

CHAPTER FOUR

To Tip or Not to Tip: Removing Chicago's Subminimum Wage

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Executive Summary

On Friday, October 6th, 2023, the Chicago City Council voted to phase out the subminimum (a.k.a. tipped) wage, the mechanism by which restaurants pay their tipped staff below the standard minimum wage.¹ Currently, Chicago businesses are allowed to pay tipped workers \$9.48 per hour, while the normal Chicago minimum wage is set at \$15.80 per hour.² The plan passed by the City Council institutes annual increases in tipped minimum wages until both minimum wages reach parity in 2028.³ The effects on key parties are still uncertain, with stakeholders including restaurants, tipped workers, consumers, and the overall business community in Chicago both worried and hopeful about the historic change. This chapter will analyze the arguments presented in favor of and against the removal of the subminimum wage for tipped workers in Chicago to understand the real-world effects of this change. Additionally, the experience of Washington, DC informs the analysis: the tipped subminimum wage was recently eliminated in Washington, DC, so some of the effects of the policy change can already be glimpsed in that jurisdiction. Washington serves as a case study, allowing a comparison of the various theoretical arguments with DC experience.

Background on the Subminimum Wage

The practice of tipping in the United States dates to the early 19th century.⁴ While the origins of modern tipping lie in Europe, tipping was implemented in the U.S. by wealthy American travelers who imitated the European practice of giving small amounts of money to servants in exchange for good service.⁵ In the post-Civil War U.S., tipping became intertwined with a race-based class system. Black men and women often worked for lower wages in tip-based roles. These workers, then, were expected to rely on tips from patrons rather than fixed wages to earn a living, an expectation that was meant to reinforce a sense of economic servitude.⁶ In the early 20th century, tipping entered the U.S. mainstream, with restaurant and hotel owners

viewing the practice as a way to save money by shifting wait staff costs onto customers.⁷ Legally, tipping was recognized and bolstered through the Fair Labor Standards Act of 1938 and 1966, which created distinctions between the minimum wages required for tipping and non-tipping hourly roles.⁸ As a result, the idea and practice of two distinct minimum wages became normalized in the U.S.

The U.S. economic landscape evolved, and tipping gradually became expected, with social norms placing the onus of tipped workers' pay on the customer rather than the employer. In fact, the U.S. is the only country to have a separate minimum wage for tipped workers, reinforcing a tipping culture that is much stronger than in most other countries.⁹ The predominance of tipping is not uncontroversial, with many consumers recognizing that it is expected, but at the same time being unhappy with the institution and the prevalence of tipping in society. The reasons for this discontent include consumer beliefs that higher wages for workers would be better than a tipping model; the relatively recent spread of pre-entered tip screens; and not knowing how much to tip or who ultimately receives the rendered tips.¹⁰

The creation of a separate, lower minimum wage for tipped workers has long been debated: viewed by some as unfair, unsafe for employees, and responsible for tilting employer/employee bargaining power in the direction of the employers.¹¹ These sorts of concerns have led California, Washington, Oregon, Nevada, Montana, Alaska, and Minnesota to adopt a uniform minimum wage, with no subminimum wage for tipped workers. Similarly, Washington D.C. is transitioning to a uniform minimum wage.¹² Chicago has recently joined the uniform minimum wage jurisdictions with the City Council's October 2023 vote, making Chicago the largest individual city in the U.S. to eliminate its subminimum wage.¹³

Before the Covid-19 pandemic, proposals for removing the tipped wage never gained sufficient enough traction to win approval in Chicago. With the onset of Covid-19, conditions such as less stable employment and increased confrontations between workers and customers resulted in an accelerated grassroots push to implement an equal minimum wage for tipped workers.¹⁴ A prime example of the newfound momentum is the activity of *One Fair Wage*, an organization that boosted its efforts during the Covid-19 pandemic to remove the tipped minimum wage across different U.S. states.¹⁵

Pushing for the removal of the tipping wage is especially relevant due to how the restaurant industry has changed as a result of Covid-related shutdowns. During these closures, many tipped wage workers did not receive unemployment benefits, in

part because their wages were too low to qualify.¹⁶ Additionally, restaurant staff often find themselves in a state of employment limbo. Job security for waitstaff has been compromised by the continued popularity of delivery and takeout options. The hardships and stresses of waiting jobs have been compounded by an increase in verbal and sexual harassment from customers post-pandemic; with the need to make an income via tips, responding appropriately is made more difficult.¹⁷ The strains in tipped-based jobs, in combination with progressive results from the 2023 Chicago mayoral election, have helped to bring about the *One Fair Wage Ordinance* which will mark the end of the subminimum wage in Chicago.¹⁸

Case Study: Washington D.C.

