

Economic Impact Statement

Montgomery County, Maryland

Bill 35-23

County Minimum Wage – Tipped Employees

SUMMARY

OLO anticipates that enacting Bill 35-23 would have a net negative impact on economic conditions in the County in terms of the Council's priority economic indicators. In this analysis, OLO performed a review of empirical studies on the economic impacts of increasing the tipped minimum wage (TMW). Based on this review, the net impact likely would be negative for the following reasons. First, due to higher labor costs and challenges mitigating these costs, the County's restaurant sector likely would experience a net decline in profitability. Second, while increasing the TMW would likely economically benefit certain tipped workers who reside in the County, it is possible that aggregate earnings in the sector would decrease due to the combined effects of reduced tipping and aggregate job and work hour declines. Third, the studies reviewed here suggest that increasing the TMW would not effectively target poor tipped workers in the County. Finally, because restaurants likely would pass-through a portion of higher labor costs to customers, the net economic impact of higher wages for certain tipped workers likely would be offset by higher prices for customers who reside in the County.

BACKGROUND AND PURPOSE OF BILL 35-23

Background

The Montgomery County minimum wage law distinguishes between employees and tipped employees. As of July 1, 2023, the minimum wage rate per hour for employees is \$16.70 for large employers, \$15.00 for mid-sized employers, and \$14.50 for small employers.^{1,2}

Over time, County law will phase out differences in minimum wage rates by employer size by raising the rate for mid-sized and small employers to the rate for large employers. The single minimum wage hourly rate will be adjusted each year by the annual average increase in the Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W) for Washington-Baltimore.³

Like most jurisdictions in the U.S., the County does not require employers to pay tipped employees the full minimum wage *before tips*. County law defines "tipped employees" as employees who are engaged in an occupation in which they

¹ Montgomery County Code, Sec. 27-68. Minimum Wage Required. Montgomery County Code defines a "large employer" as an employer who employs 51 or more employees and "small employer" as an employer employs 10 or fewer employees. "Mid-sized employer" is defined as "an employer who employs between 11 and 50 employees; or an employer who employs 11 or more employees and has tax exempt status under Section 501(c)(3) of the Internal Revenue Code; or provides 'home health services' as defined by 42 C.F.R. § 440.70 or 'home or community-based services' as defined by 42 C.F.R. § 440.180, and receives at least 75% of gross revenues through state and federal Medicaid programs."

² Also excluded from the County minimum wage are employees who are exempt from the minimum wage requirements of the State or Federal Act; or are under the age of 19 years and employed no more than 20 hours per week.

³ For a table of the wage transition, see "Minimum Wage Increase - Effective July 1, 2023."

customarily and regularly receive more than \$30 each month in tips; have been informed by their employers about the provisions of this Section; and have kept all tips they received.⁴

County law grants employers of these workers “tip credits.”⁵ Tip credits “allow employers to pay workers a guaranteed hourly wage, often referred to as the [tipped minimum wage], which is less than the statutory minimum wage as long as tips bring the worker up to the minimum wage; if tips leave the employee short of the minimum wage, employers have to make up the difference.”⁶

In the County, employers must pay tipped employees a TMW of at least \$4.00 per hour. This amount plus tips must equal (at least) the minimum wage hourly rate. Thus, the current maximum tip credits are presented in Table 1.

Table 1. Current Maximum Tip Credits in the County

Employer Size	Tipped Minimum Wage Rate	Maximum Tip Credits	Minimum Wage Rates
Large Employer	\$4	\$12.7	\$16.7
Mid-Sized Employer	\$4	\$11.0	\$15.0
Small Employer	\$4	\$10.5	\$14.5

Bill Description

The purpose of Bill 35-23 is to phase out the tip credit by July 1, 2028. It would do so by increasing the TMW rate along the following schedule:

- \$4.00 per hour, until July 1, 2024;
- \$6.00 per hour, effective July 1, 2024 until July 1, 2025;
- \$8.00 per hour, effective July 1, 2025 until July 1, 2026;
- \$10.00 per hour, effective July 1, 2026 until July 1, 2027; and
- \$12.00 per hour, effective July 1, 2027 until July 1, 2028.

By July 1, 2028, there would be a single minimum wage rate for employees and tipped employees in the County.⁷

⁴ Montgomery County Code, Sec. 27-69. Tipped Employees.

