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The Employment Effects of Eliminating the Tip Credit in Michigan

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Policy Summary

In 2014, legislation to raise Michigan's minimum wage received bipartisan support in the state legislature, and the state's wage floor rose to $9.25 at the start of 2018. The base wage paid to tipped employees such as restaurant servers was increased from $3.38 to $3.52; these employees are still legally-guaranteed the same full minimum wage as all other employees.

This fall, voters may consider at the ballot box a proposal to further increase the state's minimum wage to $12 an hour—a 30 percent increase over the current state minimum wage. However, included in this proposal is a far more radical policy change—the elimination of the tip credit, effectively raising the tipped minimum wage by 240 percent.

The following analysis demonstrates that an increase of this magnitude would be devastating to the state's service sector, and in particular its full-service restaurant industry.

Economists David Macpherson of Trinity University and William Even of Miami University first analyze the impact of an increase in the state's full minimum wage to $12 an hour by 2022. Using a methodology developed by the Congressional Budget Office, the economists estimate that the policy would cost the state approximately 17,000 jobs. This impact would be concentrated among younger employees in the hospitality and retail industries.

More harmful is the estimated impact of tip credit elimination. The economists draw on their own past research on tipped wage impacts and show that eliminating the tip credit will cost full-service restaurants as many as 14,000 jobs.

	Estimated Jobs Impact
$12 Minimum Wage By 2022	-16,955 jobs
Eliminating Tip Credit	Loss of 5,243 to 13,982 full-service restaurant jobs

These estimates are consistent with past empirical research on the restaurant employment impacts from an increase in the tipped minimum wage. When restaurants' customers recoil against paying the higher food prices necessary to offset higher labor costs, they're forced to slash staff levels—or, even worse, to close their doors altogether. This was documented most recently in San Francisco where a Harvard study identified a 14 percent increase in restaurant closures following each $1 increase in the base wage for servers.[1]

The job-market impact doesn't always have to manifest with closed doors. In New York, where the tipped wage has risen sharply in recent years, the full-service restaurant industry has experienced a dramatic slow-down in employment growth. One city restaurateur explained that he cut roughly 1,500 people from his staff (from 4,000 down to 2,500) not by firing them, but by opting not to replace employees who left.[2] The net effect is a dramatic reduction in employment opportunities in the full-service industry.

The proposal's primary supporter is a controversial New York-based labor group called the Restaurant Opportunities Center, or ROC, which has raised over $1 million for its ballot committee.[3] ROC has put forth a number of rationales for eliminating the tipped wage, none of which pass basic scrutiny, as is demonstrated in this report. Most importantly, there's considerable evidence that the vast majority of restaurant servers don't support this proposal, which would likely result in a considerable drop-off in income.

The historical evidence suggests any increase in the minimum wage is at best a poorly-targeted means to reduce poverty, and at a worst, harmful to the employees it's meant to help. In this case, the proposed tip credit elimination in this proposal turns a dangerous ballot measure into a disastrous one.

Questions & Answers About The Tip Credit

Do restaurant servers in Michigan earn less than minimum wage?
No. Servers in Michigan are legally guaranteed the same minimum wage as all other employees. Michigan and 42 other states (not to mention the federal government) permit restaurants to pay a lower base wage to servers, with the understanding that a large portion of their income is received in tips. If servers don't earn at least the state minimum, employers are *legally* required to make up the difference. In fact, servers typically earn far more than the minimum wage; Census Bureau data shows that, on average, servers report earning over $14.00 an hour, with many earning far more than that.[4]

Can restaurants afford the elimination of the tip credit?
No. A report by the consulting firm Deloitte shows that the restaurant industry keeps just a few cents from every dollar in profit—and that's before taxes.[5] Any increase in labor costs has to either be offset through higher prices on customers, or—if customers are unwilling to pay it—then through cutbacks in staff, changes in the service model, or even business closures.