Prior to the approval of the universal minimum wage law in Chicago, Washington D.C. was the largest city in the U.S. with a uniform minimum wage law. Many of the arguments proffered in the lead-up to the legislation eliminating subminimum wages were common to both cities. Simultaneously, the differences between Washington D.C. and Chicago help to highlight the relevance of the arguments used in the different locales. The fact that Washington D.C. moved earlier to a uniform minimum wage can also bring its experience to bear on the prospects for Chicago's reform.

In Washington D.C., the 2022 ballot proposal, known as Initiative 82, is responsible for creating a path to an equal minimum wage for tipped workers. The passage of Initiative 82 led to a process whereby the current subminimum wage will be gradually increased until it equals D.C.'s regular minimum wage in 2027. At that point, tipped workers will be subject to the same minimum wage that is required for non-tipped employees. As the proposal was a ballot measure, the proposal's fate was left up to Washington D.C. voters, who endorsed it by the significant margin of 74% to 26%.

The 2022 vote marked the second occasion for a subminimum wage initiative in D.C. In 2018, the voters of the city passed a similar initiative by the slimmer margin of 55% to 45%, but the measure was rejected, in the face of considerable restaurant industry lobbying, by the Washington D.C. City Council. With the lopsided 2022 vote, the support for paying an equivalent minimum wage was too strong for Council members to vote against it without incurring a substantial re-election risk. Nonetheless, the issue remained contentious in 2022, especially among those who were directly affected by its passage. Restaurant owners were concerned about how

the labor cost increases and potential price increases would affect their businesses. Additionally, some tipped employees were concerned that the minimum wage unification would result in lower tips, potentially outweighing the wage increase in terms of their overall compensation.¹⁹ The broader D.C. community was likewise concerned, generally viewing the unified wage as promoting fairness but also nervous about higher prices at restaurants. We will see that parallel arguments were raised in Chicago.

In both the Chicago and Washington D.C. contexts, tip wage theft is a prevalent issue for tipped workers. This form of wage theft occurs when employers fail to ensure that their employees receive the full amount of tips rendered, or manipulate tip-related income to decrease overall compensation to less than the legally mandated minimum wage. Employers sometimes engage in practices such as misreporting or withholding tips, requisitioning employees' gratuities, or forcing workers to share tips with non-tipped staff. Such actions can result in tipped workers receiving less than the minimum wage after factoring in their tips, violating labor laws. These common abuses within the tipping system provided the basis for arguments supporting the abolition of subminimum wages in both Washington D.C. and Chicago: reducing worker reliance on tips combats the negative effects of wage theft on workers. In this sense, shortcomings in enforcement of current rules around tipping became reasons to reduce the role of tipping by eliminating subminimum wages.

In both Chicago and Washington D.C., the risk of restaurants closing due to subminimum wage increases was a significant concern often raised by opponents of eliminating the subminimum wage, especially restaurant groups. Labor costs comprise a substantial portion of restaurant expenses, and with many employees being tipped workers, minimum wage unification would involve higher direct pay for a large portion of restaurant staff. Small or independent dining establishments with thin profit margins might be particularly impacted, with higher official wages potentially undermining their financial viability. Restaurants that can absorb the higher labor costs might still face tough decisions, including reducing staff numbers or work hours. Some experts, however, argue that the effect of minimum wage increases on restaurant closures might not be as dire as feared, pointing to other factors such as increased consumer purchasing power due to higher wages and potential savings from reduced employee turnover.

One argument in the subminimum wage debate that is rooted in the history and morality of the tipped minimum wage is related to how the tipping practice is intertwined with racial discrimination in the United States. Dating back to the post-Civil War era, the subminimum wage for tipped workers was established to avoid paying formerly enslaved people fairly for their work. At the time, this subminimum wage, intended for occupations where freed slaves were predominantly employed, was deliberately set lower to allow business owners to profit while perpetuating economic oppression.²⁰ This practice not only sustained racial inequities but also cemented the reliance on tips, shifting the burden of fair compensation from employers to customers. The legacy of this system has preserved inequalities, disproportionately affecting people of color who make up a significant portion of the service industry workforce. Many proponents of minimum wage unification in both Washington D.C. and Chicago make the argument that maintaining this legacy of racial oppression harms those currently employed in the industry and that subminimum wages should be scrapped altogether.

