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The Subminimum Wage Plus Tips: A Bad Bargain for Workers

Sylvia A. Allegretto[1]

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The latest polling on the federal minimum wage shows that more than three out of four Americans think that $7.25 an hour is too low.[1] I have often wondered how the federal $2.13 subminimum cash wage paid to tipped workers, in place since 1991, would poll? I've yet to see a poll on that question. Until the last decade or so, the subminimum wage was off the radar for much of the minimum-wage debate. Not so much these days, but even so, confusion and misunderstanding persist around the two-tiered wage-floor system.

The history of how we got here is quite intriguing. It starts with the passage of the Fair Labor Standards Act (FLSA) in 1938, which gave workers employed by firms engaged in interstate commerce the right to a minimum wage, along with other legal protections such as a forty-hour workweek and overtime pay.[2] Enacting such labor standards was historic, but just one in five workers were originally protected, as many industries were exempt. An amendment to the act in 1966 brought previously omitted service workers, including hotel and restaurant workers, under the FLSA umbrella. In doing so, the amendment also permitted employers to pay a subminimum wage to workers who customarily and regularly received tips, a category that included a large share of the newly covered workforce.

But, why institute a second-tier wage floor that relied on customer's tips to get workers to the statutory minimum? Turns out the idea, one predicated on gratuity as a replacement for employer-provided wages, was not a new one. The practice of tipping is traced to the Middle Ages and the European feudal system, when masters would sporadically give pocket change to their servants. The practice outlasted the feudal era, becoming a habit between customers—often upper class—and service workers. It also spread more generally. The modern custom of tipping was imported to the United States in the nineteenth century by upper-class American travelers to Europe. At the same time, an influx of European workers more acquainted with the practice helped to establish and spread the practice of tipping in the United States.

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In the post–Civil War period, the idea took a firm hold in the United States as employers were hiring formerly enslaved people. The Pullman Train Company, for instance, hired many formerly enslaved people and fought hard to keep paid wages very low. When investigated by the Railroad Commission of California in 1914, Pullman argued that they "paid adequate wages and did not expect their employees to exact tips"—an assertion unfounded by payroll data and strongly rejected

[1]Center for Economic and Policy Research, Washington, DC, USA

Corresponding Author:
Sylvia A. Allegretto, allegretto@cepr.net

by the commission.[3] Pullman, in fact, left it to the mostly white customers to determine the workers' compensation through voluntary and unpredictable tips.

A passionate debate about tipping developed during the Progressive Era—a period between the late 1890s and late 1910s. In this era of rapid industrialization and corporate growth, reformers sought to curtail rampant business and political corruption and the exploitation of labor, through myriad means. These included the development of stronger democratic ideals and institutions, economic competition, government regulation, political engagement, and unions.

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In 1916, William Scott, an anti-tipping crusader, wrote, *The Itching Palm: A Study of the Habit of Tipping in America*, a fierce polemic on the practice of tipping, which Scott likened to "flunkeyism."[4] Scott saw tipping as inherently undemocratic, an exchange in which one person—presumably superior—tips another, thought to be inferior. He argued that the custom of tipping was steeped in racial, ethnic, and gender biases and created degrading class distinctions, akin to that of master and slave.

It was also during the Progressive Era that the concept of minimum-wage legislation gained popularity. Hourly wage standards and workplace rules for the lowest-paid workers were sought to combat the effects of worker exploitation. Massachusetts and Minnesota were among the first dozen states to pass minimum-wage laws and workplace standards for women and children in the early 1900s. During this time, there was a continuing debate about counting tips as wages and tipping more generally. Businesses wanted tips to be counted toward wages in states with minimum-wage laws. Much later, in a hearing on wage policy that took place in 1938, Eleanor Roosevelt expressed her dislike of tipping, which she regarded as a result of the failure to provide a living wage.[5]

Debates about wage laws and tipping practices have oscillated over time. It may be hard to imagine today, but in the early 1900s, a fervent anti-tipping movement helped to pass laws, in six states, that made tipping illegal—imposing fines on employers, tippers, and those who received tips.[6] However, it quickly became clear that those laws were impossible to enforce, and they were overturned. The long history of tipping in the United States is complex, and it includes the efforts of employers to shift the responsibility for paying workers directly to customers, leaving them to decide if, when, and how much to bestow. The 1996 FLSA Amendment was fashioned, at least in part, by this history.

