measure of ownership of the extra service they provide and the menu items they sell. Companies outside the restaurant industry often give salespeople who work at a distance from headquarters a fixed base salary plus a commission on sales. The base salary provides workers with income security, and the commission provides an incentive to use

“Experiments with nontipped wages led to high staff turnover.”

localized information that people at headquarters do not have, because they are not “on the ground” in distant sales territories.¹⁸

The economics of tipping can be understood in this framework. Tipping is a pay mechanism that incentivizes servers to use their localized information for their own and their company’s benefit. Tipping aligns the incentives of servers, managers and owners for a common objective — to make people’s restaurant experiences a win for everyone. Through tipping, servers effectively become commissioned salespeople, enticed to add to customers’ experience and company sales.

Servers can reason that if they sell customers extra drinks or desserts or provide elevated and faster service, their *commission* — tip — income can rise by, say, 15 to 25 percent or more. If they provide better and faster service, they can expect more tip income. If they convince customers to become regulars, their tip income can rise even more, because “regulars” typically tip more than occasional customers, and for good economic reasons: regulars want to develop reputations for being reasonable, if not generous, tippers to receive better-than-average service, or to avoid bad service. One server/bartender interviewed for this study estimated that she received 75 percent of her tips from regulars.

It should be noted that the principal/agent problem, or lack thereof, could help explain why tipping didn’t become widespread in the United States until the early 1900s. In 1900, most Americans were “poor” by today’s standards. Eating out was a luxury. Restaurants were far from common, and they tended to be small. Restaurant owners served as cooks, servers, bartenders and bussers. They had at most a handful of workers, which means the principal/agent problem was a far less consequential management problem than it is today for much bigger restaurants and chains of restaurants. With the surge in American incomes in the last half of the 19th century, so grew the propensity for Americans to dine outside their homes. Restaurant sizes and chains grew in parallel, along with staff sizes, which magnified restaurants’ principal/agent problems, as the costs of owners monitoring their servers directly grew.

The Impact of Service on Tips, and Vice Versa

Brian Palmer, cited earlier, is convinced that: “tipping does not incentivize hard work. The factors that correlate most strongly to tip size have virtually nothing to do with the quality of service.”¹⁹ The servers interviewed for this study beg to disagree, strongly and unanimously. Indeed, none of the servers questioned paused even a moment before responding that their level of service influenced their percentage of tips, *at least on average across customers*. And, a number of scholarly studies have consistently found that the higher the customers’ assessments of the service quality they receive, the higher the tips, although the measured effect is small.²⁰

Research on Tipping and Service Quality. Assessing the impact of service quality on tipping, or vice versa, is difficult at best. “Service” and “service quality” involve inherently subjective assessments by all parties: customers, servers, managers and owners. Service and tipping are also interrelated, with each most likely affecting the other. That is, the level of service can affect the level of tipping, but the level of tipping can also affect service, and the interrelated effects can be difficult, at best, to disentangle statistically.

“Tipping turns servers into commissioned salespeople with incentives to provide quality service.”

Michael Lynn and Michael J. Sturman, researchers at Cornell University’s School of Hotel Administration, have sought to remedy the statistical problems involved in cross-customer studies by following subjects as they ate out over time.²¹ Their 51 subjects were community college students in a large southern city who were asked to record their meals out, along with reports on the particulars of their dining experience: names of restaurants, alcohol consumption, time of day, expenditures on meals and tips, and service evaluations. Their subjects reported a total of 275 dining out experiences, averaging a little over 5 meals per student.²²

The researchers found that only two variables: service quality — as assessed on a five-point scale with 1 = poor and 5 = excellent — and alcohol consumption, positively affected tip size and were statistically significant. The total amount the subjects spent on individual meals was negatively related to tip amount. The researchers concluded, “Of particular interest, however, is the

Should Tipping Be Abolished?

service quality effect, which indicated that, on average, participants tipped an extra two percent of the bill for each additional point they rated service on a five-point scale.”²³

Notice these researchers found that servers who raised their service quality one point could expect only a 2 percent increase in their total tips. The elevation of service quality by one point would, in concrete terms, increase the subjects’ tip on each \$20 check by just 40 cents.