⁵ “Minimum Wages for Tipped Employees.”

⁶ Neumark and Yen, “The Employment and Redistributive Effects of Reducing or Eliminating Minimum Wage Tip Credits.”

⁷ Introduction Staff Report on Bill 35-23, County Minimum Wage – Tipped Employees.

INFORMATION SOURCES, METHODOLOGIES, AND ASSUMPTIONS

Per Section 2-81B of the Montgomery County Code, the purpose of this Economic Impact Statement is to assess, both, the impacts of Bill 35-23 on residents and private organizations in terms of the Council's priority economic indicators and whether the Bill would have a net positive or negative impact on overall economic conditions in the County.⁸

In this analysis, OLO reviews *impact evaluations* to identify empirically well-established effects of increasing TMWs on economic outcomes. Impact evaluations are a core tool of evidence-based policymaking. They strive to answer cause-and-effect questions regarding the impact of a policy or program on a specific outcome(s).

Using the Google Scholar database, OLO identified 10 impact evaluations on the economic effects of raising the TMW. Empirical studies were selected on two criteria:

1. The study directly evaluated the effects of TMWs (as opposed to similar policies like general minimum wage) on outcomes related to the Council's priority indicators, and
2. The study used well-established strategies and methodologies to identify the causal effects of TMWs.

As shown in **Table 2**, empirical studies that used quasi-experimental methods were prioritized in the selection. Quasi-experimental studies are distinguished from non-experimental studies by their ability to better identify the causal effects of a policy intervention from outcomes correlated with, but unrelated to, the intervention due to unmeasured confounding and other threats to causal inference.

In later sections of this analysis, OLO reviews these studies to draw evidence-based conclusions regarding the impacts of TMWs on specific outcomes. These conclusions are the primary basis on which OLO infers the economic impacts that Bill 35-23 would have on businesses, residents, and overall economic conditions in the County. Importantly, the studies focus on the impacts of TMWs on the restaurant sector, in particular full-service restaurants. While the Bill would affect other service-providing businesses (e.g., taxi services), OLO limits its discussion to the restaurant sector in the County.

⁸ Montgomery County Code, Sec. 2-81B.

Table 2. Impact Evaluations on the Economic Impacts of TMW Increases

Research Design	Publication	Outcome
Quasi-Experimental	Neumark and Yen (2023), " The Employment and Redistributive Effects of Reducing or Eliminating Minimum Wage Tip Credits ," Journal of Policy Analysis and Management	wages, total earnings, employment, poverty
	Ali et al (2023), " Large Sample Evidence on Tipping Rates in the Restaurant Industry: A Comprehensive Study ," International Journal of Hospitality Management	tipping
	Sabia, et al (2018), " Minimum Cash Wages, Tipped Restaurant Workers, and Poverty ," Industrial Relations: A Journal of Economy and Society	poverty
	Paarlberg and Reyes (2018), " New York's Experience After the Tipped Minimum Wage Increase ," Institute for Policy Studies and Restaurant Opportunities Centers United	salary, employment, establishments
	Jones (2016), " Measuring The Effects of the Tipped Minimum Wage Using W-2 Data ," CARRA Working Paper Series	wages, total earnings, tipping, employment
	Allegretto and Nadler (2015), " Tipped Wage Effects on Earnings and Employment in Full-Service Restaurants ," Industrial Relations: A Journal of Economy and Society	wages, employment
Survey Experimental	Even and Macpherson (2014), " The Effect of the Tipped Minimum Wage on Employees in the U.S. Restaurant Industry ," Southern Economic Journal	wages, employment
	Tang et al (2022), " The Effect of the Minimum Server Wage on Restaurant Guest Tipping Behavior ," Journal of Foodservice Business Research	tipping
	Lynn (2022), " How Tip Credits Affect Consumer Tipping Behavior ," International Journal of Hospitality Management	tipping
Nonexperimental	Lynn (2020), " The Effects of Minimum Wages on Tipping: A State-Level Analysis "	tipping

VARIABLES

The primary variables that would affect the economic impacts of enacting Bill 35-23 are the following:

- Total earnings for tipped workers;
- Total employment for tipped workers;
- Restaurant prices; and
- Demand elasticity.