The 1966 FLSA Amendment

The 1966 FLSA Amendment made it legal to pay tipped workers a subminimum wage. The two-tiered wage-floor system hinges on a "tip-credit" provision. A tip-credit is the difference between the regular minimum wage and the subminimum cash wage paid by employers. In other words, it is the amount in tips that an employer can use as credit toward the wage bill, the total of wages the employer should be paying. The original law stipulated a fifty–fifty split of the regular minimum wage: employers paid a subminimum cash wage that was half of the regular minimum wage; the other half was provided via customers' tips. Even today, many customers do not know that a tip intended as a gratuity is often a wage-subsidy provided to the employer.

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The original 1966 tip-credit stipulation specified that a worker must "regularly and customarily" receive tips of at least \$20.00 a month. That amount has increased only once—in 1978—to \$30.00, where it remains today.

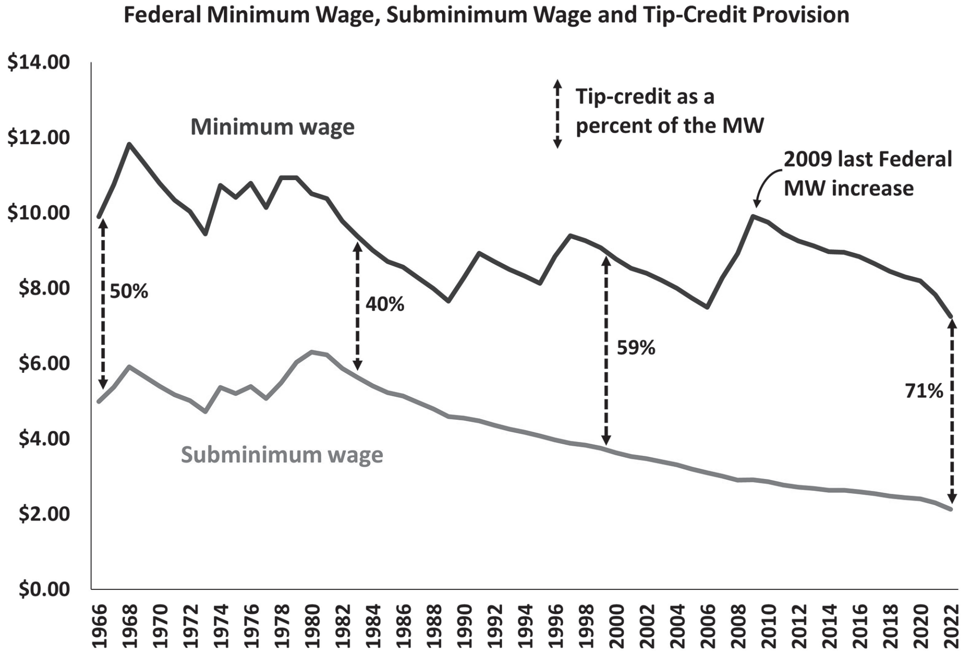

Figure 1. Federal minimum wage, subminimum wage, and tip-credit allowance.
Source: U.S. Department of Labor.
Note. Real 2022 dollars. Inflation adjusted using the CPI-U-RS (Consumer Price Index for All Urban Consumers Research Series).

Adjusted for inflation, $30.00 in 1978 is worth over $140.00 today. In fact, the eroding effect of inflation has made it easier for employers to claim the tip-credit over time.

There are three parts to the federal two-tiered wage-floor system. (Many states have higher wage-floor policies, which I discuss in the next section.) These are depicted in Figure 1, which shows the historical trends in inflation-adjusted federal minimum and subminimum wages along with allowable tip-credit percentages since 1966. The first notable trend is that inflation-adjusted values of both wage floors long ago hit their peak values. It may not be immediately obvious that the intermittent "peaks" shown in Figure 1 represent actual increases in wage-floor policy via FLSA amendments—when the new minimums regained some or all of their previous buying power. The long periods of decline are due to policy inaction coupled with increasing prices that erode buying power. Neither are automatically adjusted on any timeframe for price increases, and FLSA amendments that deliver increases have been few and far between.

