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## Payday

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## PAYDAY

YONATHAN A. ARBEL\*

### ABSTRACT

*Legislation lags behind technology all too often. While trillions of dollars are exchanged in online transactions—safely, cheaply, and instantaneously—workers still must wait two weeks to a month to receive payments from their employers. In the modern economy, workers are effectively lending money to their employers, as they wait for earned wages to be paid.*

*The same worker who taps a credit card to pay for groceries in semi-automated checkout lines depends on dated payroll systems that only transfer payments on a “payday.” Workers, especially those living paycheck-to-paycheck, are hard-pressed to meet their daily needs and turn to expensive, short-term credit products—notably, payday lenders. While the need for credit is a real one, credit providers charge a steep price, often culminating in endless debt spirals. So, why does the payday still exist?*

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\* Assistant Professor of Law, University of Alabama, School of Law. For suggestions and comments I would like to thank John Acevedo, Deepa Das Acevedo, Matt Bodie, Vincent Buccola, Stephanie Didwania, Shahar Dillbary, Don Dornberg, Brian Galle, Victor Goldberg, Avery Katz, Jonathan Korn, Ron Krotoszynski, Ronald Mann, Ben McMichael, Jonathan Nash, Mike Pardo, Michael Pressman, Robert Scott, Steve Shavell, Paige Skiba, Eyal Zamir and participants in the following conferences and workshops—Law and Economic Organization (Columbia), Contracts Conference XIV, Faculty Workshop (SMU), Midwestern Law & Economics, Law & Economics Workshop (TAU), and Private & Commercial Law (Hebrew U.). Tori Moffa, Hamilton Millwee, Tamara Imam, and Brett Linley provided diligent and careful research assistance. The editors of the Washington University Law Review, despite facing the tribulations of the COVID-19 pandemic, worked tirelessly on bringing this article to print. A review of this article can be found in Tom C.W. Lin, *A New Payday(s)*, JOTWELL (July 23, 2020), <https://corp.jotwell.com/a-new-paydays/>, and a companion playlist can be found here: [http://bit.ly/payday\\_comp](http://bit.ly/payday_comp).

*This Article studies various explanations—economic, historical, behavioral, and legal. A primary conclusion is that the payday owes its existence to legacy legal architecture. That is, payday is a software problem, not a hardware problem. The hardware—i.e., money and payroll technology—is here. We can pay workers daily; in fact, gig economy workers in developing countries will often be paid more quickly than an American employee for the same work. What holds us back is our legal software: dated Eisenhower-era legislation that failed to anticipate technological change. Surprisingly, even pro-worker legislation, such as minimum wage laws, inadvertently encourages the practice.*

*By revealing the overlooked and dated legal infrastructure that sustains the payday, this Article suggests a path for legal reform. Daily streams of payment to workers are feasible, practical, and far more efficient than most people realize. A focused reform could effectively bring an end to the puzzling and pernicious practice of having workers lend money to their employers while they wait for their payday.*

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## INTRODUCTION

Legislation often lags behind technology. As Guido Calabresi observed, “laws are governing us that would not and could not be enacted today.”<sup>1</sup> This failure is resounding in the context of employment contracts. Payment technology has made incredible advances, and today trillions of dollars are traded in the online economy, moving between parties almost instantaneously.<sup>2</sup> At the same time, workers still wait for weeks until a formal “payday” to receive their hard-earned wages. While workers sell their labor today, employers only pay them in the future, leveraging wages as another line of credit.

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1. GUIDO CALABRESI, A COMMON LAW FOR THE AGE OF STATUTES 2 (1982).

2. *At 14.2% CAGR, Online Payment Gateway Market Size Will Reach 3672.1 Million USD by 2025*, MARKETWATCH (Apr. 15, 2020, 9:02 AM), <https://www.marketwatch.com/press-release/at-142-cagr-online-payment-gateway-market-size-will-reach-36721-million-usd-by-2025-2020-04-15> [<https://perma.cc/X4VP-9V7D>].

We seem to take the payday's existence for granted,<sup>3</sup> but it exacts a heavy price. Workers who wait for payment need to support themselves; the vicissitudes of everyday life—a sudden toothache, a flat tire, a stain on their only clean work shirt—demand money, now.<sup>4</sup> With many workers living paycheck-to-paycheck,<sup>5</sup> the current payday system pushes them to payday lenders and other short-term credit providers that dot the modern urban landscape.<sup>6</sup> A payday loan is meant to help the worker bridge the gap until payday, but it involves interest rates that are on average *twenty times* higher than those of credit cards.<sup>7</sup> A \$300 loan can quickly balloon into thousands of dollars of outstanding debt, leading many borrowers to debt spirals that can culminate in deep financial distress and even bankruptcy.<sup>8</sup>

3. The modern literature has mostly neglected this question. This omission is perhaps most glaring in law and economics analyses of employment contracts, but it is by no means confined to these works. *See, e.g.*, RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* (9th ed. 2014) (reviewing major topics but neglecting pay frequency); MARK A. ROTHSTEIN & LANCE LIEBMAN, *EMPLOYMENT LAW: CASES AND MATERIALS* 420–21 (7th ed. 2011) (adumbrating pay frequency). *But cf.* JOHN R. COMMONS & JOHN B. ANDREWS, *PRINCIPLES OF LABOR LEGISLATION* 50–52 (1916) (noting the credit nature of the payday).

4. The three leading reasons why individuals borrow from alternative lenders (such as payday lenders, pawn shops, and rent-to-own stores) are basic living expenses, making up for lost income, and house or car repairs. Neil Bhutta et al., *Consumer Borrowing After Payday Loan Bans*, 59 J.L. & ECON. 225, 240 (2016); *see also* Rob Levy & Joshua Sledge, *A Complex Portrait: An Examination of Small-Dollar Credit Consumers*, CTR. FOR FIN. SERVS. INNOVATION 12 (Aug. 2012), <https://www.fdic.gov/news/conferences/consumersymposium/2012/A%20Complex%20Portrait.pdf> [<https://perma.cc/D78A-RLT3>] (reporting that approximately 37% of very short-term borrowers borrowed because “[they] had a bill or payment due before [their] paycheck arrived.” In addition, 30% of respondents borrowed to meet some unexpected expense). This borrowing likely result from the payday; *see also* Nicholas Bianchi & Rob Levy, *Know Your Borrower: The Four Need Cases of Small-Dollar Credit Consumers*, CTR. FOR FIN. SERVS. INNOVATION 12 (Dec. 2013), <https://s3.amazonaws.com/cfsi-innovation-files/wp-content/uploads/2017/01/26054909/Know-Your-Borrower-The-Four-Need-Cases-of-Small-Dollar-Credit-Consumers.pdf> [<https://perma.cc/G5AB-W4PG>] (finding that 32% of consumers borrow because of misaligned cash flow and 32% to meet an unexpected expense). Again, both reasons can be mitigated by regularized pay.

5. 15% of households reported having spent more than they earned over the last year. Jesse Bricker et al., *Changes in U.S. Family Finances from 2013 to 2016: Evidence from the Survey of Consumer Finances*, 103 FED. RES. BULL. 1, 8 (2017).

6. Paige Marta Skiba, *Regulation of Payday Loans: Misguided?*, 69 WASH. & LEE L. REV. 1023, 1031 n.22 (2012) (“[P]ayday lenders outnumber both Starbucks and McDonalds.”). Roughly 64% of all adult Americans have at least one credit card and carry an average balance of \$4800. In addition, roughly 50% of all credit card holders carry a revolving balance on which they pay interest. CONSUMER FIN. PROT. BUREAU, *THE CONSUMER CREDIT CARD MARKET* 46, 48 n.16, 56 (2017), [https://files.consumerfinance.gov/f/documents/cfbp\\_consumer-credit-card-market-report\\_2017.pdf](https://files.consumerfinance.gov/f/documents/cfbp_consumer-credit-card-market-report_2017.pdf) [<https://perma.cc/A9UA-TS3E>].

7. Skiba, *supra* note 6, at 1027.

8. *See also* CONSUMER FIN. PROT. BUREAU, *CFPB DATA POINT: PAYDAY LENDING* 4 (2014), <https://files.consumerfinance.gov/f/201403cfpbreportpayday-lending.pdf> [<https://perma.cc/KD2Y-YXJ7>] (finding that 80% of payday loans are rolled over or followed by an additional loan and that 15% of loans are followed by a loan sequence of at least ten loans).

To experience firsthand the process of obtaining a payday loan, I borrowed \$200 from a payday lender in Tuscaloosa, Alabama. I signed a postdated check to the benefit of the lender for \$235,

This Article begins by framing the payday in the context of the employment contract. The employment relationship is, at its core, an exchange of money for labor.<sup>9</sup> The payday also injects into this relationship a credit transaction, one where the employee is lending money to the employer. But this is a credit transaction that is completely artificial from the viewpoint of financial theory. Put simply, workers should not be in the business of lending money to their employers.<sup>10</sup> Not only do workers lack capital or comparative specialization in lending, but they are also badly positioned to deal with counterparty risk.<sup>11</sup> A value-creating credit transaction moves money from those who have it to those who need it, not from the Walmart employee to Walmart.