Despite attempting to correct for the deficiencies of earlier tipping studies, the Lynn/Sturman study remains replete with problems. All the subjects were community college students, many of whom were likely young, with limited disposable incomes to spend on meals out, and no attempt was made to correct for students’ age and income.²⁴ Many subjects may also have had limited experience assessing restaurant service. They may have used different evaluation standards for service as they went from restaurant to restaurant. As the students went through their restaurant experiences, some may have found it necessary to repeatedly recalibrate their scale for subsequent subjective assessments of service quality.²⁵

An Informal Survey on Tipping and Service Quality. Given the problems with research involving customers’ evaluations of service quality, some of the servers interviewed for this study were asked for their evaluations of the tie between their self-assessed level of service and their tip percentage. Of the servers who provided their minimum hourly wage rate to forgo their tipping income, all attested to a positive tie between service quality and tips, although no one thought there was a perfect correlation.

After being asked to consider the quality of their service — involving such factors as speed of service, friendliness, reliability and accuracy, and professionalism — on the same 1-5 scale Lynn and Sturman used, they were asked three questions:

- Suppose you provide a “moderate” level of service quality, which you equate with a 3 on the scale of 1 to 5. What *average* percentage tips — of customers’ total bill — would you expect?
- Suppose you improve your service further in terms of attentiveness, speed, friendliness and so forth, to a level 4. What would you expect your *average* percentage of tips would be?
- If you elevate your level of service further to a 5,

which is to say you are at the top of your server game, what *average* percentage of tips would you then expect?

Twelve servers gave these percentage tips for the different service levels shown in the table.

The most important observation from this limited survey is that servers report a much stronger tie between reported service level and the improvement in their tip income than academic researchers. The servers interviewed for this study reported that they would, on average, expect their tip percentage to rise anywhere from 20 to 40 percent in moving from a service level of 3 to 4, with the average improvement in tip percentage of more than 25 percent. In moving from a 4 to a 5 on the service scale, the average improvement for all 12 servers rose again, by a quarter. In moving from a service level of 3 to 5, the 12 servers anticipated their tip percentage would rise by slightly more than 57 percent, which suggests a sizable incentive for servers to elevate the level of their service.

The Effects of “Tipping Out.” Restaurants and bars divide the various duties involved in serving customers drinks and/or meals. Some ask servers to cover all duties, from taking orders, to delivering drinks and meals, to bussing tables, to taking payments. Others divide the duties among servers such as “runners,” who deliver meals and fetch napkins, salt and pepper shakers, or whatever else customers request on the delivery of their orders, and “bussers,” or “bus boys,” who clean tables, and cashiers. When the duties are distributed, servers usually agree to “tip out.” Typically, tipping out involves servers handing over some fixed percentage of their tips. The percentage usually varies from 5 percent to 15 percent of their tip income, but can go as high as 50 percent, depending on restaurant policies.

Most servers understand the payoff to themselves from distributing a portion of their tip income to those who facilitate their jobs and enable them to cover more customers, and garner more tip income. They realize that what they tip out doesn’t necessarily detract from their *net* tip incomes but can bolster their overall incomes. Some servers acknowledged that they often “over-tipped out” out of self-interest: They want to reward extra efforts by bussers, runners and others who enable them to cover more customers and garner more total tips.

Servers do not always directly give bussers, runners

Servers' Expected Tips from Various Levels of Service

Servers (ranked by their minimum given)	Level of Service (scale of 1 to 5, with 1 = poor and 5 = excellent)		
	3	4	5
1 (min. wage server gave \$20)	11%	15%	20%
2 (\$20)	15%	18%	20%
3 (\$25)	15%	20%	20%
4 (\$30)	15%	18%	20%
5 (\$30)	15%	20%	25%
6 (\$30)	15%	20%	25%
7 (\$30)	15%	20%	35%
8 (\$30)	15%	18%	20%
9 (\$35)	15%	18%	20%
10 (\$35)	15%	18%	22%
11 (\$35)	18%	20%	25%
12 (\$40)	15%	18%	25%
Average percentage tip (\$30 minimum wage)	14.7%	18.4%	23.1%
Increase between levels 3 and 4 and 4 and 5	25.2%		25.5%
Increase between levels 3 and 5	57.1%		

Source: Author's calculations.

and others a portion of their actual tips — that would provide an additional incentive to underreport tips, not only to the government, but also to their restaurants and staff. Many restaurants require servers to pass along a percentage of their *sales*, which bypasses the problem of servers underreporting their tips. Many servers actually prefer handing over a percent of sales, rather than tips,

and then tip out more than required. Tipping out based on sales frees servers to encourage customers to leave tips in cash and to underreport their own tip income.