Does California's experience prove that Michigan can eliminate its tip credit?
If anything, California is a cautionary tale on why Michigan should not eliminate its tip credit. As California's minimum wage has increased more-rapidly in recent years, the lack of a tip credit has exacerbated the damage to the service industry. A study by economists at Harvard Business School and Mathematica Policy Research identified a 14 percent increase in restaurant closures associated with each one-dollar increase in California's base wage for tipped employees.[6]

What other evidence do we have of tipped wage harm?
At the end of 2015, New York raised its tipped minimum wage by 50 percent, overnight. Data from the Quarterly Census of Employment and Wages shows that the state lost over 270 restaurants the following year—after consistent gains in the number of restaurants in prior years. (See case study on next page.) The slowdown was even more evident in New York City; consistent 6-7 percent industry employment growth was slashed to roughly one percent after the tipped wage hike.

A 2017 Census Bureau study also provides a cautionary tale. The author finds that, in states that have raised the tipped minimum wage, servers saw their tips *decrease*.[7]

Are tip credits related to sexual harassment?
No. This talking point is sourced entirely from a deeply-flawed report released by ROC that's rendered unreliable by serious methodological errors.[8] A decade of data from the Equal Employment Opportunity Commission, which tracks restaurant industry sexual harassment by state, shows that the percentage of harassment claims originating from the restaurant industry is equal in states without a tip credit and those that follow the federal standard.[9] In fact, a regression analysis that controls for other factors which might influence state-level sexual harassment finds a statistically significant positive relationship between a higher tipped wage and restaurant sexual harassment.[10] In other words, shrinking the tip credit may lead to more harassment charges, not fewer.

Do tipped employees support it?
Tipped employees are overwhelming opposed to eliminating the tip credit. After a poorly-understood, ROC-supported ballot measure to eliminate the tip credit was passed in Maine, thousands of tipped employees organized to save the tip credit. They were successful in persuading a bipartisan group of legislators to support tip credit restoration. Currently in New York, an even-larger movement of tipped employees —a group exceeding 20,000 people — has rallied in support of New York's tip credit.

Proponents of eliminating the tip credit have pointed to alternative no-tipping payment systems, such as the "gratuity-included" system popularized by New York restaurateur Danny Meyer. However, Meyer's staff wasn't nearly as supportive of this approach; Meyer admitted that he lost up to 40 percent of his staff after making this change.[11]

Who's supporting this, and what's their agenda?
The vast majority of the over $1-million budget for the tip credit ballot measure comes from out-of-state donors

at ROC. ROC has a checkered past, including having been sued by its own employees for, among other things, failure to pay minimum wage.[12] ROC views the elimination of the tip credit as a first step in getting the restaurant industry to implement a "no tips" policy.[13] ROC founder Saru Jayaraman was explicit when she said, "this system of tipping needs to go."

Case Study: New York's Experience

On December 31st, 2015, New York State raised the employer portion of the food service tipped minimum wage by 50 percent overnight to $7.50 from $5. Census Bureau data demonstrates New York full-service restaurant establishments and employment growth fell dramatically in the following year, 2016.

Number of Full-Service Restaurants in New York Falls in 2016. According to the Quarterly Census of Employment and Wages (QCEW), the number of full-service restaurants in the state fell in 2016 by 273, a 1.4 percent decrease from 2015. This drop in full-service restaurants followed several years of full-service restaurant growth in the state. (See Figure 1 below.)

Full-Service Employment Growth in New York Falls in 2016. Employment growth at full-service restaurants in New York also fell precipitously in 2016 following the Dec. 31, 2015 tipped minimum wage increase. In 2016, full-service restaurant employment growth fell to 1.3 percent, down from 3.6 percent in 2015 and 4.2 percent in 2014. (See Figure 2 on next page.)

New York Full-Service Restaurant Pullback is Not Limited to Upstate. This decline in New York's fullservice restaurants isn't limited to upstate, where economic conditions are less vibrant. In New York City, full-service restaurant employment growth has also plummeted following the 50 percent tipped minimum wage increase. In 2016, it fell to 1.3 percent – less than one quarter the 6.5 percent average rate between 2010 and 2015. The last time the city experienced full-service employment growth this slow was in 2009 – during the heart of the Great Recession. (See Figure 3 on next page.)