The last major argument that holds relevance in subminimum wage debates is the concept of “border wards.” Border wards come up in both Chicago and Washington D.C. The argument here is essentially that restaurants located in wards (city political districts) on the outskirts of Chicago will be put at a disadvantage because they compete with restaurants in the suburbs, which are not required to pay the full minimum wage. The fear is that customers will start dining out in the nearby suburban restaurants and that Chicago restaurants will themselves relocate to the nearby suburbs to take advantage of the legal differences between the two jurisdictions. Based on the proximity and ease of access between Chicago and Washington D.C. to their surrounding areas, the border wards argument presents a serious concern for both cities.

Arguments For and Against the Removal of the Subminimum Wage

Tipped Worker Wage Insecurity

A major argument used by proponents of the removal of the tipped wage is that separate tipped minimum wages result in more financial insecurity for tipped workers.²¹ The logic is that due to tipped workers having a separate lower minimum wage, they have less security in how much they take home at the end of the day, leading to more stress and poverty as well.²² Pay insecurity especially plays a role in regards to young women, who are often the primary employees in tipped wage roles.²³

Looking specifically at young, prenatal women, Andrea et al. shows that increases in the subminimum wage resulted in reductions in negative birth outcomes, as well as reductions in stressors among women employed in subminimum wage work.²⁴ That is, increases in the subminimum wage seem to reduce poverty-related stress for expectant mothers.²⁵ Andrea et al., then, suggests that bringing the subminimum wage to parity with the overall minimum wage would have measurable positive effects on stress-related factors among tipped wage workers.

Restaurant Operations and Consumer Activity

One of the most common arguments against increases in the tipped minimum wage comes from restaurant owners and management who argue that such increases will result in them being forced to either shut down due to a lack of financial viability, or to raise menu prices and thus drive away customers. While this argument is surely sensible – higher costs can lead to both lower profits and fewer customers – in practice the size of the overall restaurant industry does not seem to change with variations in the subminimum wage.²⁶ Lynn and Boone find that, while increases in subminimum wages and minimum wages do lead to higher wage bills at full-service restaurants, the number of these restaurants does not decline.²⁷ Much of the evidence, however, is drawn from relatively small changes in minimum statutory wages: larger and larger hikes in minimum wages would be more likely to eventually alter restaurant employment and the number of establishments.²⁸

Tipping Discrimination by Race and Sex

One of the arguments which supporters of a tipped wage often use is that tipping reflects quality service and promotes such service, but this incentive-based argument is often not borne out in practice. Studies show that a portion of tipped workers' take-home pay is determined by discrimination on the part of the consumer.²⁹ This implicit and potentially explicit discrimination has been found to be based on factors such as race, sex, and the physical appearance of a server.³⁰ While studies on employer-based discrimination toward employees are plentiful, the literature on how consumer biases manifest themselves in the take-home pay of tipped staff is less common. Still, it is an important aspect for understanding the factors that determine overall worker compensation. For example, researchers have found that white workers receive more tips than Black workers after controlling for factors such as service quality and restaurant atmosphere.³¹ The same disparity can be

found when looking at the attractiveness of tipped workers. Customers outside of several restaurants were asked to fill out a survey about the amount of the bill and tip, characteristics of the dining experience, and server and own demographics.³² Even after controlling for factors such as dining experience and the cost of the bill, the more attractive servers earned more in tips by nearly 1.5 percentage points.³³ Such studies show that factors unrelated to service quality often determine the amount of tips a worker receives. Given this data, proponents of doing away with the tipped minimum wage often note the lack of agency for some tipped workers, making the case that tipped staff should be paid fairly, irrespective of non-service factors.

