Institute *for* Policy Integrity
NEW YORK UNIVERSITY SCHOOL OF LAW

January 4, 2018
Melissa Smith, Director of the Division of Regulations, Legislation, and Interpretation, WHD
ATTN: RIN 1235-AA21
Subject: Comments on the Failure to Conduct an Adequate Economic Analysis of the Proposed Rescission of Tip Regulations under the Fair Labor Standards Act

The Institute for Policy Integrity at New York University School of Law[1] offers the following comments on the Department of Labor's failure to conduct an adequate economic analysis of its proposed rescission of tip regulations under the Fair Labor Standards Act. Policy Integrity is a non-partisan think tank dedicated to improving the quality of government decisionmaking through advocacy and scholarship in administrative law, economics, and public policy.

The notice of proposed rescission reveals only that the rule was classified as a "significant regulatory action" under Section 3(f) of Executive Order 12,866[2]; in fact, the Office of Information and Regulatory Affairs has classified the proposed rescission as an "*economically* significant regulatory action,"[3] as defined under Section 3(f)(1) of Executive Order 12,866. This is appropriate, as the proposed rescission will likely result in an annual effect on the economy of $100 million or more, given the size of the restaurant industry, number of tipped workers, and average annual tips per worker.[4] Moreover, the proposed rescission also qualifies as economically significant under the definition in Section 3(f)(1) of the Executive Order because the rule will likely adversely affect a sector of the economy, productivity, or jobs.[5]

For all regulations, Executive Order 12,866 requires agencies to propose or adopt rules "only upon a reasoned determination that the benefits of the intended regulation justify its costs."[6] For economically significant regulations, agencies are required to prepare a detailed assessment "including the underlying analysis, of costs anticipated from the regulatory action (such as, but not limited to . . . any adverse effects on the efficient functioning of the economy, private markets (including productivity, employment, and competitiveness) . . . together with, to the extent feasible, a quantification of those costs."[7] Such regulatory impact analyses are

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[1] No part of this document purports to present the views, if any, of New York University School of Law.

[2] 82 Fed. Reg. 57,395, 57,403 (Dec. 5, 2017).

[3] https://www.reginfo.gov/public/do/eAgendaViewRule?pubId=201710&RIN=1235-AA21 (emphasis added).

[4] The agency estimates there are up to 1.3 million tipped workers in full-service restaurants and drinking establishments. 82 Fed. Reg. at 57,396. If each worker sees an average of only $100 in tips per year, then the effect of the proposed rescission easily passes the threshold for significance. The IRS estimates there is about $27.5 billion annually in tipped income nationwide (40% of which, or $11 billion, goes unreported). *How Much Do Waiters Really Earn in Tips?*, The Atlantic, Feb. 18, 2015.

Note that the $100 million threshold can be reached by transfer effects as well as by costs and benefits. *See, e.g.*, OMB, 2016 Draft Report to Congress on the Benefits and Costs of Federal Regulations and Agency Compliance with the Unfunded Mandates Reform Act 2, 7-8 (2016) (including transfer rules in its list of major rules).

[5] Exec. Order 12,866 § 3(f)(1).

[6] Exec. Order 12,866 § 1(b)(6).

[7] Exec. Order 12,866 § 6(a)(3)(C)(ii).

prepared under the standards of the Office of Management and Budget's *Circular A-4*. *Circular A-4* requires that, for economically significant regulations, agencies should (among other steps): assess market failures like market power and asymmetric information; quantify important direct and indirect costs and benefits under plausible scenarios and assumptions; and separately quantify important distributional effects and transfers.[8]

Yet despite these requirements, the Department of Labor makes little effort to quantify important effects of the proposed rescission, to consider a range of realistic assumptions, or even to explain why the rescission's purported benefits justify the total possible costs. For example, the agency does not attempt to study empirically how employers will likely reallocate tips or how consumers will likely respond. Nor does the agency attempt to model or quantify the purported, reduced deadweight loss in the labor market, offering only the conclusory statement, without support, that reduced deadweight loss would outweigh the regulatory familiarization costs.[9] That unsupported conclusion follows the agency's admission that, "Analysis of reduced deadweight loss would be a standard method for quantifying the gains to society of increased employment resulting from a policy such as the one proposed"[10]—yet no such analysis is even attempted.