If the payday does not serve a clear financial purpose, what might explain its dogged persistence? This Article evaluates a variety of reasons: economic, sociological, historical, legislative, and even psychological. The primary conclusion is that the payday is a software problem, not a hardware problem. The hardware of the economy, both money and payroll technologies, has greatly advanced over the last century, allowing us to quickly and cheaply pay for both goods and services. To wit, a freelancer doing work in India for an American employer as part of the gig economy, who performs the same work as an American employee, will often be paid faster than the American counterpart.<sup>12</sup> What hinders progress is our legal software:<sup>13</sup> Eisenhower-era legislation that failed to keep pace with modern technology. In fact, as this Article reveals, the culprit is often pro-worker

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representing a 638.75% APR. Sociologist Lisa Sevron worked for a payday lender and reported her experiences in LISA SEVRON, *THE UNBANKING OF AMERICA: HOW THE NEW MIDDLE CLASS SURVIVES* (2018).

9. See, e.g., COMMONS & ANDREWS, *supra* note 3, at 2 (describing the employment contract as a “relation between a propertyless [sic] seller of himself, on the one hand, and a propertied buyer on the other.”).

10. See *infra* Part I.B for a discussion of this point.

11. Counterparty risk is defined as the “the likelihood or probability that one of those involved in a transaction might default on its contractual obligation.” Chris B. Murphy, *Counterparty Risk*, INVESTOPEDIA (May 14, 2019), <https://www.investopedia.com/terms/c/counterpartyrisk.asp> [<https://perma.cc/K7EA-AEUA>].

12. In the online platform Upwork, hourly workers receive weekly pay five day afterwards (a 12-day cycle). See Lena E., *Faster Payouts for Hourly Contracts*, UPWORK (May 5, 2020, 12:24 PM), <https://community.upwork.com/t5/Announcements/Faster-payouts-for-hourly-contracts/m-p/739876> [<https://perma.cc/W8UL-7TQU>]. Freelancer.com allows some contractors to withdraw payments within a single business day after verification. See *Daily Withdrawal Requests*, FREELANCER, <https://www.freelancer.com/support/freelancer/payments/daily-withdrawals> [<https://perma.cc/8PAN-DNP9>].

13. Conceptualizing legislation as software is a productive metaphor and suggests a different paradigm to that envisioned in CALABRESI, *supra* note 1. Both legislation and software need to be updated to account for new circumstances and new information; both need to combine efforts of different groups, sometimes with different agendas; both worry about documentation of designer intent; and both face complex inter-dependencies. Software technology has created a number of interesting solutions to these problems that the legal literature is yet to address, such as alpha and beta versions, periodic updates, branches, and commits. See *generally Git Theory*, GITHUB, <https://github.com/SCOREC/core/wiki/Git-Theory> [<https://perma.cc/5GFU-2682>].

legislation, which stands in the way of progress, sometimes actively encouraging longer pay periods.<sup>14</sup>

This Article's central message is that abolishing the payday is desirable, efficient, and surprisingly feasible. To move to a system of daily pay, two challenges of legal origin must be overcome: compliance costs and payment costs. To assure compliance with legal norms, employers must verify payments—and doing so daily can be expensive. Transferring money to employees is also costly, given the sizable minority of workers who are unbanked and underbanked.<sup>15</sup> How can we offer payments at scale without compromising compliance costs or burdening workers with check-cashing costs?

To address these issues and others, the proposed framework offers to decouple compliance from pay.<sup>16</sup> Every day, workers are to receive roughly 93% of their daily pay, leaving some slack until a biweekly “accounting day.”<sup>17</sup> On accounting day, the employer verifies compliance and makes true-up adjustments as needed. To address issues of money transfer, which are of particular concern for the unbanked and the underbanked, I explore the increasing use of digital money and payroll cards. This Article concludes that moving to daily streams of payment is both feasible and desirable, although it contemplates a transition period. By abolishing payday, we can spare employees the indignities of the payday, increase consumer liquidity, enhance worker autonomy, reduce the size of the payday lending industry, and improve the American economy as a whole.<sup>18</sup>

This Article highlights the importance of regularly updating our legal software. Payday legislation started as a mode of progressive reform towards the end of the nineteenth century. Overcoming initial resistance from legislators and courts, payday laws were passed to discourage the predatory behavior of companies, which were lending to their employees at usurious rates. Remarkably, despite the poor money and payroll technologies that existed at the time, the legislation was effective, and for a short period of time, workers were paid weekly. By an ironic twist of fate, it is possibly the rise of the welfare state that led to the move from weekly to the much slower biweekly pay.<sup>19</sup> The birth of the welfare state was

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14. See *infra* Sections II.A, F, G.

15. I discuss the phenomena and problems of the unbanked and underbanked *infra* notes 202–215 and accompanying text.

16. See *infra* Part IV.

17. For a discussion of the methodology behind this framework, see *infra* Part IV.

18. For conceptual clarity, daily streams of payments are no longer payday in the conventional sense of a special day which aggregates pay for multiple days of work.

19. There are various terms of art used to describe pay frequency. For expositional simplicity, this Article refers to payment modes that are more frequent than once a month and less frequent than once a week as ‘biweekly.’ See *infra* Part I.A.

spurred by the introduction of social security and social security taxes. The administrative burden occasioned by various related laws, such as the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act (FUTA), the Fair Labor Standards Act (FLSA), and tax withholdings made frequent pay more difficult. Thus, the same laws that were meant to protect employees ended up harming them in an unanticipated way: by depressing the frequency of pay, they increased the need for expensive short-term credit solutions.

This Article unfolds in four Parts. Part I sets the stage by explaining the tenuous relationship between employment contracts and the payday. Part II explores a variety of reasons for the existence of the payday and evaluates whether any counsels in favor of keeping this practice. Part III explains why the payday should be abolished and Part IV explains how this could be achieved in practice.

To understand why the payday exists, Part I covers the basic theory of employment contracts. It explains why the payday is not a natural part of employment contracts and why, from a finance perspective, it is an artificial and inefficient credit transaction.

If financial logic does not explain the existence of payday, what does? Part II explores a variety of potential reasons and justifications—historical, legal, economic, psychological, and sociological. Special attention is given to a psychological attempt to justify the payday: the idea that the payday helps employees overcome some of the behavioral challenges of saving and budgeting their own money.<sup>20</sup> Refuting this idea is important because some might worry that moving to daily streams of payment would lead to profligacy among employees. To this end, I present empirical evidence that frequent pay does not increase spending. In fact, there is some reason to worry that infrequent pay may result in excessive spending, because of the higher availability of cash on hand. Most important, however, is the argument that employer-side savings are extremely risky, as they expose employees to opportunistic behavior, counterparty risk, and employer bankruptcy.<sup>21</sup> To the extent that workers need help managing money, an insured, trusted financial institution provides a much more robust solution than postponing wages.

Part II highlights one especially worrisome reason for the continued existence of the payday: ineffective legislation. For public sector employees, legislation often mandates by fiat long pay periods. The

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20. See, e.g., Christopher A. Parsons & Edward D. Van Wesep, *The Timing of Pay*, 109 J. FIN. ECON. 373 (2013).

21. See also Shlomo Benartzi et al., *The Law and Economics of Company Stock in 401(k) Plans*, 50 J.L. & ECON. 45, 46 (2007) (arguing that employees over-invest in their employers' stock and that "investing a dollar in company stock . . . is often worth only 50 cents.").



President of the United States is paid, by law, on a monthly basis.<sup>22</sup> In the private sector, badly drafted legislation also encourages late payments; in particular, and not without irony, wage and hour legislation unwittingly encourages long pay schedules. These defects, overlooked by employment law scholars and policymakers, have substantial consequences for the welfare of employees.<sup>23</sup>

Understanding the sources of the payday allows the development of solutions. Part III first explains the large stakes involved in abolishing the payday. It then explains why abolishing the payday is imperative and why seemingly more moderate alternatives, such as advance payments, are insufficient and risky. It closes by examining the legislative changes that would be needed to abolish the payday.

The key proposal here, developed in Part IV, is to move from biweekly pay to daily streams of payment of the good faith estimate of the employee's daily pay. Every two weeks, the employer will have an "accounting day" and will add to the day's pay any shortfall in payments. For the part of the workforce that is either unbanked or underbanked, payments can be made using pay cards and similar Fintech solutions. While there are some nuances and practical considerations in implementing this proposal, it is important to recognize at the outset that it does not derogate from the rights of either employees or employers. By contrast, adopting this proposal will greatly advance the welfare of all American employees and would also take a bite out of the large payday lending industry, increase worker autonomy, and correct some historical defects in legislation. In fact, implementing this proposal only requires modest changes to the legislative framework.<sup>24</sup>

Even if one disagrees with any of the specific policy prescriptions, the key message of this Article is that the payday should not be taken as a neutral or natural fact of the modern economy. The existence of the payday has substantial consequences in terms of efficiency, distribution, and autonomy. While we live in an exceptional period with historically low-interest rates,<sup>25</sup> the harms of the payday will only be amplified as interest

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22. 3 U.S.C. § 102 (2018); U.S. CONST. art. II, § 1, cl. 7 ("The President shall, at stated Times, receive for his Services, a Compensation . . .").