Worker Safety and Sexual Harassment

Another key argument in favor of removing the subminimum wage is to reduce sexual harassment and other threats to worker safety faced by tipped staff, as well as increase the ability for workers to advocate for themselves. Covid-19 raised the stakes and prevalence of these threats: workers routinely receive less in tips when they enforce Covid-19 safety precautions when interacting with customers.³⁴ The fact that tipped staff have to decide between earning a livable wage and enforcing safety policies results in many workers understandably opting for the former, increasing their level of exposure and risk.³⁵ While Covid-19 related safety issues are new, cases of sexual harassment on the part of customers are not, and over the course of the Covid-19 pandemic, cases of sexual harassment have increased.³⁶ With the pandemic, there has been a surprising number of customers asking waitstaff to remove their masks so that the customers can better judge their looks.³⁷ While workers should be able to respond and retaliate appropriately to suggestive comments and actions by customers, waitstaff have reported a reluctance to do so, given their reliance on tips for their incomes and livelihoods.³⁸

These sorts of distressing personal dynamics are reflected in surveys of how waitstaff are treated by customers, how waitstaff actions affect their tips, and how deciding to appease or not to appease an inappropriate customer can affect tips.³⁹ Removing the subminimum wage would help workers to advocate for themselves in the wake of bad customer behavior. The subminimum wage and the enhanced reliance on tips for compensation empowers customers and disempowers servers, undermining the wellbeing of waitstaff.

Wage Effects on Fringe Benefits

One argument often deployed against increasing the subminimum wage for tipped workers is that while monetary wages will increase, overall compensation might stay the same or even fall as employers respond by cutting fringe benefits. This argument is a specific instance of the broader argument that mandating certain employee benefits or pay increases will crowd out benefits that are not required of employers. While there is not much research on how an increase in the tipped wage impacts fringe benefits, Simon and Kaestner examine the effects on fringe benefits of increases in the regular minimum wage and sick pay mandates. Increases in the minimum wage appear to have negligible effects on non-wage forms of compensation.⁴⁰ For instance, researchers found that there are no significant changes in health benefits after increases in minimum wages were implemented.⁴¹ Similarly, another study finds that when mandatory sick pay benefits are implemented they are not accompanied by a crowding out of non-mandated benefits.⁴² While traditional economics suggests that in perfectly competitive situations, mandatory increases in pay will be offset by decreases in non-monetary compensation, the existing empirical evidence shows that the changes in non-monetary pay are insignificant.

Interpersonal Restaurant Dynamics – Tip Skimming

Wage theft is a relatively common problem in restaurants, with establishments often trying to cut corners to save money in an industry that is very competitive.⁴³ Wage theft costs U.S. workers approximately \$50bn per year in lost wages, with over 80% of restaurants violating wage and hour laws in some form.⁴⁴ Tip skimming, along with improperly recorded hours and overtime, is one of the most common ways in which workers experience wage theft.⁴⁵ Tip skimming is the practice of taking a portion of worker tips and distributing them to non-tipped workers. While the practice is illegal, as tips can only go towards hourly, tipped employees, there have been numerous cases of restaurants either adding managers to the tip pool or taking a percentage of tips to pay other restaurant costs.⁴⁶ While there have been some notable instances of workers suing their employers for their tips – and winning – many of these industry practices go unreported. Employees might fear possible employer retaliation, not know their rights, or not possess solid evidence of the illegal practices.⁴⁷

Another form of wage theft that occurs for tipped workers is underpaying. While the subminimum wage law allows businesses to pay tipped workers less than

the standard minimum wage, the employers must still ensure that tipped workers' income from wage and tips reaches or exceeds the minimum wage. Nonetheless, a recent report found that in Washington D.C., only 35% of businesses tracked tips in order to ensure their tipped workers earned at least the regular minimum wage after factoring in tips.⁴⁸ While it is unclear whether raising the tipped minimum wage would change the behavior of restaurants, a uniform minimum wage would shift workers' wages into a more consistent income stream, ensure workers are taking home at least the minimum wage, and limit opportunities for wage theft in the restaurant industry by reducing the importance of tips.⁴⁹

Restaurant Relocation Risk

One of the major points of contention that came up with the passage of the *One Fair Wage Ordinance* in Chicago is the idea that border wards would face declining numbers of diners and restaurants. The fear is that restaurants and their customers would flee to the proximate suburbs, where subminimum wages would remain legal.⁵⁰ The concern is understandable: restaurants that do not have to pay above the subminimum should be able to control labor costs more effectively than those restaurants that must pay higher wages. At the same time, however, the data suggest that the fear of relocation is misplaced.⁵¹ Luca and Luca find that changes in the minimum wage in a city do not have a meaningful impact on restaurants shutting down.⁵² While it seems that when stratified by restaurant rating, the lower rated restaurants may be more likely to exit, this correlation is weak and statistically indistinguishable from zero.⁵³ While more research is needed, the Luca and Luca results somewhat weaken the prevalent argument presented in the Chicago context, where many "border ward" aldermen were concerned about the economic impact of the *One Fair Wage Ordinance* on their districts.