Most problematically, the agency makes little effort to quantify possible effects on employment and worker earnings, either in terms of costs or negative distributive impacts. Instead the agency offers a short, vague discussion covering a handful of factors that could point toward one conclusion or another, and then limits even that sparse discussion by conceding it would apply only in the medium to long run;[11] what might happen to workers and their wages in the immediate future is not explored. Ultimately, the agency fails to assess the magnitude or even the overall direction of possible distributional and efficiency effects for affected employees and their wages.

The agency bemoans the scarcity of relevant research and lack of data,[12] and yet the agency does not seem to have surveyed even readily available relevant literature. For example, a study by Oz Shy on the effects of tipping on hourly wages and total tip-inclusive hourly worker compensation could shed light on the earning implications of tip pools for tipped employees.[13] The agency offers as a "given"—without any review of the literature—that the labor market is "perfectly competitive" and that wages will respond accordingly.[14] Yet such an assumption of perfect competition is not at all obvious for the labor market for tipped workers in the food service industry. In fact, the bulk of the evidence from economic studies shows that the food services industry does not behave like a simple, perfectly competitive market. A useful paper by V. Bhaskar, Alan Manning, and Ted To (the latter a research economist with the U.S. Bureau of Labor Statistics), entitled *Oligopsony and Monopsonistic Competition in Labor Markets*, surveys

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[8] *Circular A-4* at 4-5, 14, 18, 38

[9] 82 Fed. Reg. at 75,410.

[10] 82 Fed. Reg. at 57,408.

[11] 82 Fed. Reg. at 57,408.

[12] 82 Fed. Reg. at 57,408.

[13] Oz Shy, *Do Tips Increase Workers' Income?*, 61 MANAGE. SCI. 2041 (2015)

[14] 82 Fed. Reg. at 57,408.

some of the theory and empirical results on imperfect competition in labor markets.[15] One study surveyed provided "a clear and simple example of wage dispersion" in an imperfect market for restaurant labor in northern Virginia.[16] Another study showed that restaurant employment and wages did not respond in New Jersey as classical economic theory would have predicted based on an assumption of perfect competition.[17] Recent evidence from San Francisco and Washington State also supports this finding, showing that the food services labor market did not respond to minimum wage increases in the way a simple model of perfect competition would predict.[18] Imperfect and asymmetrical information among the employees most likely to seek work in the food service industry can contribute to imperfect labor markets with distorted wages.[19] Because the rule's potential costs and distributional effects could depend heavily on assumptions about perfect versus imperfect labor markets, *Circular A-4* would require the agency to consider a range of plausible scenarios and assumptions.[20] The Department of Labor failed to do so.

Ultimately, the Department of Labor has not adequately explained why the proposed rescission's alleged benefits justify the myriad of unanalyzed costs and potentially negative distributional effects to workers. Without such an explanation, the proposed rescission should not move forward.

Sincerely,
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[15] 16 J. Econ. Persp. 155 (2002).

[16] *Id.* at 156.

[17] *Id.* at 167.

[18] Arindrajit Dube, Suresh Naidu & Michael Reich, *The Economic Effects of a Citywide Minimum Wage*, 60 ILR REV. 522–543 (2007); *and* Michael Reich, Sylvia Allegretto & Anna Godoey, *Seattle's Minimum Wage Experience 2015-16*, CWED POLICY BR. (2017).

[19] 16 J. Econ. Persp. 155 (2002), *supra* note 15, at 172.

[20] *Circular A-4* at 42.