The last time the minimum wage was increased was in 2009 (noted in Figure 1), when it rose to $7.25.[7] We are currently in the longest period of federal inaction regarding wage policy. Perhaps more shocking is the fact that the current value (i.e., not inflation adjusted) of the subminimum wage has been stuck at $2.13 since 1991. It is barely perceptible in Figure 1 because the increase to $2.13 was preceded by nominal sub-wages of $2.09 and before that $2.01—resulting in a very long decline in the real (i.e., price adjusted) value.

But why and how was the subminimum wage delinked from the minimum wage? As Figure 1 shows, at some point, the subminimum stopped increasing in concert with increases in the regular minimum wage, as it had done since 1966. Unfortunately, it became a bargaining chip in 1996, when then President Clinton sought to increase the $4.25 federal minimum wage. The

$4.25 minimum had been in place since 1991, the same year that ushered in the hourly subminimum wage of $2.13. In 1996, Tea Party activist Herman Cain was head of the powerful National Restaurant Association. The National Restaurant Association campaigned to decouple the subminimum wage from future minimum-wage increases. Ultimately, they agreed not to fight an increase in the regular minimum wage, so long as there was no subsequent increase in the subminimum wage—ever again. And that is exactly what happened. The 1996 FLSA Amendment stipulated a 0.90 cent increase in the minimum wage over two steps, from $4.25 to $5.25. But it froze the subminimum wage, in perpetuity, at $2.13 per hour. That is where it remains today, more than three decades later. This subminimum wage has been a boon for any business with tipped workers, especially for full-service restaurants given their heavy reliance on tipped workers.

The 1996 amendment ensured that the tip-credit allowance afforded to employers would become ever more generous over time with any subsequent increases in the minimum wage, while the frozen-subminimum wage would lose nearly any meaningful value as inflation would erode its worth over time. Press coverage announcing the 1996 amendment made little note of the decoupling of the wage floors, nor did it point out the permanence of the $2.13 sub-wage. The National Restaurant Association was also silent about the move. Failure to publicly explain the details of the 1996 FLSA Amendment may well account for the lingering lack of knowledge that persists even today. It certainly helped to keep it off the policy radar and away from broad-based criticism for a long time.

The federal two-tiered wage-floor system that allowed for a subminimum wage to be paid to tipped workers was questionable policy from the beginning. Today customers' tips pay the lion's share of wages for tipped workers in states that abide by the federal wage floors, while employers have benefited from paying their tipped workers a cash wage of just $2.13 per hour for the last thirty-two years. Since 1966, the nominal (i.e., without adjusting for inflation) subminimum wage has increased from 0.63 cents to $2.13—otherwise $1.50 over fifty-seven years.

The States Take Action

Given policy inaction at the federal level, states have acted to increase wage floors via ballot initiatives or through the legislative process.[8] Relatively generous wage floors have been ushered in by some states over the last decade or so, resulting in a variety of policy scenarios across the United States. Figure 2 shows the vast landscape of state wage-floor and tip-credit provisions as of January 2023, when twenty-three states increased minimum and/or subminimum wages.[9]

Each bar in the figure represents a state, plus Washington, D.C. The darker segment denotes the hourly subminimum, while the lighter segment represents the hourly tip-credit allowance afforded to employers. Combined, the two amount to the statutory state minimum wage listed at the top of each bar.

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In total, there are twenty states, depicted at the bottom of the figure, with minimums at the $7.25 federal level. Of these twenty states, fourteen also maintain the federal $2.13 subminimum wage with a $5.12 tip-credit. Another six states have lower tip-credit allowances (i.e., a higher sub-wage). The fourteen states that follow both federal policies have never deviated, which is why the federal policies still matter to so many low-wage workers.[10]

Today, there are thirty-one states, plus Washington, D.C., with minimums above $7.25 and with tip-credit allowances ranging from zero to $10.75. Seven of these states, represented by solid dark bars, do not allow for a tip-credit provision.[11] A "no tip-credit" policy means that tipped workers earn the same regular minimum as any other worker, and all tips are a gratuity on top of the wage. Each of these seven states has statutory minimums significantly above the federal rate, ranging from $9.95 in Montana to $15.74 in Washington State.