The "border" argument, quite prominent in Chicago, exists in the Washington D.C. context, too, but it has not been a point of focus, even though both Chicago and Washington D.C. are cities with immediate access to the surrounding suburbs with commercial districts. One would expect that border concerns would serve as a major argument in Washington D.C. for those opposing the elimination of the subminimum wage, but this turned out not to be the case – perhaps due to a capitulation to the popular will. The border ward argument in Chicago was largely promoted by individual aldermen of those boundary wards, rather than by other groups opposed to the change. In Washington D.C., alternatively, 2022 marked the second time the city

voted to remove the subminimum wage, and while the council repealed the first initiative, the overwhelming popular support for it the second time around meant that it became politically imprudent to oppose the public sentiment.

Further, border wards are themselves a larger presence in Chicago than in Washington. In Chicago, each of the 50 aldermen are representatives of particular wards, with their duty being dedicated to the interests of their specific areas. In Washington D.C., eight of the 13 council members represent a specific city district. That is, many more local politicians represent Chicago border areas than those who represent D.C. border areas. The notion of a “border ward” has more public and political resonance in Chicago than in Washington, D.C. One manifestation of this enhanced resonance is that concerns with border wards is a more compelling argument against implementing a uniform minimum wage in Chicago.

Conclusion

The Chicago City Council's historic decision to phase out the subminimum wage for tipped workers marks a transformative moment in minimum wage history, as well as for Chicago's relationship to worker rights. This action positions Chicago among a growing number of jurisdictions questioning the value of – and doing away with – the dual minimum wage system.

The arguments surrounding the removal of the subminimum wage reveal reasonable concerns on the part of both proponents and opponents of the policy. While opponents of removing the subminimum wage are concerned with the health of the restaurant business in Chicago, it seems that other jurisdictions that have pursued tipped wage increases have remained strong in terms of restaurant activity. On the other side, instituting a unified minimum wage seems to bring the benefits of increasing tipped worker physical, emotional, and financial security by rebalancing the power dynamic in service situations to be less skewed towards customers. Chicago's commitment to equalizing minimum wages aligns with the changing societal preferences for fairer compensation and more equitable treatment for all workers, irrespective of their roles. By scrutinizing the historical context of tipping in the United States, the dismantling the subminimum wage system appears to be more than just another policy tweak, but rather a step towards rectifying the entrenched racial and economic inequities that have persistently plagued the service industry.

Drawing insights from the Washington D.C. case study enriches our understanding of the potential consequences and benefits associated with this meaningful policy shift. While apprehensions about restaurant closures and economic challenges were voiced, the growing empirical data provide reassurance. The lack of a significant correlation between minimum wage increases and restaurant closures challenges the narrative that equalizing wages would jeopardize the economic viability of the restaurant industry. This observation offers a practical counterpoint to the concerns raised by opponents of the subminimum wage removal.

Arguments in favor of eliminating the subminimum wage highlight pervasive issues like wage theft, discriminatory tipping practices, and compromised worker safety. These concerns are further amplified by the disruptions caused by the Covid-19 pandemic. The decision to equalize the minimum wage not only addresses these pressing issues but also demonstrates a commitment to the overall well-being of tipped workers. The potential positive impacts on mental and physical health, too, identified in empirical studies, provide a compelling rationale for the policy transformation.

Further, restaurant relocations to suburbs, driven by increased labor costs, is a potential effect worth keeping an eye on; nonetheless, this prospect should be weighed against the potential benefits for workers that may come with the removal of the subminimum wage. So far, there is little evidence that such induced relocations are significant. Overall, the potential benefits seem sufficiently weighty, and the costs sufficiently contained, that removing the subminimum wage is a positive policy development.

As Chicago embarks on this path of change, it becomes imperative to closely monitor and assess the longer-term, real-world impacts. The city's experience, even any unforeseen disadvantages that reveal themselves later, will serve as a valuable guide for other jurisdictions contemplating similar reforms. In dismantling the subminimum wage, Chicago cannot only rectify some historical injustices, but also set a precedent for fostering a more just, equitable, and humane work environment within the service industry.

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