23. The Restatement of Employment Law defers to the employer's choice regarding the payday. RESTATEMENT OF EMP'T LAW § 3.01 cmt. a (AM. LAW INST. 2015) ("Employees also have a right to be paid the compensation they have earned on a timely basis, usually in conformity with the employer's normal payroll practices.").

24. Pay frequency interacts in complex ways with a variety of workers' rights and issues, such as wage theft, wage discrimination, and minimum wage. For example, frequent pay would expand workers' ability to sue for equal-pay violations, as the Lilly Ledbetter Fair Pay Act of 2009, 42 U.S.C. § 2000e-5 (2018) holds that every payment resets the 180-day statute of limitations. In general, frequent pay will tend to expand worker rights and, at the very least, will not derogate them.

25. *Federal Funds Rate—62 Year Historical Chart*, MACROTRENDS, <https://www.macrotrends.net/2015/fed-funds-rate-historical-chart> [https://perma.cc/KLS7-97UK] [hereinafter MACROTRENDS].

rates rise. The recent outbreak of Covid-19 powerfully demonstrates the importance of liquidity. Many of the recent developments in Fintech suggest that the payday lives on borrowed time. It is perhaps time to call this loan.

## I. THE PAYDAY PUZZLE

### A. *The Two Employment Contracts*

What is the purpose of an employment contract? Roughly 130 million Americans are considered employees and are thus parties to an employment contract.<sup>26</sup> These contracts feature a great deal of variability, as they each stipulate different norms the employee must abide by—the employee’s various rights, benefits, and perquisites, as well as the employee’s duties, obligations, and loyalties. Still, at its core, the contract is premised on a very basic economic transaction: a “bargained-for exchange of labor for consideration.”<sup>27</sup> The employment contract is an exchange relationship, which the parties seek to optimize according to their own circumstances.<sup>28</sup>

This exchange transaction stands at the heart of the employment contract, and I denote it here as  $K_1$ . In this  $K_1$ , the employee is selling labor, broadly defined as time, skill, effort, and any other aspect of his or her human or social capital. In consideration, the employer gives the employee “money,” which could include wages, tips, perquisites, in-kind transfers, and any other value that redounds to the employee from the employer. When the employment contract describes the employee’s duties, it outlines the scope of labor that is exchanged. When the employment contract stipulates the employee’s pay and benefits, it states the payment that is exchanged for this labor. The concept of  $K_1$  is sufficiently capacious and abstract to capture all employment contracts, despite the fact that they differ in almost any other respect. In this high level of abstraction, we can say that  $K_1$  is responsible for the annual exchange of at least 6.4 trillion dollars.<sup>29</sup>

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26. BUREAU OF LABOR STATS., LABOR FORCE STATISTICS FROM THE CURRENT POPULATION SURVEY (2019), <https://www.bls.gov/cps/cpsaat08.htm> [<https://perma.cc/5XN7-HFLA>].

27. *Vanskike v. Peters*, 974 F.2d 806, 809 (7th Cir. 1992).

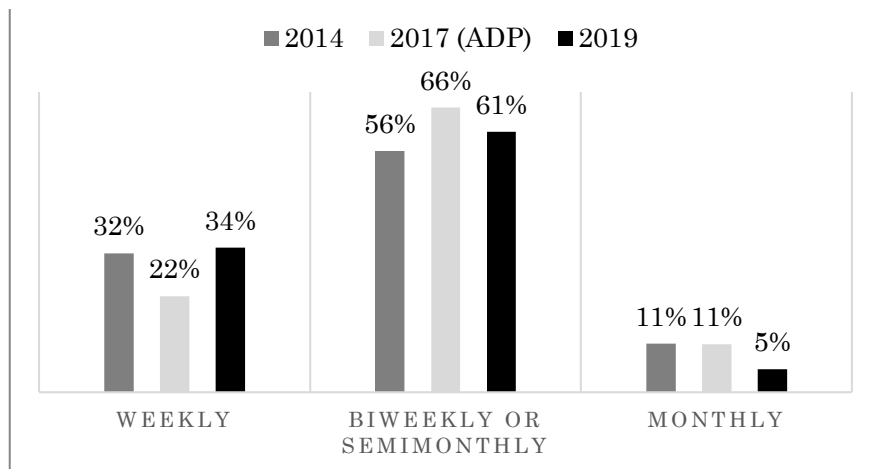
28. PATRICK BOLTON & MATHIAS DEWATRIPONT, CONTRACT THEORY 4 (2005) (studying the optimal design of the exchange relationship).

29. Based on the product of 130 million full time employees, BUREAU OF LABOR STATS., *supra* note 26, working fifty-two weeks per year and earning on average \$956 per week, BUREAU OF LABOR STATS., TABLE B-3: AVERAGE HOURLY AND WEEKLY EARNINGS OF ALL EMPLOYEES ON PRIVATE NONFARM PAYROLLS BY INDUSTRY SECTOR, SEASONALLY ADJUSTED (2020), <https://www.bls.gov/new.s.release/empsit.t19.htm> [<https://perma.cc/B5KW-GXYZ>].

What both economists and lawyers will often miss is another striking regularity in modern employment contracts. Besides the  $K_1$  aspect of the transaction, most contracts also include a *payday*—a gap in time between the moment work is rendered and payment is transferred. Almost all payments by the employer are paid in *arrears*—that is, *after* the employee “gave” his or her labor to the employer. The following figure summarizes the frequency of the payday and the typical lag involved in payments, based on data made available by the Bureau of Labor Statistics for the years 2014 and 2019, and data available from the private payroll company, ADP, for 2017:

*Figure 1 – Pay Frequency, US Private Businesses*

Sources: Bureau of Labor Statistics (BLS); Private Payroll Company (ADP)



This figure summarizes pay frequency data, based on a very large sample of nonfarm employees.<sup>30</sup> The chart shows that most American employees are paid twice a month, on either a biweekly or semimonthly basis.<sup>31</sup> The difference between biweekly and semimonthly is fairly subtle: a biweekly

30. Based on the product of 130 million full time employees, BUREAU OF LABOR STATS., *supra* note 26, working fifty-two weeks per year and earning on average \$956 per week, BUREAU OF LABOR STATS., TABLE B-3: AVERAGE HOURLY AND WEEKLY EARNINGS OF ALL EMPLOYEES ON PRIVATE NONFARM PAYROLLS BY INDUSTRY SECTOR, SEASONALLY ADJUSTED (2020), <https://www.bls.gov/news.release/empsit.t19.htm> [<https://perma.cc/B5KW-GXYZ>] (farm workers were excluded from this study). The ADP data comes from a private payroll company, ADP, as reported in Tomaz Cajner et al., *Using Payroll Processor Microdata to Measure Aggregate Labor Market Activity* 44 (Bd. Of Governors of the Fed. Reserve Sys., Fin. & Econ. Discussion Series 2018-005, 2018), <https://doi.org/10.17016/FEDS.2018.005> [<https://perma.cc/LN9E-Y2AA>].

31. Biweekly also denotes twice a week; however, in the wage payment context, it is used to denote payment frequency of once every fourteen days.

payday takes place every fourteen days, while a semimonthly payday takes place twice a month, on two separate days (e.g., the 1st and the 20th). Given the existence of fifty-two workweeks in a year, this means that a biweekly payday translates to either twenty-six or twenty-seven paydays per year, whereas a semimonthly payday entails a fixed number of twenty-four paydays. Beyond the twice-monthly pay, the figure also shows that a sizable minority of employees are paid weekly and a small minority on a monthly basis.<sup>32</sup>

The existence of a payday may seem obvious—indeed, many take it for granted—but it hides significant complexity. The worker is providing work today: stacking the shelves, cleaning the floor, building a wall, attending to customers, etc. But for services rendered today, the employee is only paid in the future, on payday. In other words, wage and salary payments in the economy are, by and large, in arrears.

Thus, the very idea of the payday implies a temporal distance between the moment the employee is providing services, the quid of  $K_1$ , and the moment she is paid, the quo of  $K_1$ . As noted by John Commons and John Andrews in their 1916 treatise on labor law:

When the laborer starts to work for [the employer], he also becomes, for a time, a creditor. He contributes his services in advance of compensation. He is a temporary investor in the business. While he works he passes over to the employer the title to his product, and retains a claim for wages. When his wages are paid his investment is liquidated.<sup>33</sup>

The economic classification of this aspect of the transaction is straightforward. When a person buys a car from the dealership, he or she can pay on the spot for the exchange. But he or she can also agree with the dealer to pay in the future, perhaps in monthly installments. This is the financing part of the exchange. By the same logic, when an employer receives services today but pays for them in the future, on payday, this is a credit transaction. In addition to the exchange relationship, what we called  $K_1$ , the employment contract thus embodies a second credit transaction, what we might call  $K_2$ . This  $K_2$  contains the agreement between the parties to defer payment for money *earned* until payday. The parties will not always explicitly set the payday in the contract, but of course, they agree to some kind of payday—and this part of the agreement, explicit or implicit, makes  $K_2$ . As in any credit agreement, we can identify three parts: an employee-lender, an employer-borrower, and wages-principal.