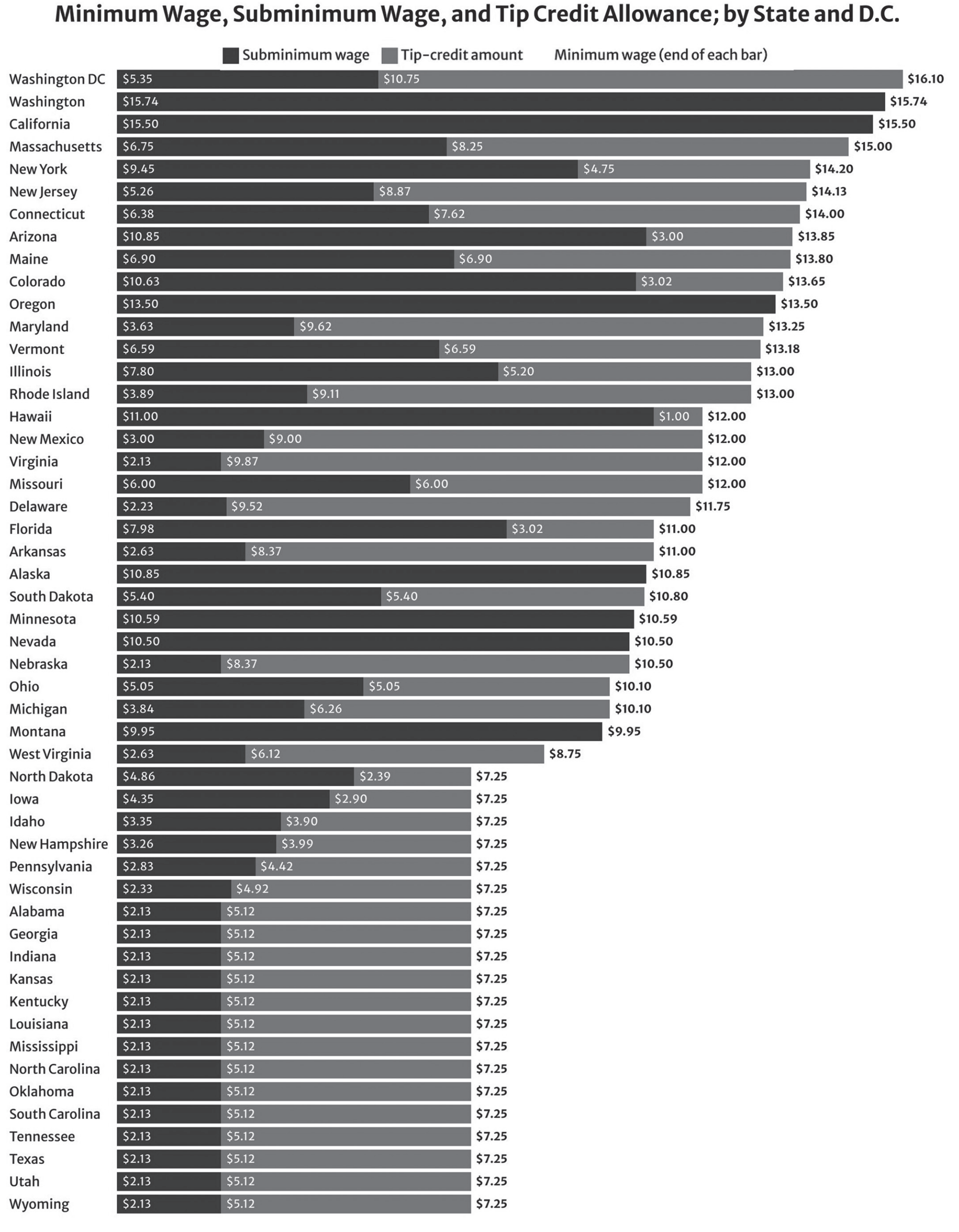

Figure 2. Minimum wage, subminimum wage, and tip-credit allowance; by state and D.C.
Source: Economic Policy Institute's Minimum Wage Tracker.
Note. Policies as of January 1, 2023.