Some restaurants use reported tip income as a means of monitoring server performance. If restaurant managers recognize that quality servers generally receive 20 percent of sales in tips, servers who consistently report tip income

Should Tipping Be Abolished?

of 10 percent of sales might be subject to extra monitoring due to suspected inferior service. This concern pressures servers to be more honest than otherwise in reporting their tip income.

Many of the runners and bussers in the restaurants covered for this study were novice employees, who also had lower hourly wages. However, they indicated they were willing to accept their initial “low pay rate” for the opportunity to prove themselves, and to eventually break into the ranks of servers, maybe even become bartenders. This suggests that bussers and runners *expected* a lower wage rate as an investment in their future higher wage opportunities.

Restaurant Congestion, Service Quality and “Tip Gambling.” Studies on the tie between service and tips generally assume that servers have at least some flexibility in the level of service they provide and, hence, some control over their percentage of tips. However, observers of server activity assert that service quality is affected by other factors outside of servers’ control, such as the number of tables they are assigned, the time of day and restaurant congestion.

During busy mealtimes, servers can be pressed to the limit of their ability to give every customer the quality of service they might like to provide. Thus, they may resort to a well-worn strategy for service workers everywhere: optimizing the allocation of time and energy to maximize tip income. Under the pressures of congestion, servers might have to restrict their service quality to a level 3 or 4 when they would prefer to provide the 4 or 5 level that would elevate their tips.

Restaurant bills often present customers with suggestions of how much tips would equal at different levels, such as 12, 15, 18, 20 and 22 percent. For groups of 12 or more, restaurants may assess a percentage tip, such as 18 percent, noted at the bottom of their bills. Servers have admitted that they sometimes don’t add the required tip, gambling that the selected groups will tip more than 18 percent. Servers admit that some gambles don’t pay off, but occasionally, if they have selected customers carefully, they “win.”

The Rise in Restaurants’ Minimum Wage Rates and Fringe Benefits. Several states and municipalities have raised their minimum wage rate and mandated fringe benefits, and have scheduled even higher minimums and benefits for the future. For example, Seattle has mandated

a city-wide minimum wage of \$15 an hour. As stated above, California raised its minimum wage to \$10 an hour at the start of 2016. New York State raised its minimum wage rates to \$9.00 an hour at the start of 2016, with political efforts afoot from Governor Mario Cuomo to increase the minimum wage to \$15 an hour in coming years. Fast-food workers’ minimum wage is \$10.50 in New York City and \$9.75 in the rest of the state.²⁶

Labor activists are pressing for a “living wage” of \$15 or \$18 an hour, as well as a variety of employer-provided fringe benefits, such as paid sick and parental-leave days and health insurance or sick leave.²⁷ The Obama administration has long favored an increase in the federal minimum wage to at least \$10, with the minimum thereafter adjusted upward annually with the inflation rate. In his 2015 State of the Union Address, President Obama proposed raising the federal minimum wage to \$10.10 an hour, challenging members of Congress who objected to a pay hike to try living on such a wage.²⁸

Coincidental with the increases in mandated minimum wages and fringe benefit hikes, a growing number of restaurants have begun instituting or experimenting with eliminating tipping, raising servers’ hourly wage rate and hiking menu prices.

Is there a connection? Possibly. Although it is too early for statistical tests of the correlation, there are reasons to suspect a tie-in. For example, if the California minimum wage is raised to, say, \$15 an hour — which restaurants would have to pay, regardless of servers’ tip income — the total compensation of the median server from this study would rise to \$36 an hour — *assuming no adjustment in menu prices*. However, that last caveat is not likely to hold, at least beyond some increase in the state minimum wage.