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32. The data collection methodology is not sufficiently clear to discern what share of American employees are paid on shorter time spans than weekly.

33. COMMONS & ANDREWS, *supra* note 3, at 50.

A natural question is whether this is a true credit transaction, as  $K_2$  does not seem to indicate any interest rates. This, however, should not be too distracting: credit transactions do not require explicit quotes of interest or even any interest at all to count as credit transactions. Consider how auto traders will sometimes offer “zero-interest financing.” The auto trader will not really offer a free loan but rather will build the cost of the loan into the price of the car. Some part of the price, then, can be seen as interest—the premium the dealer charges for offering “free” finance. And even if the trader charges no interest at all, it would still be a loan that would have to be repaid on pain of default and collection. That is to say, a loan is a loan even if it does not involve interest payments.<sup>34</sup>

It may be tempting to try and define the problem away. If we were to define the unit of work as two weeks’ full of work, there wouldn’t be  $K_2$ , because the payment is only due when the work-unit is completed. On reflection, however, such definitional games are unpersuasive. Defining work in two-weeks units is ad-hoc and does not map any underlying transfer of value. Effort, skill, and time do not come in two-weeks increments, rather, they are continuous. The worker’s daily expenses, as well, do not come in such neat packages. In fact, employers have attempted to redefine labor units; in one case, they sought to define work as a year’s full of work.<sup>35</sup> This way, employers hoped, they did not have to pay until the end of the year, and if the employee quits—or is encouraged to quit—before the end of the year, they could avoid the obligation to pay. For sound policy reasons, courts and legislators rejected this view.<sup>36</sup> More theoretically, if the employee is understood to be selling time, then time does not come at two-week increments.<sup>37</sup>

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34. Loans also have a maturity date; here, it is the payday. In a biweekly  $K_2$ , the worker lends 1/14 of the salary daily to the employer. The period until maturity shortens every day; at first, the loan is for thirteen days, but on the last day of work, the loan is only for that same day. On average, the maturity date is 6.5 days in the future and the loan is remade every two weeks. In a daily pay system, the loan matures on the same day it is paid, so it involves minimal interest, and so I do not explore here the possibility of hourly pay.

35. *Britton v. Turner*, 6 N.H. 481, 481, 485–86 (1834) (holding that, despite the employee quitting before the end of the stipulated year of work, the employer still had an obligation to pay under restitution); Matthew T. Bodie, *Employment as Fiduciary Relationship*, 105 GEO. L.J. 819, 840, n.133 (2017) (“Modern wage payment schemes require that employees be paid . . . for all time worked, regardless of the length of term.”).

36. See *infra* notes 124–132 and accompanying text.

37. With independent contractors, it is sometimes the case that payment is made on a project-completion basis (even though, even there, advances are common). Employment contracts, however, normally separate work tasks and payment, and pay on the basis of time worked.

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To quickly recap, so far we have considered the existence of two “contracts” implicit in the employment relationship:  $K_1$  and  $K_2$ .  $K_1$  is the standard exchange of labor for money;  $K_2$  is the credit transaction whereby payments for  $K_1$  will only be made on payday. The  $K_2$  loan includes some “interest” payment in the form of higher than otherwise wages. With this in mind, we can turn our attention to how odd  $K_2$  appears from a financial perspective.

### *B. The Puzzle of $K_2$*

Finance theory teaches that, at the most fundamental level, loans create value by moving money from those who have it to those who need it.<sup>38</sup> Banks lend money to cash-strapped businesses, venture capitalists to promising entrepreneurs, and bondholders to growing companies. Such transactions create value because they are *mutually advantageous*. A loan enables the borrower to seize profitable investment opportunities and smooth consumption over time. At the same time, the loan also allows the lender to use its money as a source of profit, through interest payments. As long as the interest payment is between the value to the borrower and the cost of lending to the lender, the parties would find a credit transaction mutually advantageous.

This basic logic of finance is well-recognized; however, applying it to employment contracts presents a puzzle. As we just saw,  $K_2$  is a ubiquitous part of the economy. It covers the Walmart employee stocking the shelves, the grocery store teller working the register, and the cook at McDonald’s flipping burgers; it covers employees from store clerks to university professors to executives. In all of these cases,  $K_2$  facilitates a loan from employees to employers—it is a loan from those with little money to those with more money. Why, then, is the Walmart employee lending money to Walmart? Why are service technicians lending money to Comcast? And why are police officers lending money to the government?

It may be tempting to answer these questions with the same logic as any other financial transaction. Borrowers (employers) borrow because they benefit from having cash on hand and lenders (employees) lend because they profit from the interest payment. On reflection, however, the benefits to employers are vastly exceeded by costs to employees. The intuition is straightforward: households are in no position to lend money to firms.

The benefit to employers from  $K_2$  loans is relatively small. One reason for that is that some employers do not even need cash. It is well-known that

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38. See generally Dan Bernhardt, *Money and Loans*, 56 REV. ECON. STUD. 89 (1989).

no large American company pays employees daily. Yet we find firms like Alphabet which, despite holding \$117 billion in cash, still uses  $K_2$  with its janitors, programmers, and marketers.<sup>39</sup> Apple holds \$100 billion in cash, and Microsoft lags with only \$50 billion, yet both use the payday.<sup>40</sup> The federal government is also not particularly cash hungry, and yet it mandates the use of a biweekly payday in all of its employment contracts.<sup>41</sup> Even employees of the Federal Reserve—which quite literally prints money—are paid on a biweekly basis.<sup>42</sup> This offers some evidence that the reason behind  $K_2$  is not liquidity.

Still, many employers, especially small businesses, are not as cash rich as these companies, and they do stand to benefit from liquid funds. However, even for those employers, the benefit from  $K_2$  loans is smaller than first appears. To estimate the size of the benefit, consider the cost of borrowing from alternative lenders. After all, employers borrow from banks, capital markets, specialized lenders, and a variety of other sources. In 2019, for example, the weighted average interest rate on loans to small businesses ranged from 5.1% to 5.66%.<sup>43</sup> If we use this rate to measure the gain the business receives from paying a typical employee in arrears, it becomes clear that the gain is fairly small. For an employee earning \$50,000 annually who is paid on a monthly basis, the *annual* payday credit benefit to the employer is only \$108.<sup>44</sup>

The benefit to employers is not large, but the cost to employees of lending money is significant. Employees are not in a position, nor do they have the skills, to lend money to their employers.<sup>45</sup> Monitoring and secured credit, two common features of credit transactions, are all but absent in the

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39. Richard Waters, *Google Parent Alphabet Overtakes Apple to Become New King of Cash*, FIN. TIMES (July 31, 2019), <https://www.ft.com/content/332dd974-b349-11e9-8cb2-799a3a8cf37b>.

40. *Id.*

41. 5 U.S.C. § 5504 (2018).

42. Telephone Interview with Payroll Department, Fed. Reserve (Feb. 5, 2020).

43. See FED. RES. BANK OF KAN. CITY, SECTION A: VOLUMES AND TERMS A.6 (2019), [https://www.kansascityfed.org/~media/files/publicat/research/indicatorsdata/smallbusiness/2019/sbls\\_aggregat edatapdf\\_sept2019.pdf?la=en](https://www.kansascityfed.org/~media/files/publicat/research/indicatorsdata/smallbusiness/2019/sbls_aggregat edatapdf_sept2019.pdf?la=en) [<https://perma.cc/N6TN-SEYB>].

44. The calculation assumes daily compounding with 5% APR and the average salary in 2019 of \$50,000. The calculation itself is not straightforward due to compounding, but it can be approximated in the following manner.

\$50,000 per annum implies a salary payment of \$137 per day. At the beginning of the month, the employee has to wait roughly thirty days to be paid. On the last day of the month, however, the employee receives pay on the same day. On average, then, each payment is delayed by 15 days. 5% APR implies a daily interest rate of 0.014% (0.05/365). This means that the employee is lending every day of the year, on average, \$137 for fifteen days at a rate of 0.014%. Overall, the value of this transaction is  $365 * 137 * 15 * 0.00014 = 105.01$ . (The difference between \$105 and \$108 is due to compounding).

45. Most lenders will not lend absent a credit check and, where a large part of their portfolio is staked with a specific borrower, would require contractual controls. Neither of these characterize household lending decisions to employers.

employee-employer relationship. And, of course, to lend money one needs liquid cash. But workers are often subject to severe liquidity constraints which make it very costly for them to offer loans to their employers. 40% of Americans with a credit card carry a credit card balance,<sup>46</sup> and roughly 16% of households reported essential expenses that are unmet, with 10.5% reporting unpaid utilities.<sup>47</sup> In a survey, roughly 21% of households reported difficulty in accessing credit for their own needs.<sup>48</sup>

Rather than being providers of cheap credit, households often turn to expensive credit products to finance daily expenses—such as payday lenders, credit card companies, advance tax refunds, and pawnshops—and the size of these industries illustrates the need felt by households.<sup>49</sup> The cost of such borrowing is considerable. Congress estimated (quite crudely) that every late-paid dollar costs the employee an additional dollar—i.e., 100% cost of borrowing.<sup>50</sup> However, the real costs tend to be even higher. When households borrow, they use a variety of sources, which include bank loans (with a ~10% cost of borrowing on average),<sup>51</sup> credit cards (a 16% cost of borrowing),<sup>52</sup> and payday lenders (typically 400%).<sup>53</sup> For those households that use payday lending regularly, the finance costs can amount to a large percentage of their annual earnings.

