The end of some tipping

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Economists study equilibriums. This allows them to accurately predict many outcomes, but it also prevents them from providing any insight into how long it will take to reach those outcomes. For instance, a colleague and I predicted the drastic drop in housing prices that led to the Great Recession, which started in December of 2007. Unfortunately, we made the prediction in 2004, which is so early that our prediction was probably worthless. It took three years before the forces we saw had any real influence on the economy.

As an economist, I go through life spotting activities that do not make any sense (at least to me), and I, almost automatically, formulate predictions about how things will change. One activity that does not make sense to me is the prevalence of tipping. I worked as a waiter for about 8 years, so I have some expertise in which actions used to lead to tips and which did not. When I was younger, waiters in full-service restaurants got tips and employees at takeout restaurants did not.

Today, many takeout restaurants put pressure on customers to tip. At drive-through coffee shops, people who pay with credit cards are often asked if they want to tip 15 percent, 20 percent, or 25 percent. And these tips are for low levels of service that only include pouring a drink, perhaps making it, handing the drink to a customer, and collecting payment. Back in my day, at a fancy restaurant, the waiter provided service while the customers stayed at one of the restaurant's tables, and that service was delivered over a period of about an hour and 15 minutes. That is a lot more service than the one minute of service provided by the drive-through coffee shops.

Just to give you an idea of how out-of-hand tipping has gotten, I have heard of people who work at drive-through coffee establishments that, with tips, earn $30 an hour. That adds up to a $60,000 annual salary, which is a lot for unskilled labor, and more than the establishments need to pay to attract workers.

I always thought that the drive-through coffee shops were hurt by their credit card machines that recommended tips. For instance, if a coffee shop sells takeout coffee for $5, the price to the customer becomes $6 when the customer adds on a 20 percent tip. How will customers react when the price of coffee increases from $5 to $6? They will buy fewer coffees of course. This is a general principle in economics – when the price of a product increases, people buy less of it. So in this case, the suggested tips cause the coffee shop to lose customers.

I have trouble figuring out why coffee shops use credit card readers that suggest tips. By doing so, they decrease their sales. Remember in my example, the coffee shop is getting $5 per cup of coffee. The shop will earn this $5 per cup for fewer coffees when the credit card machine pressures people into paying an extra dollar for the coffee. Remember, the employees get to keep the $1 tip, not the shop. With fewer $5 sales, the coffee shop will be less profitable.

My prediction is that takeout restaurants and drive-through coffee shops will stop using the credit card machines that suggest tips. This has already started to happen. A few weeks ago, I went into a Dunkin Donuts, and it had a big sign that said no tipping. Chick-Fil-A also prohibits tipping. These policies will lower the actual price their customers pay – at least compared to the inflated prices that exist when tips are strongly suggested. I suspect that other drive-through restaurants will follow Dunkin Donut's lead. When will this happen? I do not know; I am only an economist.

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