Both actual increases in servers’ minimum wage *and* the prospective increases could cause restaurants to voluntarily reconsider server compensation packages, especially their tip policies. It may cause restaurants to seek ways to offset the rise in their server labor costs, perhaps by increasing menu prices and denying servers’ access to tip income. But adjusting server compensation packages can leave those workers with lower total compensation per hour, a reduced number of hours of work, and a shift for some to other less desirable employment venues. The servers interviewed for this study were firm in their belief that such a shift in

compensation would undercut customer service, along with their own compensation.

Conclusion

A mandate that requires restaurants to replace servers' tip income with an hourly wage rate might work in some markets, but this study's survey results suggests such a mandate for casual, sit-down restaurant markets could be opposed by many — including servers and customers, as well as restaurant executives, managers and owners. It is hard to imagine that any government will impose a minimum hourly wage high enough to compensate for servers' lost tip incomes. The evidence indicates that eliminating tipping will lower servers' incentives to provide quality service, which suggests that not only will customers' experiences suffer, restaurants' costs of monitoring servers will increase, potentially undercutting the incomes of both servers and owners.

Overall, the various arguments labor advocates make for abolishing tipping are probably well-intended, with the welfare of servers at heart. The arguments certainly sound good, but they are divorced from the key economic realities of the server-labor and restaurant market economics they have highlighted. An industry that is as rapidly changing and competitive as the restaurant industry needs to retain as much of its flexibility in service and labor markets as it can. It needs continued labor-market freedom to experiment with different combinations and levels of meals and with different combinations of compensation packages. While some restaurants might find that a "hospitality included" pricing plan works best for them, it will not necessarily work for others.

Notes

1. The author is indebted to a number of restaurant servers and managers for helpful conversations for over a year, especially restaurant managers Ronald Lutfi and Jon Allington, who reviewed a preliminary draft of this article and offered comments, and servers Jeremy Wise and Jillian Jones.
2. If a fixed hourly wage rate were considered a superior form of compensation, many servers should be expected to take an hourly wage rate lower than their current total hourly compensation. Entrepreneurs could organize restaurants that pay a lower fixed hourly wage rate, and lower expected menu prices, which means their profits would rise. Those restaurants that did not adopt the fixed hourly wage rate would lose market share and access to capital to those restaurants that did make the switch.
3. Saru Jayaraman, "Why Tipping Is Wrong," *New York*

Times, October 15, 2015.

4. Ibid. Jayaraman adds, "The subminimum wage for tipped workers also enshrines pay inequity for a predominantly female work force, perpetuating the gender pay gap. For African-American female servers, the disparity is even greater: ROC [Restaurant Opportunities Centers] United calculates that they earn only 60 percent of what male servers are paid, costing those women more than \$400,000 over a lifetime. So while restaurants employ about seven percent of American women, nearly 37 percent of all sexual harassment claims to the Equal Employment Opportunity Commission come from restaurants."
5. Hunter Stuart, "9 Reasons We Should Abolish Tipping, Once And For All," *Huffington Post*, January 10, 2014.
6. Brian Palmer, "Tipping Is an Abomination: Here's How to Get Rid of It," *Slate*, July 2013.
7. Jeffrey H. Ruzal, "New York Tip Law Update: Subminimum Wage for Tipped Employees Will Increase to \$7.50 per Hour on December 31, 2015," *National Law Review*, October 27, 2015.
8. See a discussion of the minimum wage rates across all states at the U.S. Department of Labor.
9. Margo Roosevelt, "\$13 an Hour by 2017? California Joins Minimum Wage Battle with New Bill," *Orange County Register*; June 3, 2015.
10. The eight restaurants where the surveyed servers worked in Orange County, California, were Applebee's (where the cheeseburger/fry combination was \$10.49), Islands (\$11.19), Dick Church's Café (\$8.35), Classic Q Sports Club (\$11.85), Chili's (\$9.99), Hennessey's Tavern (\$8.25), Red Robin (\$9.29) and T.G.I. Friday's (\$11.79).
11. Restaurants who employ servers 30 or more hours a week must provide them with fringe benefits, most notably health insurance, which is why a substantial majority of servers interviewed worked 28 or 29 hours a week at any one restaurant. They often worked in total more than 40 hours a week at two or more restaurants.
12. I understand this survey is not without problems in terms of accuracy of the wage-rate estimates given (although, as noted, several servers gave their hourly wage estimates after checking the record of their tip income on their smartphones). If all restaurants are forced, by law, to abolish tipping, servers might respond differently. Their options would be narrowly restricted by what all restaurants would be required to do, which can be expected to lower servers' overall compensation and workplace benefits.
13. Jonathan Lansner, "O.C. Wages Are 12% Higher Than U.S., But Cost of Living is Much Pricier, Too," *Orange County Register*, April 22, 2015.
14. Daniel Victor, "Joe's Crab Shack to Test No-Tipping Policy," *New York Times*, November 11, 2015.
15. Pete Wells, "Danny Meyer Restaurants to Eliminate Tipping," *New York Times*, October 14, 2015.