Such significant declines in New York full-service restaurant establishments and employment growth in 2016 following years of increases suggest the dramatic tipped minimum wage increase is to blame. But perhaps other factors are responsible. To control for broader economic trends that may have harmed full-service restaurants, consider full-service restaurants in other states that didn't pursue dramatic tipped minimum wage increases.

FIGURE 1

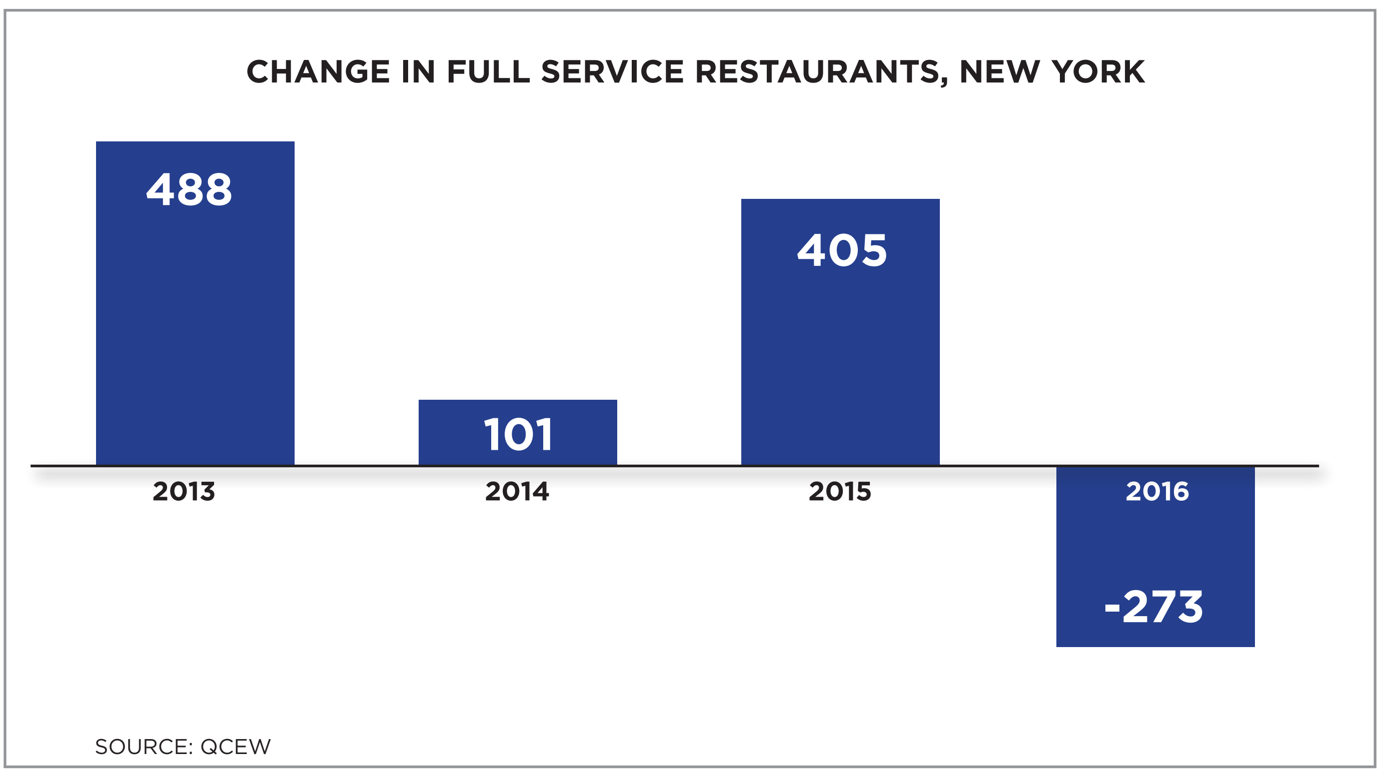


FIGURE 2

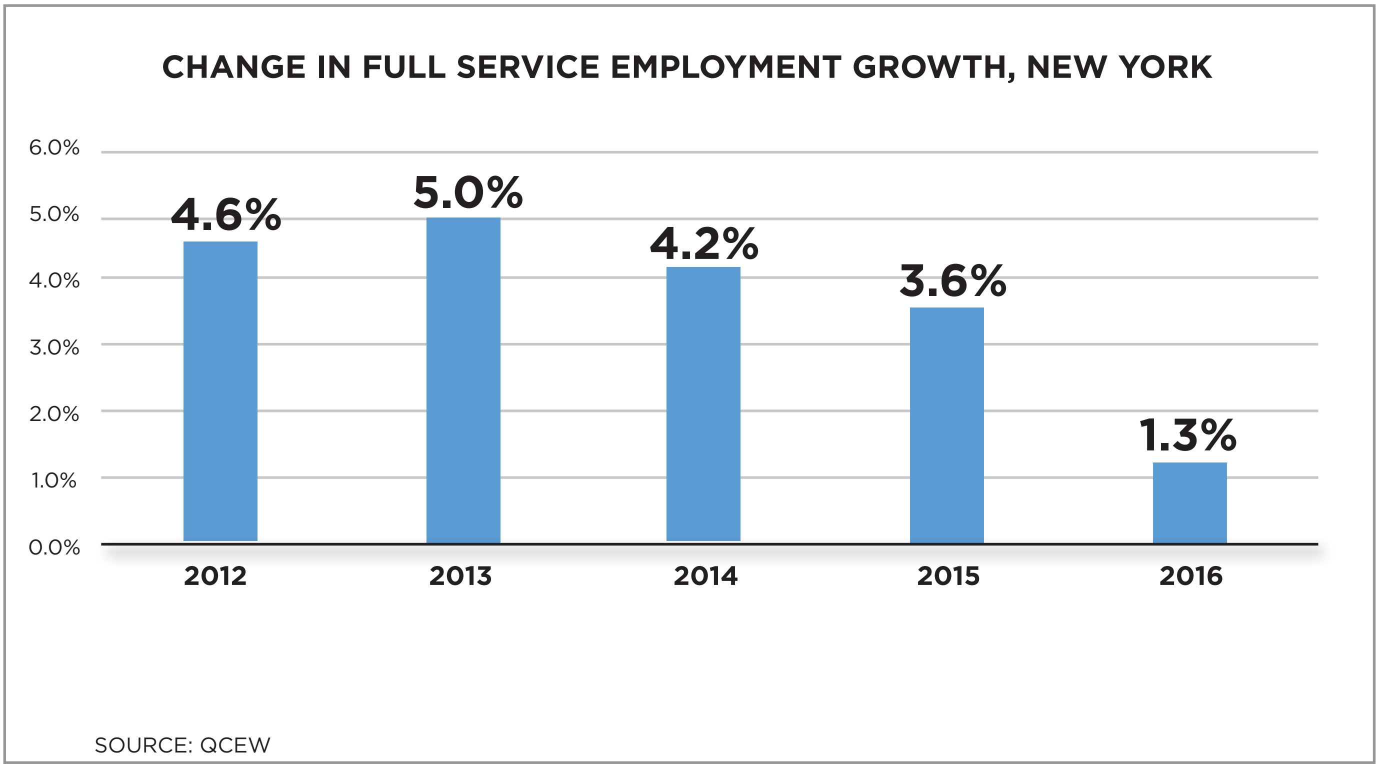
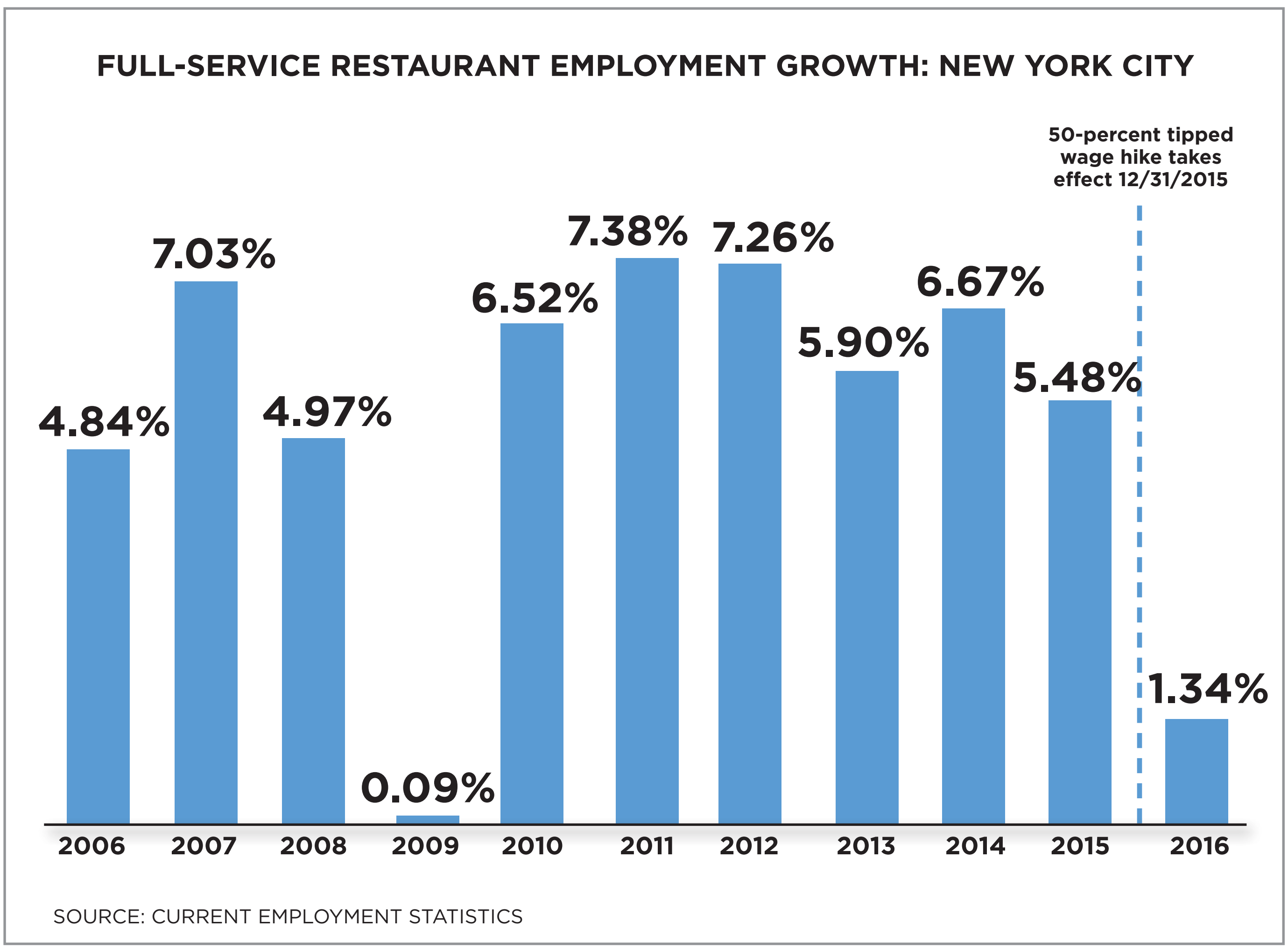