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46. CONSUMER FIN. PROT. BUREAU, *supra* note 6, at 55. The bottom quartile of Americans had a median net worth of \$200 in 2016. Jesse Bricker et al., *Changes in U.S. Family Finances from 2013 to 2016: Evidence from the Survey of Consumer Finances*, 103 FED. RES. BULL. 1, 17 (2017); Kathleen Elkins, *Here's How Much Money Americans Have in Savings at Every Income Level*, CNBC MAKE IT (Oct. 11, 2018, 12:02 AM), <https://www.cnbc.com/2018/09/27/heres-how-much-money-americans-have-in-savings-at-every-income-level.html> [<https://perma.cc/Y4QV-BXDZ>] (“29 percent of households have less than \$1,000 in savings.”).

47. JULIE SIEBENS, U.S. CENSUS BUREAU, EXTENDED MEASURES OF WELL-BEING: LIVING CONDITIONS IN THE UNITED STATES: 2011 11, Table 3 (2013), <https://www.census.gov/prod/2013pubs/p70-136.pdf> [<https://perma.cc/X87A-BK5C>].

48. See Bricker et al., *supra* note 5, at 27 (2017); see also Matt Tatham, *The Number of Americans with Bank Accounts Rises*, EXPERIAN (Mar. 25, 2019), <https://www.experian.com/blogs/ask-experian/research/the-decline-of-the-unbanked-and-underbanked/> [<https://perma.cc/C94N-8H6F>] (In 2017, nearly 20% of respondents were underbanked and 14.1 million adults had no bank account).

49. In 2016, the revenue of short-term lenders (i.e., fee and interest payments) was \$57.9 billion dollars. See ERIC WILSON & EVA WOLKOWITZ, CTR. FOR FIN. SERVS. INNOVATION, 2017 FINANCIALLY UNDERSERVED MARKET SIZE STUDY (2017), [https://s3.amazonaws.com/cfsi-innovation-files-2018/wp-content/uploads/2017/04/27001546/2017-Market-Size-Report\\_FINAL\\_4.pdf](https://s3.amazonaws.com/cfsi-innovation-files-2018/wp-content/uploads/2017/04/27001546/2017-Market-Size-Report_FINAL_4.pdf) [<https://perma.cc/DV99-99NA>].

50. 29 U.S.C. § 216(b) (2018) (“Any employer [in violation] . . . shall be liable to the employee . . . in the amount of their unpaid minimum wages . . . and in an additional equal amount as liquidated damages.”).

51. See BD. OF GOVERNORS OF THE FED. RES. SYS., CONSUMER CREDIT APRIL 2020 (2020), <https://www.federalreserve.gov/releases/g19/current/g19.pdf> [<https://perma.cc/GQY6-YHYV>].

52. See Kelly Dilworth, *Average Credit Card Interest Rates: Week of June 3, 2020*, CREDITCARDS.COM (June 3, 2020), <https://www.creditcards.com/credit-card-news/rate-report.php> [<https://perma.cc/P3QW-QLF5>]. Timely payment of credit card balances would avoid these interest charges, but in practice, 47% of Americans carry a balance on their credit cards and so they pay interest on credit card purchases. CONSUMER FIN. PROT. BUREAU, *supra* note 6, at 55–56.

53. *What Is a Payday Loan?*, CONSUMER FIN. PROT. BUREAU (June 2, 2017), <https://www.consumerfinance.gov/ask-cfpb/what-is-a-payday-loan-en-1567/> [<https://perma.cc/TFE8-SSQ4>].



The costs to households are not strictly financial. The liquidity crunch has broader effects on household welfare. Lack of access to funds is not only a financial issue; concerns with liquidity create financial stress, which is associated with higher mortality and worse health outcomes.<sup>54</sup>

Judged in terms of the standard model of credit,  $K_2$  fails to produce *social* value. The cost of lending by the household far exceeds the benefits that accrue to the employers. True, larger employers would reap larger benefits, but the costs to employees would scale by a similar factor. And, to be sure, if the employer does not bear the full costs, the employer might not care about them and excessively engage in  $K_2$ , even if it comes at a severe cost to the worker. I will return to the private incentive of employers later,<sup>55</sup> but for now, the key point is that, from a social perspective,  $K_2$  destroys value because the costs of the loan exceed its benefits. We—society—want businesses to borrow using capital markets and lenders that can, more accurately, price and monitor risk. We do not want to create a line of credit which consists of employees' wages.

Importantly,  $K_2$  is not a one-off transaction, so value may be destroyed multiple times. It is not just that households need to bridge the first two weeks of employment; instead,  $K_2$  involves a continuous cycle of borrowing and repayment. Consider a hypothetical low-pay employee starting work on January 1, 2020, with only a small amount of cash on hand. The employee is paid biweekly and so has to borrow on January 1 against future earnings to support daily expenses. Come payday on January 15, the employee is paid and finally has cash on hand. But the employee also owes money. Now the employee has to repay the loan, plus interest, and make do with whatever is left. If the remainder is insufficient, the employee will have to borrow again. And again. And again. In the worst-case scenario, a debt spiral emerges—the employee would need to borrow back-to-back on a revolving basis.<sup>56</sup>

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54. Todd H. Baker, *FinTech Alternatives to Short-Term Small-Dollar Credit: Helping Low-Income Working Families Escape the High-Cost Lending Trap* 7–8 (Harvard Kennedy Sch., M-RCBG Associate Working Paper Series, No. 75, 2017), [https://www.hks.harvard.edu/sites/default/files/centers/mrcbg/files/75\\_final.pdf](https://www.hks.harvard.edu/sites/default/files/centers/mrcbg/files/75_final.pdf) [<https://perma.cc/YB4B-6FUA>].

55. I return to this point *infra* Part II.C.

56. A survey in England found that one in five payday borrowers were unable to repay the debt on time, leading to a debt cycle. Jill Insley, *Payday Loan Borrowers 'Trapped in Debt Spiral'*, THE GUARDIAN (May 18, 2012), <https://www.theguardian.com/money/2012/may/18/payday-loan-borrowers-trapped-debt-spiral> [<https://perma.cc/5DZF-QFZJ>].

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Employment contracts include two key components,  $K_1$  and  $K_2$ .  $K_1$  is the basic exchange of labor for capital.  $K_2$  is a credit transaction that is superimposed on the employment relationship. However, unlike  $K_1$ , the credit transaction of  $K_2$  does not generate social value—from a financial perspective at least. The absence of financial logic presents the payday puzzle. Households are in no position to lend money to their employers, at least in the general case. Businesses have better access to liquidity, pay lower interest rates, and do not face the same pressures as individuals do when funds are running out. We shall now explore alternative, non-financial reasons for the existence of the payday, the topic of the next Part.

## II. PAYDAY: HISTORICAL, LEGAL, SOCIAL, AND ECONOMIC EXPLANATIONS

The payday is a fixture of modern employment contracts. As Part I just demonstrated, however, there is nothing natural—from a financial perspective—in the modern matrimony between  $K_1$  and  $K_2$ . If  $K_2$  serves any social function, it is not one that is rooted in financial logic. So what reasons could there be for the continued existence of the payday in today's economy?

In trying to answer this question, a broad range of possible reasons present themselves: historical, legal, social, and economic. My goal here is to examine and evaluate the leading reasons on the basis of two criteria: first as an explanation and then as a justification. This tracks the difference between understanding why a social practice exists and understanding whether it should persist. The explanation for why the train is late—the conductor is a late riser—is causally satisfactory, but it does not present a justification. Similarly, as we will see, many of the possible explanations for the payday fail as justifications.

### A. Path-Dependence

Justice Holmes once observed that “[t]he life of the law has not been logic; it has been experience.”<sup>57</sup> From keyboard layouts to tax legislation, path-dependence explains a variety of social arrangements.<sup>58</sup> In these cases, past choices, justified by historical contingencies, continue to affect

57. OLIVER WENDELL HOLMES, JR., *THE COMMON LAW* 1 (1881).

58. See generally Paul A. David, *Path Dependence, Its Critics, and the Quest for 'Historical Economics,'* in *THE EVOLUTION OF ECONOMIC INSTITUTIONS: A CRITICAL READER* 120 (Geoffrey M. Hodgson ed., 2007); Mirit Eyal-Cohen, *Unintended Legislative Inertia*, 55 *GEO. L. REV.* (forthcoming 2020) (manuscript at 20–27), <https://papers.ssrn.com/sol3/papers.cfm?abstractid=1753389> (discussing the role of path dependence in tax legislation).

decisions far into the future. Once adopted, too many social arrangements become dependent on past historical events, making the transition to an alternative system (even if superior) too costly.<sup>59</sup> Consider, for example, how obsolete area codes are in phone numbers today; although they feel natural, logical, and perhaps inevitable for participants in the system, they are hard to explain to outsiders. In a similar manner, the payday may be yet another instance of inefficient social equilibria that results from path-dependence. This conclusion becomes clear within a historical analysis that considers how the payday emerged in an environment with inferior money and payroll technologies.