Washington, D.C., has the highest minimum wage ($16.10), coupled with a $5.35 sub-wage. In percentage terms, Washington, D.C., has a tip-credit allowance that is not much different than the federal rate (67 vs. 71 percent); but dollar-wise, at $10.75, it provides the largest employer wage-subsidy in the United States. There are just two states, Virginia and Nebraska, that have subminimum wages of $2.13 coupled with minimum wages that are substantially higher than the federal rate—$12.00 and $10.50, respectively. These wage policies result in large tip-credit allowances in Virginia and Nebraska; $9.87 (82 percent) and $8.37 (80 percent), respectively. Voters in Nebraska passed a ballot measure that will phase in a $15.00 minimum wage, by January 2026 with annual indexing for inflation.[12] Nebraska plans to keep its $2.13 subminimum wage policy in place, which will result in a $12.87 (86 percent) tip-credit.

High-Versus Low-Road Policies

The numerous and varied state policies represent a sort of experiment that has played out across the country for a few decades now. The scenario can be characterized as a mix of low-, middle-, and high-road approaches. Low-road states are those that follow the federal wage floors; high-road states are the seven states that do not allow for a tip-credit provision; the rest fall in the middle.

Where you work matters. Generally, tipped workers do better in states that have high-road policies—those with more generous regular minimum wages coupled with a no tip-credit provision. Restaurant waitstaff represent the single largest tipped occupation in the United States. The Bureau of Labor Statistics (BLS) reports that the median hourly wage (including tips) was $11.00 for waitstaff in the full-service restaurant industry in 2019, prior to the pandemic disruption. The median was $9.04 in the states that have a $2.13 subminimum wage, and $12.69 in the seven high-road states—a 40 percent difference which is twice as high as the percentage difference for all workers.[13]

Too often, tipped workers are among the ranks of the working poor—but even more so in the $2.13 states. Poverty rates for the *overall* workforce across the low-, middle-, and high-road state scenarios are similar; 6.7, 5.7, and 6.2 percent, respectively. For waitstaff and bartenders, the comparative rates are 18.5, 14.9, and 11.1 percent, respectively.[14] Poverty rates are far too high for workers in general, but rates are highest for tipped workers in the $2.13 states. The economic circumstances of workers are, in part, a result of wage-floor policies.

My colleagues and I have written extensively on the subminimum wage and have shown that tipped workers, nearly 70 percent women, are overwhelmingly low-wage earners.[15] Yes, there are some who do really well, such as servers and bartenders who work in high-end establishments and land the lucrative shifts. For this reason, the minority of higher-earnings tipped workers are often in favor of the current system. But opportunities for high-end tipped work are few and disproportionately go to men. More typically, earnings are volatile due to myriad circumstances outside of a worker's control such as whether one is scheduled for a busy shift or if inclement weather cuts down on the number of customers.

The cycle of high-road practices can benefit workers and businesses.[16] From 2001 through pre-pandemic 2019, U.S. employment in full-service restaurants grew by 41.2 percent, far outpacing the 15.6 percent in the overall private sector. More specifically, in the years after the Great Recession but prior to the pandemic—2012 through 2019—the number of businesses and the rate of employment growth in full-service restaurants were higher in the high-road versus the low-road states. The growth in full-service restaurants was 10.8 percent versus 13.4 percent, and employment growth in the sector was 15.3 percent versus 17.0 percent in low-road states compared with high-road states, respectively. Note that, over this timeframe, the real (adjusted for inflation) federal minimum and subminimum wages fell by nearly 22 percent, while wage floors in the high-road states continued to increase.