IMPACTS

WORKFORCE ▪ TAXATION POLICY ▪ PROPERTY VALUES ▪ INCOMES ▪ OPERATING COSTS ▪ PRIVATE SECTOR CAPITAL INVESTMENT ▪ ECONOMIC DEVELOPMENT ▪ COMPETITIVENESS

Impact Evaluations

Earnings and Employment

The studies reviewed here provide strong evidence that raising the TMW increases employer-paid wages to tipped workers in full-service restaurants. However, the evidence is mixed on whether the policy increases or decreases total earnings for the workers. As discussed below, the literature points to two reasons why the net effect is uncertain.

First, it is unclear whether the decline in customer tipping caused by TMW hikes outweighs higher employer-paid wages. Jones (2018) examines the impact of increasing the TMW at the employee-level on hourly wages and total compensation per hour for tipped servers (waitstaff and bartenders), using linked IRS W-2 administrative records and survey data from 2005 to 2011. She finds “strong evidence that hourly wages paid by restaurant owners to their servers increase with increases in [TMW].” However, she finds no effect on total compensation, due to decreased tips. As she writes, “I do not find that overall compensation increases with increases in the tipped minimum wage—this is due to total tips decreasing in response to tipped minimum wage increases. Tips per hour appear to decrease in response to higher tipped minimum wages in the same proportion as FICA wages increase (5 or 6 percent).”

Several studies support Jones’ finding that increasing TMWs decreases tipping among guests. Ali et al (2023) examine the impact of increasing the TMW. The study uses a large dataset consisting of 68.5 million guest checks “involving 43 unique operating restaurant brands with 1202 locations in 41 states and the District of Columbia over a recent 36-month period.” They find that tipping rates are negatively and significantly related to TMW and that “for each 1 dollar increase in servers’ tipped minimum wage the tipping rate drops by 6 basis points.” These findings are consistent with Lynn (2020)’s study that uses point-of-sale and customer survey data on restaurant tip sizes in 2013, 2015, and 2018. After controlling for regular minimum wage and cost of living, he finds that “states with higher tipped minimum wages have lower average tip percentages in restaurants.” Finally, Tang et al (2022) and Lynn (2022) conduct separate survey experiments on nonrandom samples of American adults. They both find that higher TMWs cause respondents to reduce tips.

However, Even and Macpherson (2014) examine the impact of increasing the TMW at the state-level on average weekly earnings—including any reported tip income—for tipped workers in the full-service restaurants using data from 1990 to 2011. They find “fairly robust evidence that increasing the tipped minimum wage improves earnings of full-service

restaurant workers.” Similarly, Allegretto and Nadler (2015) examine the impact of increasing the TMW at the County-level on average weekly wages for a given quarter for tipped workers in full-service restaurants from 1990 to 2013. They find that “raising the tipped wage significantly increases earnings of workers in FSRs.”

Another reason for the uncertain net effect is TMW hikes may reduce jobs and available hours. Neumark and Yen (2023) examine the impact of increasing the TMW at the state-level on average weekly wages and total earnings for tipped full-service restaurant workers using data from 1990 to 2019. They find that raising the TMW increases average weekly wages and decreases employment. Moreover, they find that “the negative employment elasticity exceeds the positive elasticity for earnings per worker,” meaning employment is more responsive to raising the TMW than wages. For this reason, they conclude “the estimated effect on total earnings is negative (although indistinguishable from zero). This evidence suggests that tipped restaurant workers do not benefit, on average, from increases in the tipped minimum wage.”

Even and Macpherson (2014) find higher TMWs reduce aggregate employment and hours for tipped workers in the restaurant industry. Jones (2018) finds the relationship between the TMW and employment to be nonlinear. As she writes, “[a]n increase in the tipped minimum wage has a quadratic relationship with sector employment, where employment first increases, levels out, and then decreases as the tipped minimum increases.”

Other studies find no negative employment effect from TMW increases. Allegretto and Nadler (2015) find an insignificant effect. In another study, Paarlberg and Reyes (2018) examine the impact of New York’s TMW increase in 2015 at the County-level on average salaries for full-service restaurant workers over a two-year period. In terms of employment, they find that “in some cases New York counties did better than their neighbors, in others, they fared comparably or not as well. On the aggregate, New York counties performed better.” Moreover, Paarlberg and Reyes (2018) find that New York border counties saw average salaries increase at higher rates (11.5%) than surrounding border counties (5.3%). This suggests the net effect may have been positive for workers covered in their analysis.