The first moral exhortation on the payday is in the Bible, where it is admonished that one should not “take advantage of a hired worker who is poor and needy . . . . Pay them their wages each day before sunset, because they are poor and are counting on it.”<sup>60</sup> Whether daily pay was indeed broadly practiced in the old world with any regularity, though, is historically unclear.

Moving to the modern era, under early English common law, employers were initially only required to pay within the pre-agreed pay period; in the absence of a specific agreement, the default was payment at the end of the contract.<sup>61</sup> The old default presumably reflects the idea of piece-rate work, which was a common mode of employment in the eighteenth century.<sup>62</sup> By contrast, if one counts certain agricultural workers, such as sharecroppers, as wage laborers, their pay was only seasonal.<sup>63</sup> Still, as early as the seventeenth century, we find growing indications of weekly and even daily wages in England.<sup>64</sup> By the nineteenth century, wage work became the dominant form of payment and English workers were commonly paid on a weekly basis.<sup>65</sup> Across the pond, American workers in the nineteenth

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59. David, *supra* note 58, at 10–12.

60. *Deuteronomy* 24:14–15; *see also Leviticus* 19:13 (“Do not hold back the wages of a hired worker overnight.”).

61. ROBERT GILDERSLEEVE PATERSON, *WAGE PAYMENT LEGISLATION IN THE UNITED STATES* 68–69 (1918). The duration of the employment contract was imputed, in part, from the pay period. Jay M. Feinman, *The Development of the Employment at Will Rule*, 20 *AM. J. LEGAL HIST.* 118, 120–21 (1976). For development of similar ideas in early American law, *see id.* at 125–26.

62. E. P. Thompson, *Time, Work-Discipline, and Industrial Capitalism*, 38 *PAST & PRESENT* 56, 78–79 (1967).

63. *See generally* Joseph D. Reid, Jr., *Sharecropping as an Understandable Market Response: The Post-Bellum South*, 33 *J. ECON. HIST.* 106, 109–120 (1973).

64. JAMES E. THOROLD ROGERS, *SIX CENTURIES OF WORK AND WAGES: THE HISTORY OF ENGLISH LABOUR* 430 (1884), <https://socialsciences.mcmaster.ca/econ/ugcm/3113/rogers/sixcenturies.pdf> [<https://perma.cc/552G-2LDU>]; Peter H. Lindert & Jeffrey G. Williamson, *English Workers' Living Standards During the Industrial Revolution: A New Look*, 36 *ECON. HIST. REV.* 1, 13 n.38 (1983); Jeremy Boulton, *Wage Labour in Seventeenth-Century London*, 49 *ECON. HIST. REV.* 268 (1996) (noting daily pay).

65. Thompson, *supra* note 62, at 78–79.

century were also paid commonly on a wage basis, but it seems like factory workers and many other employees were only paid on a monthly basis.<sup>66</sup>

As wage payment evolved in the nineteenth century, it faced a critical challenge; both payroll and money technologies were nascent and highly inefficient.<sup>67</sup> Taken for granted today, the use of a standard unit of currency—the federal U.S. dollar—was not always common in the early American republic, and the Supreme Court labored to encourage its use.<sup>68</sup> Monitoring hours worked and computing pay also proved challenging, especially if one has to compute withholdings, garnishments, benefits, and deductions for a large workforce.<sup>69</sup> And then there is the difficulty of disbursing pay—consider the illuminating complaint of a nineteenth-century business owner:

If the larger mills should pay once a week it would entail considerable more expense. The Pacific Company employs between five and six thousand hands, and it would be extremely difficult for the paymaster to visit all these people once a week, carrying his trunk up and down stairs, and taking receipts from each one. He has to go to the help so as not to stop the work.<sup>70</sup>

These difficulties with cash and computation seem dated today, but they were of utter importance in the time when wage pay evolved.

The evolution of the payday faced another formative moment towards the end of the nineteenth century. As part of a large movement of workers, wage and salary workers started organizing and lobbying for legislation that would mandate more frequent pay.<sup>71</sup> Their efforts were initially met with strong resistance. Many legislators were unresponsive, and even when the legislature was responsive, courts were reluctant to approve pay frequency

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66. PATERSON, *supra* note 61, at 76–77 (noting the “custom of monthly wage payments which prevailed in most lines of industry prior to 1885”); ESTELLE M. STEWART & J. C. BOWEN, BUREAU OF LABOR STATS., HISTORY OF WAGES IN THE UNITED STATES FROM COLONIAL TIMES TO 1928 77 (1934) (noting that in 1771 pay-per-product was abolished in the glass industry in favor of monthly pay). However, this source does not find any regular pay period across industries. *See, e.g., id.* at 90, 92; *see also* CHRISTOPHER L. TOMLINS, LAW, LABOR, AND IDEOLOGY IN THE EARLY AMERICAN REPUBLIC 275 (1993) (citing *M’Millan and M’Millan v. Vanderlip*, 12 Johnson 165 (N.Y. 1815)).

67. I turn to the technological issues *infra* Part II.G. In addition, wage work requires time technology—a watch—as emphasized by Thompson, *supra* note 62, and more conceptually, “the abstraction of a man’s labour from both his person and the product of his work . . . [and] a method of measuring the labour one has purchased, for purposes of payment, commonly by introducing a second abstraction, namely, labour-time.” MOSES I. FINLEY, THE ANCIENT ECONOMY 65 (1973).

68. *See generally* SHARON ANN MURPHY, OTHER PEOPLE’S MONEY: HOW BANKING WORKED IN THE EARLY AMERICAN REPUBLIC (2017).

69. *See infra* Part II.G.

70. Esther Redmount et al., *The Effect of Wage Payment Reform on Workers’ Labor Supply, Wages, and Welfare*, 72 J. ECON. HIST. 1064, 1069 (2012).

71. PATERSON, *supra* note 61, at 70.

legislation.<sup>72</sup> Such regulation was challenged as an unwarranted imposition on the parties' freedom of contract and a due process violation.<sup>73</sup>

The first large win for workers was in Massachusetts.<sup>74</sup> The charismatic governor of Massachusetts, George D. Robinson, was a champion of regular pay. In the legislative hearing, he urged that a weekly payday be implemented for several reasons. The proposed law would increase worker autonomy, limit the scope of debt collection lawsuits, increase the use of cash (a major concern at the time),<sup>75</sup> and instill a better sense of money management among employees.<sup>76</sup> He also noted that the experience from voluntary weekly pay was favorable and thus refuted many of the chief concerns. Workers still saved and did not "waste their earnings in frequent debaucheries."<sup>77</sup> Indeed, even large employers found that the system was practicable and added few costs.<sup>78</sup>

The weekly payday in Massachusetts signaled a national change. Reports on the enforcement of this law seem positive.<sup>79</sup> Other states followed suit and adopted weekly or biweekly pay periods.<sup>80</sup> Courts, too, changed their attitude and grew increasingly accepting of such provisions.<sup>81</sup> One reason for this growing acceptance was the concern that employers use their bargaining power to offer unfair loans (advances) to employees.<sup>82</sup> Another

72. See LINDLEY D. CLARK & STANLEY J. TRACY, BUREAU OF LABOR STATISTICS, LAWS RELATING TO PAYMENT OF WAGES 16–19 (1926), [https://fraser.stlouisfed.org/files/docs/publications/bls/bls\\_0408\\_1926.pdf](https://fraser.stlouisfed.org/files/docs/publications/bls/bls_0408_1926.pdf) [<https://perma.cc/MHS5-RU69>].

73. See PATERSON, *supra* note 61, at 92–93 (documenting twelve cases where wage regulation was deemed unconstitutional and fourteen where it was also constitutional).

74. PATERSON, *supra* note 61, at 70 (citing 1879 Mass. Acts 483); Redmount et al., *supra* note 70, at 1064; see also PATERSON, *supra* note 61, at 68 (noting that wage period laws are "of comparatively recent origin."). For the legislative history, see *Am. Mut. Liab. Ins. Co. v. Comm'r of Labor & Indus.*, 163 N.E.2d 19, 21 (Mass. 1959).

75. See MURPHY, *supra* note 68, at 17–20.

76. See George D. Robinson, Governor, Mass., Address of His Excellency George D. Robinson to the Two Branches of the Legislature of Massachusetts 33 (Jan. 3, 1884) ("[T]he lesson of economy be practically taught every day."); see also *id.* at 36–38.

77. *Id.* at 33–34.

78. *Id.* at 34 ("It is, I submit, always wise and salutary to devise legislation of such a character as will reach the humblest and the poorest citizen, who has no voice but his own to present his needs,—no power in combination with others to emphasize his opinions.").