Should Tipping Be Abolished?

16. Tien Nyugen, "Traditional Tipping Isn't the Only Way — Here Are 3 Alternatives That Are on the Table," *Los Angeles Times*, January 22, 2016.

17. Kathryn Vasel, "This Restaurant Killed Tipping...and Now It's Bringing It Back," 2016. *USA Today*, January 19, 2016.

18. Economists have long argued that tipping exists because it is a more efficient system of rewarding servers than its alternatives, such as direct monitoring of servers. See Michael Conlin, Michael Lynn and Ted Donoghue, "The norm of restaurant tipping," *Journal of Economic Behavior and Organization*, Vol. 52, No. 3, February 2013, pages 297-321; N. Jacob and A. Page, "Production, information costs and economic organization: The buyer monitoring case," *American Economic Review*, Vol. 70, 1980, pages 476-478; and Edward E. Lawler, *Strategic Pay: Aligning Organizational Strategies and Pay Systems* (San Francisco: Jossey-Bass, 1990). See also several works by Edward Lazear: "Why Is there mandatory retirement?" *Journal of Political Economy*, Vol. 87, No. 6, December 1979, pages 1,261-84, and "Performance pay and productivity," *American Economic Review*, Vol. 90, No. 5, December 2000, pages 1,346-61.

19. Brian Palmer, "Tipping Is an Abomination."

20. See Michael Lynn, "Restaurant tipping and service quality: A tenuous relationship," *Cornell Hotel and Restaurant Administration Quarterly*, Vol. 42, pages 14-20; and Michael Lynn, "Tip levels and service: An update, extension and reconciliation," *Cornell Hotel and Restaurant Administration Quarterly*, Vol. 44, 2003, pages 139-148.

21. Michael Lynn and Michael J. Sturman, "Tipping and Service Quality: A Within-Subjects Analysis," *Journal of Tourism and Hospitality Research*, Vol. 34, No. 2, 2010, pages 269-275.

22. The subjects reported eating at restaurants comparable to several of the restaurants covered in this study: Bennigans, Black Eyed Pea, Caraba's, Chili's, Denny's, IHOP, Landry's,

Olive Garden, Pizza Hut, Red Lobster and T.G.I. Friday. The researchers report that four of 10 meals out were lunch and three out of 10 involved alcohol consumption.

23. Michael Lynn and Michael J. Sturman, "Tipping and Service Quality: A Within-Subjects Analysis," page 6.

24. According to the American Council for Community Colleges, this group is hardly representative of the broad sweep of the country, much less all students, even though they constitute half of all students in post-secondary education: "Community colleges are the gateway to postsecondary education for many minority, low income, and first-generation postsecondary education students." Their average age is 29. One-third receive Pell grants, according to the American Association of Community Colleges; see "Students at Community Colleges." Available at <http://www.aacc.nche.edu/AboutCC/Trends/Pages/studentsatcommunitycolleges.aspx>. The attrition rate for community-college students (39 percent) is also far higher than students attending four-year public colleges and universities (17 percent), according to the College Board, *Trends in Higher Education*, 2015.

25. Of course, service quality ratings could be distorted by such factors as restaurant ambience, menu prices, quality of the food and restaurant crowdedness.

26. Corinne Ramey and Mike Vilensky, "Minimum Wage Set to Increase in New York," *Wall Street Journal*, December 30, 2015.

27. For details on the California sick-leave mandate, see http://www.dir.ca.gov/dlse/Paid_Sick_Leave.htm.

28. Michelle Ye Hee Lee, "Obama's claim that raising the minimum wage helps low-wage workers 'make ends meet,'" *Washington Post*, February 2, 2015.