Violations, Exploitation, and Other Challenges

Tipped workers face unique challenges due to the two-tiered system in which tips plus a cash wage must equate to at least the regular state minimum wage. The legal obligation of employers to make up the difference between tips and the statutory minimum has become more of an issue as tip-credit amounts vary from $5.13 at the federal level to over $8.00 in eleven states including $10.75 in Washington, D.C. How this obligation is monitored is unclear. At what point does an employer stop the clock to tally up hours,

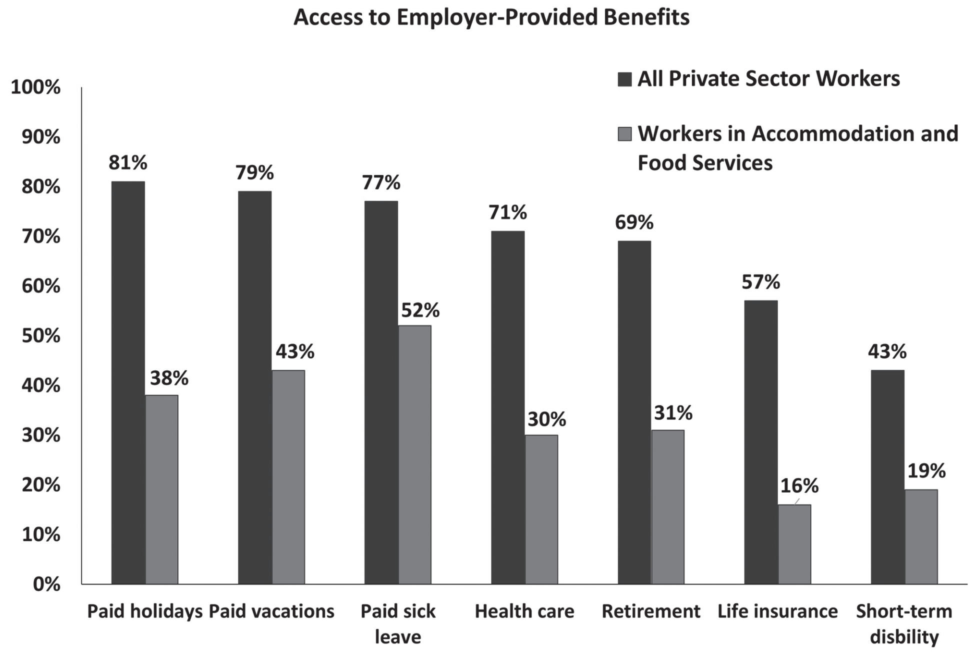

Figure 3. Access to employer-provided benefits.
Source. U.S. Bureau of Labor Statistics National Compensation Survey March 2022 data.
Note. These data represent all workers within the Accommodation and Food Services sector, including managers and supervisors. It is likely that these shares would be much lower if they reflected access for tipped workers only.

tips, secondary tips paid to other workers, and cash wages? Compliance is difficult and requires a complex accounting system, even if a good-faith employer would like to comply. In practice, monitoring compliance is largely left to tipped workers themselves, who typically must approach the manager if they are owed money. The possibility of retaliation, such as being fired or moved to slow shifts, makes many workers fearful of confronting a manager or an employer.

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Violations of laws governing the tip-credit are responsible for many injustices suffered by workers. These include potential wage theft, not paying a cash wage, and paying a subminimum wage to workers who are not engaged in tipped work. According to Department of Labor data, the restaurant industry is fraught with such violations.[17] From 2010 through 2019, 85.3 percent of investigated full-service restaurants and bars had some type of violation, and one in ten violated a FLSA law. For those years, the Department of Labor recovered $114.7 million in back wages for all violations across the two industries and $113.9 million in back wages for FLSA violations in particular. Civil monetary penalties totaling $14.0 million were assessed. Without clear rules and enforcement around the two-tiered system, high rates of violations will persist. Tipped workers—especially women—are also vulnerable to harassment. Too often, they have to put up with bad behavior on the part of customers or even bosses, who control scheduling.

It is hard to make ends meet on low earnings, especially in low-quality jobs that lack benefits. In the restaurant industry, for example, the lack of benefits can be dangerous for the workplace as a whole. If workers do not have paid time off, they are likely to show up for work when they are sick, because they cannot afford to lose earnings, putting themselves at further risk and posing a danger to coworkers and customers, who may become infected.

Benefit data in Figure 3 are from the National Compensation Survey, administered by the BLS. That chart shows benefit access for the private sector workforce and for all workers in Accommodation and Food Services (AFS), including waitstaff and bartenders (there are no data specifically on tipped workers).