79. KAN. DEP'T OF LAB. AND INDUS., THIRD ANNUAL REPORT OF THE BUREAU OF LABOR AND INDUSTRIAL STATISTICS (1888) 324–325 ("[A]ll of the corporations manufacturing or doing business in Massachusetts have cheerfully complied with the [weekly pay law]."). Reports from other parts of the country also appear positive; see e.g., STATE OF N.Y., SEVENTH ANNUAL REPORT OF THE FACTORY INSPECTORS, 45–46 (1893); Robinson, *supra* note 76, at 36–38.

80. PATERSON, *supra* note 61, at 70–88. A few states adopted a monthly pay obligation. *Id.* at 88–92. One example of weekly pay is 1891 R.I. Pub. Laws 38.

81. Claudio J. Katz, *Protective Labor Legislation in the Courts: Substantive Due Process and Fairness in the Progressive Era*, 31 L. & HIST. REV. 275, 288 (2013).

82. Steven L. Willborn, *Indirect Threats to the Wages of Low-Income Workers: Garnishment and Payday Loans*, 45 STETSON L. REV. 35, 40 (2015); *State v. Brown & Sharpe Mfg. Co.*, 25 A. 246, 252 (R.I. 1892) (grounding payday legislation in a concern with "the greed of corporate capital.").

was the concern that regular payment is “much more a matter of life and death to a workingman . . . than to the employing corporation.”<sup>83</sup> Even the Supreme Court weighed in and held that states are well within their powers to regulate pay frequency legislation.<sup>84</sup> This ruling came only nine years after *Lochner*,<sup>85</sup> but it withstood *Lochner* era standards, as it was seen more as a form of preventing fraud and abuse than substantive regulation of the terms of the deal.<sup>86</sup>

The boom in payday regulation was followed by a quick bust. As soon as 1916, most states had already moved to the modern system of biweekly pay.<sup>87</sup> Massachusetts was the last bastion of weekly pay,<sup>88</sup> but even there the practice has changed drastically. In 1959, the weekly pay law was still on the books, but many companies were paying biweekly.<sup>89</sup> In a high-profile case, the Supreme Judicial Court of Massachusetts ruled that weekly pay was still the norm,<sup>90</sup> but the decision recognized that it was perhaps time for a change.<sup>91</sup> Others criticized the decision for creating “unnecessary paper work . . . and add[ing] administrative burdens.”<sup>92</sup> Soon thereafter, the legislature changed the law to allow for biweekly pay.<sup>93</sup>

Labor historian Nelson Lichtenstein proposed a more provocative explanation for the decline of weekly pay.<sup>94</sup> In the 1930s, as part of the New Deal, President Franklin D. Roosevelt introduced the Federal Insurance Contributions Act (FICA) tax as part of the social security reform. In 1938, Congress introduced the minimum wage and the Fair Labor Standards Act (FLSA).<sup>95</sup> Then, in 1943, Congress also introduced the payroll tax, which

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83. COMMONS & ANDREWS, *supra* note 3, at 51.

84. *Erie R.R. Co. v. Williams*, 233 U.S. 685, 766 (1914).

85. *Lochner v. New York*, 198 U.S. 45 (1905).

86. See *Adkins v. Children’s Hosp. of D.C.*, 261 U.S. 525, 547 (1923), *overruled in part by W. Coast Hotel Co. v. Parrish*, 300 U.S. 379 (noting that “[i]n none of the statutes thus sustained was the liberty of [the parties] interfered with. Their tendency and purpose was to prevent unfair, and perhaps fraudulent, methods in the payment of wages . . .”). See also David E. Bernstein, *Lochner Era Revisionism, Revised: Lochner and the Origins of Fundamental Rights Constitutionalism*, 92 GEO. L.J. 1, 9 (2003); David N. Mayer, *Substantive Due Process Rediscovered: The Rise and Fall of Liberty of Contract*, 60 MERCER L. REV. 563, 650 (2009).

87. COMMONS & ANDREWS, *supra* note 3, at 51.

88. Emilie Tavel, *Companies Request Talk with State on Weekly Pay Ruling*, CHRISTIAN SCI. MONITOR, Dec. 23, 1959, at 2.

89. *Id.*

90. *Am. Mut. Liab. Ins. Co. v. Comm’r of Labor & Indus.*, 163 N.E.2d 19 (Mass. 1959).

91. *Id.* at 22. (“Many good reasons may today exist for the payment of wages less often than weekly, including the greater financial responsibility of most employers, the payment of family obligations on a monthly basis or better family financial security than existed in years gone by.”)

92. Emilie Tavel, *Sparks Due on Law for Weekly Pay*, CHRISTIAN SCI. MONITOR, Dec. 18, 1959, at 1.

93. MASS. GEN. LAWS ch. 149, § 148 (2020). For the reforming act, see MASS. GEN. LAWS ch. 133, § 502, approved July 20, 1992, and by § 599 made effective as of July 1, 1992.

94. *The Indicator from Planet Money: The Best Day for Payday*, NPR (Oct., 30, 2018, 3:47 PM), <https://www.npr.org/transcripts/662224497>.

95. Fair Labor Standards Act of 1938, 29 U.S.C. § 201 (2018).

required employers to withhold federal income tax from employees' pay.<sup>96</sup> The result was an increased administrative load on employers who had to compute pay without computers.<sup>97</sup> According to Lichtenstein, the effect of this legislation was to make weekly pay too expensive, leading to a push to move to biweekly pay.<sup>98</sup> There is a bitter irony here, as legislation that is ostensibly pro-worker might have had this unanticipated adverse consequence on pay frequency. The same legislation that guarantees minimum wage, unemployment insurance, and Medicare may be inadvertently pushing employees into the hands of payday lenders and other short-term credit providers.

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Path-dependence may explain why we still have the payday today: we are relying on a century-old body of legislation that was optimized to deal with inferior money and payroll technology. Defaults tend to become sticky and even the presence of financial incentives to contract out of them may not be enough to overcome their viscid pull.<sup>99</sup> Being the first-mover to break a social equilibrium carries risks and costs, and free-riding logic may result in inaction (consider, again, our dated system of area codes). However compelling as an explanation, path-dependence is only a weak justification for the continuation of this practice. *Fin-de-siècle* labor wars, concerns with scrip and truck, difficulties of computing wages by hand, and heavy coin chests carried among work sites are considerations that carry little weight in the age of modern payroll and money technology.<sup>100</sup>

### *B. The Synchronization of Bills and the Payday*

Another potential reason for the continued existence of the payday is the seeming alignment of the timing of bill payments and the payday. Today, households pay most of their bills—utilities, rent, mortgage, internet,

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96. Current Tax Payment Act of 1943, Pub. L. No. 68–120, 57 Stat. 126 (1943).

97. For proportion, today, roughly 30% of the pay is made through “fringe benefits” which are often paid to third parties and require a more complex set of computations. BUREAU OF LABOR STATS., EMPLOYER COSTS FOR EMPLOYEE COMPENSATION HISTORICAL LISTING 50, Table 2 (2019), <https://www.bls.gov/web/eccc/ecccqrtn.pdf> [<https://perma.cc/9GDV-GVVT>].

98. Chris Hayes, *The Breakdown: Why Are We Paid Every Two Weeks?*, THE NATION (Jan. 21, 2011), <https://www.thenation.com/article/archive/breakdown-why-are-we-paid-every-two-weeks/>.

99. See generally Alan Schwartz & Robert E. Scott, *The Common Law of Contract and the Default Rule Project*, 102 VA. L. REV. 1523, 1566–69 (2016).

100. See *infra* Part II.G.

phone, insurance payments, and so on—on a monthly basis.<sup>101</sup> Monthly outlays place the payday into a larger social equilibrium, with both ingoing and outgoing money streams being closely tied together. Monthly bill payments, it is worth noting, are a somewhat recent historical development—a fact that played a role in the debates over longer pay periods.<sup>102</sup>

The synchronization of bills and the payday appears, at first glance, harmonious; like clockwork, money comes in and goes out. But this is deceptive. Households pay bills for goods and services that they consume or use throughout the month. Whereas households consume daily, they only pay monthly.<sup>103</sup> This means that the service provider is not only providing the service, but it is also providing credit: selling electricity today but receiving payment only at the end of the month. We see here  $K_2$  attaching again to a primary transaction, the sale of electricity, only this time around it is the household that borrows rather than lends.

Economic logic dictates that utility providers charge for this service and for the risk of default. Households, however, are not the most reliable borrowers. Some households default on their utility payments, and the cost borne by all other households is greater for this reason.<sup>104</sup> After all, the provider bears both the cost of not having access to their earned payments and the risk of default by the household. Hypothetically, out of every \$150 in the electric bill, perhaps \$10 can be seen as interest. Exactly how much households today pay for this loan is not clear, but the overall economic effect is likely to be noticeable.<sup>105</sup>

Consider, then, the situation from the individual's perspective. Jane is working all month as a store clerk, but she is paid at the end of the month. Throughout the month, she needs to consume groceries, utilities, and other everyday expenses, but her employer will not pay her until the end of the month. For groceries, she uses her credit card—paying a few dozen dollars on her revolving balance. For utilities, she doesn't need to borrow per se, but she is paying a higher price, perhaps a dozen more dollars. And while most of her daily expenses are financed by someone else, she is lending money to her employer. Somehow, on each transaction, she is on the losing

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101. See, e.g., *Utility Bills*, NEV. PUB. UTILS. COMM'N, [http://puc.nv.gov/FAQ/Utility\\_Bills/](http://puc.nv.gov/FAQ/Utility_Bills/) [<https://perma.cc/H395-XYE8>] (“Generally, meters are read monthly for electric, natural gas and water services, and monthly bills are generated for phone services.”).