FIGURE 3



In neighboring Pennsylvania and New Jersey, where the tipped minimum wage is roughly the federal standard, full-service restaurant establishments increased in 2016.

Number of Full-Service Restaurants in Pennsylvania Grows in 2016. According to QCEW data, the number of full-service restaurants in Pennsylvania grew in 2016 by 218, a 2.5 percent increase over 2015. This increase was greater than those in 2015 or 2014.

Number of Full-Service Restaurants in New Jersey Grows in 2016: A similar trend is seen in New Jersey, which added 212 restaurants in 2016 after adding 84 restaurants the year before. That represents a 3.1 percent increase in 2016, after a 1.2 percent increase in 2015.

TECHNICAL ANALYSIS
Estimating the Impact of Tip Credit Elimination in Michigan

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In 2018, the state of Michigan has a minimum wage requirement of $9.25 per hour and allowed employers of tipped workers to take a credit of up to $5.73 per hour in satisfying the minimum wage requirement. That is, for example, if a worker earns $5.73 or more hour in tips, the employer may pay the worker a "tipped minimum wage" of $3.52 per hour and satisfy the minimum wage requirement.

In an earlier study of the impact of tip-credits on employment in the full-service restaurant industry, we found that a 10 percent increase in the tipped minimum wage causes employment in the full-service restaurant industry to fall by 0.3 to 0.8 percent.[14] A Michigan ballot initiative would lead to an increase in the minimum wage to $12.00 on January 1, 2022 with indexing to the Consumer Price Index thereafter. The tipped minimum wage would rise to 100% of the minimum wage on January 1, 2024. Without passage the new ballot initiative, the tipped minimum wage would remain at $3.52.

We estimate the effect of increasing the tipped minimum from $3.52 to $12.00 by using Congressional Budget Office projections of the Consumer Price Index to deflate the 2024 minimum into 2017 dollars ($10.67).[15] The base comparison is the January 1, 2018 tipped minimum wage in 2017 dollars ($3.45). We use data from the Quarterly Census of Employment and Wages (QCEW) for Michigan to estimate the number of workers employed at full-service restaurants between January 2017 and September 2017.[16]

The Quarterly Census of Employment and Wages (QCEW) data provides estimates of employment based on workers covered by either state of federal unemployment insurance. The estimates of employment are monthly and are available by 6-digit NAICS industry at the state and county level. During the first three quarters of 2017, we estimate there were an average of 148,092 workers employed in Michigan's full-service restaurant industry. Based on the CBO projections of employment growth between 2017 and 2024, predicted employment in full services restaurants in 2024 is 154,563.

For the ballot initiative, an increase in the real tipped minimum wage from $3.44 to $10.67 represents a 210% increase in the tipped minimum. Using our range of elasticities, this implies that employment in the full service restaurant industry would fall by 3.4 to 9.0 percent.[17] This translates into a loss of between 5,243 and 13,982 jobs in the Michigan full service restaurant industry.

The evidence in our earlier study suggests that the bulk of this job loss will be borne by the tipped workers in the industry – i.e., servers, bartenders, and attendants. Other industries with tipped workers may be affected as well, though we have no evidence on the size of the impact in those industries.

Estimating Employment Loss from an Increase in the Minimum Wage in Michigan to $12 an Hour

We use data from the Current Population Survey (CPS) Outgoing Rotation Groups (ORG) from January 2015 through December 2017. For each worker in the sample, we estimate an hourly wage. For hourly workers, this is the reported hourly wage. For non-hourly workers, it is estimated as weekly earnings divided by weekly hours. The group of potentially affected workers is restricted to private sector workers whose wage is at or above the minimum wage (less 25 cents) during the year of the sample survey. For example, in the 2016 data, since the minimum wage was $8.50, anyone earning at or above $8.25 is included in our group of potentially affected workers. We include people with wages up to $.25 below the minimum due to the fact that there may be some reporting error in the wage data.

To project the distribution of wages in 2022 without passage of the new legislation, we assume that every potentially affected worker has wage growth of 2.9 percent annually until 2022. This assumption is based on the CBO's own forecast of wage growth for low skill workers in their study of the employment effects of minimum wage hikes.[18] Also, given that under current law Michigan raised its minimum wage to $9.25 on January 1, 2018 with no further scheduled increases, we assume that the minimum wage would be $9.25 in 2022. For any worker who earned at or above the minimum in the year of the survey (2015 to 2017) and whose predicted wage in 2022 was below the projected minimum of $9.25, we increase their wage to $9.25. For workers who earned up to $.25 below the minimum in the year of the survey, we increase their wage by the amount that the minimum wage increased. This means, for example, that a person who earned $.15 less than the minimum wage in 2016 would still earn $.15 below the new minimum in 2022.