The rates of leave and other benefits available to AFS workers pale in comparison with those in the overall private sector—even as the AFS numbers include managers and supervisors. Even when tipped workers have some benefits, they lose out in other ways. The small share of tipped workers who do get paid leave, for example, lose money because they have to forgo tips when they take advantage of the benefit. Disparities in basic benefits point to the need for universal benefits, provided by the government or mandated by law.

What Can Be Done

It is far past the time to raise both of the federal wage floors. As state-by-state policy variation shows, there are clear pathways to change. Decreasing the tip-credit allowance over time to ultimate elimination is one way. That would not spell the demise of a robust restaurant sector or the end of customer tipping. We know that, because both exist in states that do not allow for a tip-credit. What matters is creating a well-thought-out policy that allows ample time for implementation so that businesses can successfully transition to higher-road policies. Special consideration should be afforded to small businesses and to those in rural areas by creatively using, for instance, the tax code to help with the transition and/or temporarily providing wage subsidies.

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There are many dedicated people and groups across the country who have been advocating for more generous wage policy, at federal, state, and local levels. They include worker activists, unions, policy organizations, legislators, and academics. But there are also powerful monied interests who are a roadblock to change, including the National Restaurant Association, which has been lobbying to keep wages low since 1919.

It has been more than a decade since the Fight for $15 took hold in the United States. At the same time, organizations such as Restaurant Opportunities Centers United and One Fair Wage have been advocating for the elimination of tip-credit provisions and subminimum wages. Today, 62 percent of Americans think the federal minimum should be increased to $15.00. Of those opposed to the $15.00 minimum, a majority (71 percent) still favor an increase, but less than $15.00.[18] To date, three states (California, Massachusetts, and Washington) plus Washington, D.C., have minimums of at least $15.00. Of these, only Massachusetts has a subminimum wage ($6.75). In eight other states, the minimum is currently slated for an increase to $15.00. Each of those eight states will continue to have subminimum wages, ranging from $2.13 (Nebraska and Virginia) to $9.00 in Illinois.[19]

Bad News and Good News

The federal Raise the Wage Act of 2021 proposed to institute a $15 federal minimum wage in six steps by 2025 and would have eliminated the subminimum wage over time. It was part of the $1.9 trillion Covid-19 relief bill, but it failed to pass the Senate in March 2021. In opposition were fifty Republicans, along with eight Democrats. If it had passed, the act would have increased earnings for one in five workers, or 32 million. It would have meant raises for over 3.5 million tipped workers.[20]

Fortunately, states have made significant progress. A majority of states have more generous wage policies than those at the federal level. In addition, there are nearly fifty counties and municipalities within those states with policies higher than the state level. But local progress has been headed-off in half of the states by the passage of preemption laws, prohibiting local governments from setting wage floors higher than the state policy, even in cities that have a much higher cost of living.[21]

Among our peer countries, the U.S. minimum wage ranks 17th, and we are the only country to have a subminimum wage for tipped workers. In Europe, restaurant prices generally reflect the total cost of a meal: a standard service charge is added to the bill, and tips, if given at all, are modest. Moreover, jobs such as waitstaff tend to be of higher quality due to a combination of unions and/or sectoral bargaining, higher minimum wages, and universal social programs such as health care and paid time off. Without subminimum wages, restaurants compete on the basis of earnings and job quality to attract workers. By comparison, in the United States, where there are very low subminimum wage policies, tipped workers are more akin to independent contractors, and the restaurant is a workspace where tips are a means of earning a living wage.

Tipped workers, like many other workers in the United States, could benefit greatly from a voice in the workplace, especially as they face some unique circumstances. Yet, just 1.7 percent of workers in food services and bars are represented by a union—far less than the already low rate of 6.8 percent in the overall private sector.[22] Sectoral bargaining across trades in a particular industry—as opposed to shop-by-shop organizing, which is the usual case in the United States—would provide an avenue to negotiate much-needed benefits and protections to tipped workers such as waitstaff, bartenders, and car wash attendants. In any case, it is high time workers in the United States are allowed to exercise their right to organize without undue, often illegal, employer obstruction.

Every worker has the right to work with dignity at a fair wage. In the United States, our lowest earners have been waiting far too long for change. It is ludicrous to think that the United States cannot pursue and successfully implement high-road standards and labor protections at the federal level to uplift millions of workers and institute a fairer economic system regarding the tipped workforce.