Overall, there is strong evidence that raising TMW increases employer-paid wages for tipped workers in full-service restaurants and causes customers of these restaurants to reduce tips. The evidence also points to the potential for raising TMWs to reduce jobs and available hours for tipped workers in the industry. However, it is uncertain whether the benefit of higher employer-paid wages outweighs the costs of lower tips and/or employment.

Distributional Impacts

Two studies reviewed here examined the distributional impact of TMWs. In their study of the impacts of TMWs on tipped full-service restaurant workers, Neumark and Yen (2023) also examine whether increasing TMWs would target poor or low-income families or reduce the likelihood of being poor or very low income. They find weak support for its poverty-alleviating effects. As they write,

“we find that neither eliminating the tipped minimum wage nor increasing it are likely to deliver redistributive benefits. However, some of these conclusions are more fragile with respect to whether we focus on more recent data only or use a longer sample period; the latter evidence, which does not point to distributional benefits of higher tipped minimum wages, is more robust and reliable.”

In another study, Sabia et al (2018) examine the effect of TMW increases for restaurant workers on poverty using data from 1988 to 2014. Their findings are sensitive to whether poverty is measured at the family-level (i.e., all persons in a

household who are related by blood, marriage, or adoption) or household-level (i.e., all person in the house, condominium, or apartment dwelling). The researchers write,

“we find that tipped minimum cash wage increases are associated with a reduction in the risk of poverty among tipped restaurant workers, with an estimated elasticity of -0.2 . However, this result is strongest when using the family...as the resource-sharing unit. When we use the household ... instead, we estimate poverty elasticities that are 50 to 75 percent smaller in magnitude and statistically indistinguishable from zero at conventional levels. This difference in findings is consistent with evidence that a substantial share of tipped workers who live in a poor family simultaneously live in a nonpoor household together with persons unrelated by blood, marriage or adoption who contribute to the household’s income.”

They conclude the “results suggest that the poverty-alleviating effects of tipped minimum cash wages are overstated by failing to account for income contributed to households by such workers.”

Overall, the evidence suggests that raising the TMW is ineffective at increasing income for poor restaurant workers.

Establishments

Only one study reviewed here examined the impact of increasing the TMW on the survival of restaurant establishments. In their study of the impact of New York’s TMW increase on full-service restaurant workers, Paarlberg and Reyes (2018) find that New York counties saw higher increasing in establishments than their neighbors. This finding suggests that the TMW increase did not significantly reduce the number of restaurants. However, the study does not indicate the extent to which the policy change affected the rate of entry and exit of restaurants.

Overall, there is limited evidence on the impact of TMWs on restaurant survival, with one study with limited geography and temporal scope finding no negative impact.

Businesses, Non-Profits, Other Private Organizations

OLO anticipates that enacting Bill 35-23 would have negative impacts on certain private organizations in the County in terms of the Council’s priority economic indicators.

The primary businesses affected by the policy change would be full-service restaurants.⁹ The studies reviewed above provide strong evidence that raising the TMW increases employer-paid wages to tipped workers in full-service restaurants. Thus, restaurants with tipped workers in the County would experience significant increases in operating expenses in the form of higher labor costs. Holding all else equal, higher labor costs would reduce net profits for restaurants. However, owners and managers most likely would respond to the increase in labor costs in ways that protect profit margins.

First, it is likely the Bill would result in workforce reductions for restaurants. Indeed, the studies reviewed above suggest that owners and managers likely would reduce jobs and/or available hours for tipped workers. However, studies have

⁹ As stated above, the Bill would affect other service-providing businesses, like taxi services, but OLO limits its discussion to restaurants based on the scope of studies reviewed here.

found service quality to affect customer satisfaction and revisit intentions.¹⁰ Thus, owners and managers may risk losing revenue if workforce reductions undermine service quality.

Second, restaurant owners and managers likely would pass-through a portion of higher labor costs to customers in the form of higher menu prices. In fact, studies on general minimum wage increases have found substantial cost pass-throughs.¹¹ However, a widely cited study on food price elasticities found that “[f]ood away from home was most responsive to changes in prices among other categories ... and more elastic than demand for food at home.”¹² Thus, owners and managers may risk losing revenue if they pass-through too much of the costs to customers.