Estimating Affected Workers and Employment Loss

After generating the forecast of the 2022 distribution of wages reflecting wage growth, we identify workers who would be affected by the new law mandating a $12.00 minimum as those with wages between the minimum wage currently legislated for 2022 ($9.25) and the proposed minimum ($12). We also include those workers who were slightly below (up to $.25) below the old and new minimum.

To estimate the number of affected workers in 2022, we adjust earnings weights in the 2015-2017 CPS data to reflect employment growth between the survey year and 2022. This is accomplished by growing the survey weights by 1.01% per year until 2022 based on CBO projections of employment growth.[19] After we adjust the weights, we estimate the number of affected workers by summing their earnings weights and dividing the total by 36 (the number of months of data).

To estimate employment loss, for each affected worker we compute:

$$L = e * (\text{Proposed Min Wage} / \text{Min Wage 2022} - 1)$$

where e is an assumed elasticity of employment with respect to changes in the minimum wage, Min Wage 2022 is the $9.25 minimum wage currently legislated for 2022, and Proposed Min Wage is the $12.00 minimum that is being proposed for 2022. To estimate the aggregate employment loss in the economy, we use earnings weights to sum L across workers. We also follow the Congressional Budget Office (2014) and use an elasticity of 0.15 for non-teenagers and 0.45 for teenagers.

Jobs Impact By Age

Age	Number Affected	Job Loss
16-19	119,996	8,520
20-24	160,183	3,052
25-30	77,512	1,334
31-40	85,127	1,263
41-50	63,041	946
51-65	90,906	1,403
>65	23,507	438
Total	**620,273**	**16,955**

[1]https://www.yelpblog.com/2017/04/yelp-data-shows-economic-impact-minimum-wage-increase-harvard-study
[2]http://video.foxbusiness.com/v/5779074274001/?#sp=show-clips
[3]Campaign finance data, Michigan Secretary of State
[4]Current Population Survey.
[5]https://s3.amazonaws.com/s3.documentcloud.org/documents/291534/t288-nrarept2010.pdf
[6]Ibid.
[7]https://www.census.gov/library/stories/2017/09/tipped-minimum-wage.html
[8]https://www.epionline.org/wp-content/uploads/2018/03/2018_EPI_ABadTip_NYTipCredit_FINAL-1.pdf
[9] EPI analysis of EEOC data, 2007-2017.
[10]Forthcoming analysis of EEOC data.
[11]https://ny.eater.com/2018/2/6/16978464/danny-meyer-tipping-staff-turnover
[12] https://nypost.com/2007/03/22/social-justice-hypocrites/
[13] https://www.minnpost.com/politics-policy/2018/03/amid-another-debate-over-local-minimum-wage-question-seldom-asked-why-not-ge
[14]Even, William E., and David A. Macpherson. "The Effect of the Tipped Minimum Wage on Employees in the U.S. Restaurant Industry." Southern Economic Journal 80, no. 3 (2014): 633-655.
[15]The CBO forecast for inflation and employment growth can be found at https://www.cbo.gov/sites/default/files/recurringdata/51135-2018-04-economicprojections_1.xlsx
[16]The QCEW is available at http://www.bls.gov/cew/.
[17]This range of estimates is obtained by multiplying the change in the natural log of the tipped minimum wage by the elasticities of .03 and .08.
[18]The CBO report can be found at http://www.cbo.gov/sites/default/files/44995-MinimumWage.pdf. See page 20.
[19]This projection is based on the CBO's April 2018 report The Budget and Economic Outlook: 2018 to 2028. It is available at https://www.cbo.gov/publication/53651