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ORCID iD

Sylvia A. Allegretto https://orcid.org/0000-0003-0922-314X

Notes

1. YouGov poll, August 2-5, 2022.
2. At the time, the definition of interstate commerce was limited from what it encompasses today. For example, today it extends to companies that buy intermediate goods from out of state.
3. Kerry Segrave, *Tipping: An American Social History of Gratuities* (Jefferson, North Carolina and London: McFarland & Company, Inc., 1998), p. 17.
4. William Scott, *The Itching Palm: A Study of the Habit of Tipping in America* (Philadelphia: Penn Publishing Co., 1916).
5. Segrave, *Tipping*, p. 67.
6. Segrave, *Tipping*. Appendix 2 provides summaries of state laws.
7. The Fair Minimum Wage Act of 2007 increased the federal minimum from $5.15 to $7.25 in three steps.
8. There are twenty-six states that allow for ballot initiatives and/or referendums. An initiative enables citizens to propose new statutes or constitutional amendments. A referendum process permits citizens to repeal or uphold a law passed by the legislature.
9. Florida, Connecticut, D.C., Nevada, and Oregon will increase minimum and/or subminimum wages later in 2023.
10. The federal minimum wage of $7.25 and $2.13 subminimum applies in states with no minimum-wage law (Alabama, Louisiana, Mississippi, South Carolina, and Tennessee) or minimum wages below the federal level (Georgia and Wyoming).
11. Hawaii policy generally does not allow a tip-credit. Employers may pay $1.00 below the regular minimum wage if an employee's combined base wage plus tips exceeds $7.00 per hour more than the regular minimum wage.
12. States with annual indexing: Alaska, Arizona, Colorado, Connecticut, Florida, Maine,

Minnesota, Missouri, Montana, Nebraska, Nevada, New Jersey, New York, Ohio, Oregon, South Dakota, Vermont, Virginia, Washington, and Washington, D.C.
13. The median wage difference for all workers in the $2.13 versus the high-road states is 19.9 percent.
14. Elise Gould and David Cooper, *Seven Facts about Tipped Workers and the Tipped Minimum Wage* (Washington, DC: Economic Policy Institute, 2018), Figure 1.
15. See, for example, Sylvia Allegretto, *Should New York State Eliminate Its Subminimum Wage?* (Berkeley: Center for Wage & Employment Dynamics, University of California, Berkeley, 2018). Sylvia A. Allegretto and Carl Nadler, “Tipped Wage Effects on Earnings and Employment in Full-Service Restaurants,” *Industrial Relations: A Journal of Economy and Society* 54, no. 4 (2015): 622-47: Sylvia Allegretto and David Cooper, *Twenty-Three Years and Still Waiting for Change* (Washington, DC: Economic Policy Institute, 2014).
16. See S. Allegretto, M. Reich, K. Jacobs, and C. Montialoux, *The Effects of a $15 Minimum Wage in New York State* (Berkeley: University of California, Berkeley, 2016). Dynamic minimum wage model, p. 3.
17. Author’s analysis of U.S. Department of Labor Enforcement Data: Data Catalog—Enforcement Data—U.S. Department of Labor (dol.gov).
18. Pew Research Center, available at https://www.pewresearch.org/fact-tank/2021/04/22/most-americans-support-a-15-federal-minimum-wage/.
19. They are Connecticut, Delaware, Illinois, Maryland, Nebraska, New Jersey, New York, and Virginia. See the Economic Policy Institute’s Minimum Wage Tracker for details.
20. David Cooper, Zane Mokhiber, and Ben Zipperer, *Raising the Federal Minimum Wage to $15 by 2025 would lift the Pay of 32 million Workers* (Washington, DC: Economic Policy Institute, 2021).
21. See Preempting progress: State interference in local policymaking prevents people of color, women, and low-income workers from making ends meet in the South—Economic Policy Institute (epi.org).
22. Bureau of Labor Statistics Union Members 2022: Union Members—2022 (bls.gov).

Author Biography

Sylvia A. Allegretto is a senior economist at the Center for Economic and Policy Research, working from Oakland, CA.