In sum, the Bill likely would significantly increase labor costs for restaurants. Owners and managers likely would reduce jobs or hours and/or pass-through costs to customers to protect profits. However, these actions may risk revenue loss from the potential effects of lower service quality and/or higher menu prices on customer demand for eating out. The limited evidence reviewed above suggests these dynamics may not affect the size of the County’s restaurant sector. But they likely would result in a decrease in total profitability.

It is beyond the scope of this analysis to assess the Bill’s potential impacts on other businesses in terms of the Council’s other priority indicators.

Residents

OLO anticipates that enacting Bill 35-23 would have a neutral impact on residents in the County in terms of the Council’s priority economic indicators.

The primary residents affected by the policy change would be tipped-workers full-service restaurants who reside in the County. The studies reviewed above provide strong evidence that raising the TMW increases employer-paid wages to tipped workers and reduces tips. The evidence also suggests that certain workers may experience reduced hours and employment. Overall, OLO anticipates that certain tipped workers would experience net income gains, while others may experience a neutral or negative affect. In addition, the studies reviewed above suggest that these income gains likely would not target poor workers in the industry.

The Bill would also impact customers of restaurants who reside in the County. As previously discussed, increasing the TMW likely would increase menu prices. Residents whose demand is unchanged by higher prices would experience a net increase in household expenses, holding all else equal. However, certain residents likely would reduce their consumption of eating out at full-service restaurants, either by eating at home and/or shifting to limited-service restaurants.

Due to time constraints, OLO was unable to determine the percentages of residents who are tipped workers at County restaurants and who comprise the customer base of these restaurants. Nevertheless, OLO suspects that the Bill would have an overall neutral impact on residents because it would involve a transfer from resident workers to customers.

¹⁰ For a review of studies on this topic, see Bichler, Pikkemaat, and Peters, “Exploring the Role of Service Quality, Atmosphere and Food for Revisits in Restaurants by Using a e-Mystery Guest Approach.”

¹¹ Repetti and Roe, “Minimum Wage Change Effects on Restaurant Pricing and Employment”; Basker and Khan, “Does the Minimum Wage Bite into Fast-Food Prices?”

¹² Andreyeva, Long, and Brownell, “The Impact of Food Prices on Consumption.”

Beyond this potential impact, OLO does not expect the Bill to affect residents in terms of the Council's other priority indicators.

Net Impact

OLO anticipates that enacting Bill 35-23 would have a net negative impact on economic conditions in the County in terms of the Council's priority economic indicators. In this analysis, OLO performed a review of empirical studies on the economic impacts of increasing the tipped minimum wage (TMW). Based on this review, the net impact likely would be negative for the following reasons. First, due to higher labor costs and challenges mitigating these costs, the County's restaurant sector likely would experience a net decline in profitability. In theory, this could undermine the competitiveness of the sector and may undermine the County's reputation for a "business friendly environment." Second, while increasing the TMW would likely economically benefit certain tipped workers who reside in the County, it is possible that total earnings in the sector would decrease due to the combined effects of reduced tipping and aggregate job and work hour declines. Third, the studies reviewed here suggest that increasing the TMW would not effectively target poor tipped workers in the County. Finally, because restaurants likely would pass-through a portion of higher labor costs to customers, the net economic impact of higher wages for certain tipped workers would be offset by higher prices for customers who reside in the County.

DISCUSSION ITEMS

As shown in this analysis, increasing the TMW would have multifaceted economic impacts. This analysis was unable to assess all the potential impacts—for example, the policy's impact on the non-restaurant sector, wage theft, etc. For this reason, Councilmembers may want to consider requesting a more thorough review of the Bill.

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CAVEATS

Two caveats to the economic analysis performed here should be noted. First, predicting the economic impacts of legislation is a challenging analytical endeavor due to data limitations, the multitude of causes of economic outcomes, economic shocks, uncertainty, and other factors. Second, the analysis performed here is intended to *inform* the legislative process, not determine whether the Council should enact legislation. Thus, any conclusion made in this statement does not represent OLO's endorsement of, or objection to, the Bill under consideration.

AUTHOR

Stephen Roblin (OLO) prepared this report.