102. *Am. Mut. Liab. Ins. Co. v. Comm’r of Labor & Indus.*, 163 N.E.2d 19, 22 (Mass. 1959) (noting as a modern development “the payment of family obligations on a monthly basis.”).

103. Technically, mortgage payments are in arrears, but rent is most often paid in advance.

104. See U.S. ENERGY INFO. ADMIN., RESIDENTIAL ENERGY CONSUMPTION SURVEY (RECS) (2018), <https://www.eia.gov/consumption/residential/data/2015/hc/php/hc11.1.php> [<https://perma.cc/3CWE-VUDT>] (roughly 17% of all households received disconnect notices). The cost of default by some households is then spread to the bills of all other paying households.

105. The savings from abolishing  $K_2$  will be split between the utility providers and the end-consumer—but the exact split requires a more nuanced analysis of the market and tariff regulation.



end. Being a risky borrower, Jane is paying a large amount to the utility company in implicit interest; being an unsophisticated, under-capitalized lender, Jane is receiving less in wage premium than her cost of borrowing.<sup>106</sup>

Overall, households both borrow and lend, always on worse terms. Borrowing and lending do not offset each other; instead, they amplify each other, being two unnecessary and costly credit transactions. Rather than clockwork, bills and the payday are more like oarsmen—rowing in opposite directions, only to stay in place.<sup>107</sup> As an explanation, the synchronization of bills and pay may make some sense, syncing income and expense. As a justification, however, it fails; there is no reason to preserve one for the other. If anything, it would be socially desirable to abolish both. On reflection, this synchronization seems to be contributing to the path-dependent pull of historical considerations, making it all the more difficult to imagine breaking away from the biweekly pay convention—although it makes the case for abolishing the payday more compelling.

### *C. Employer Power and Lack of Sophistication*

Another potential reason for the persistence of  $K_2$  is rooted in the unequal distribution of power and sophistication between employers and employees. If employers enjoy strong bargaining power, they may insist on  $K_2$  as a source of cheap credit. And if employees are unsophisticated, they may yield to such demands without negotiation, not realizing that  $K_2$  is essentially a credit transaction.

In the standard economic model of wages, what determines wages is marginal productivity—how much value the employee is producing for the employer.<sup>108</sup> A more productive worker would receive higher wages. In this model, one consistent idea is that of a wage premium or a “compensating wage differential.”<sup>109</sup> If the employee produces some additional benefit to

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106. The loan from the utility company relieves some of the liquidity pressure of the household, but as explained, this is a form of (forced) credit that comes at a cost, albeit implicit in the price of utilities.

107. The reasons for  $K_2$  in this context are likely to be distinctive from the ones in the employment context. It is possible that households prefer lump sums outlays because they allow for easier detection of overcharges or give them power in disputes vis-à-vis the company. This is a fertile area for future research.

108. PIERRE CAHUC ET AL., LABOR ECONOMICS 82–83 (2d ed. 2014) (exploring, in the simple model of labor demand, optimal wages).

109. The existence of wage premiums was consistently confirmed. See, e.g., Don Fullerton & Gilbert E. Metcalf, *Tax Incidence* 28 (Nat'l Bureau of Econ. Research, Working Paper 8829, 2002), <https://www.nber.org/papers/w8829.pdf> [<https://perma.cc/KQE7-N5XH>] (noting that the shared incidence of payroll taxes “has been tested and confirmed repeatedly.”); Jonathan Deslauriers et al., *Estimating the Impacts of Payroll Taxes: Evidence from Canadian Employer-Employee Tax Data 2* (Inst. of Labor

the employer beyond his direct labor output, the wage would be adjusted upwards to include a wage premium. That is, if the employee agrees to receive payment infrequently, the employer would be willing to pay a wage premium relative to an employee who is paid frequently.

The size of the wage premium for payday, as well as its very existence, are empirical questions that received little attention.<sup>110</sup> Some complicating factors are market failures, market organization, and regulation. Now, on theoretical grounds alone, it is clear that employers will not be willing to offer a wage premium that fully compensates the worker. To do so, the employer would have to pay them their costs of lending—but as we just saw, the costs to employees exceed the benefits to employers.<sup>111</sup>

Still, if employers do not have to pay a full wage premium, they may use employee wages as a line of credit. To be able to extract such a benefit, employers must wield considerable bargaining power. And while it is clear that many employers do, in fact, wield such power (think of a single employer in a small town), this surely does not describe the entire economy. Outside of monopsonic employers, the distribution of power is far more heterogeneous. Even middle-class employees often find themselves in a position to negotiate portions of their salary and benefits, and firms invest considerably in the retention efforts of these employees. Yet, we do not find daily pay common even among these employees.<sup>112</sup>

A deeper challenge to the asymmetric power explanation lies in the idea of effective pay. Even supposing that the employer can avoid paying a wage premium, the employer would find better and worse ways to exercise its bargaining power. Both the employer and the employee care about more than the per-hour wage; they care about the entire package of pay, benefits, work conditions, and duties—that is, they care about the effective wage. The more benefits the employer provides, the more costly it becomes to employ workers, even if the per-hour wage remains the same.

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Econ., IZA DP No. 11598, 2018), <http://ftp.iza.org/dp11598.pdf> [<https://perma.cc/8VAY-L6Z4>] (“The consensus is that [payroll] taxes are partially to completely shifted to workers, at least in the long run . . .”). *But see* Emmanuel Saez et al., *Payroll Taxes, Firm Behavior, and Rent Sharing: Evidence from a Young Workers’ Tax Cut in Sweden*, 109 AM. ECON. REV. 1717, 1718 (2019) (finding firm-level differences in incidence and employment effects of payroll tax cuts). In other contexts, see, e.g., John M. Abowd & Orley Ashenfelter, *Anticipated Unemployment, Temporary Layoffs, and Compensating Wage Differentials*, in *STUDIES IN LABOR MARKETS* 141 (Sherwin Rosen ed., 1981) (premium for risk of layoffs); John R. Graham et al., *Employee Costs of Corporate Bankruptcy* (Nat’l Bureau of Econ. Research, Working Paper No. 25922, 2019) (bankruptcy risk).

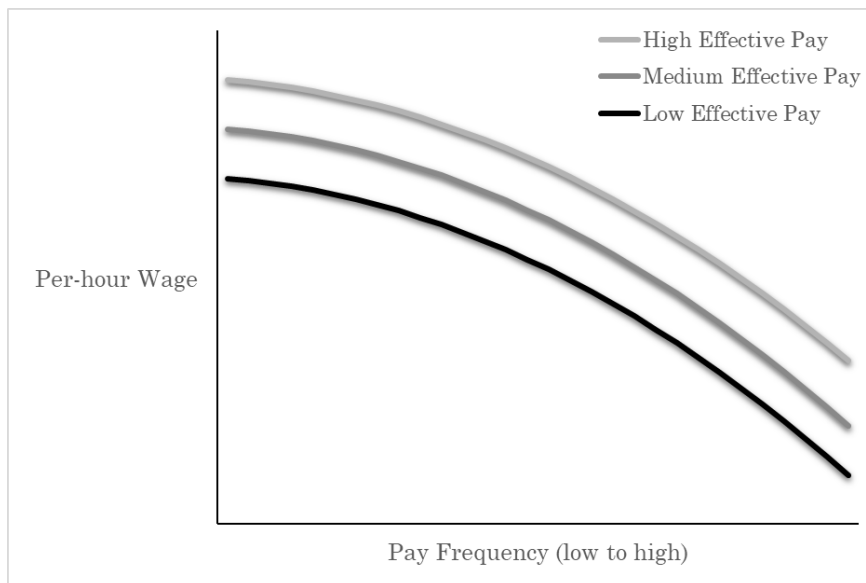
110. The one exception is Redmount et al., *supra* note 70, at 1066 who find that the 19th century reforms in Massachusetts resulted in lower average wages but increased hours of work, with a net positive effect on effective wages.

111. *See supra* Part I.B.

112. Parsons & Van Wesep, *supra* note 20, at 374 (showing that frequency of pay falls with income, so that middle and high-income workers are paid less frequently than low-income workers).

Now, even for employers who wield enough power that they can unilaterally dictate the terms of employment, the choice of effective pay requires some balancing. Set too low, few workers would come to work and those who do would work fewer hours and leave at the first opportunity. The profit-maximizing employer would want to offer the minimal package of pay and benefits that still attracts enough workers. If the benefits are high, the employer can offer a somewhat lower wage and still attract enough workers; if the employer cuts benefits, it would likely have to offer more in the way of pay to attract the same number of employees. The following figure illustrates this basic tradeoff:

*Figure 2 – Effective Pay with Different Mixes of Per-Hour Pay and Pay Frequency*



As the Figure illustrates, paying more frequently allows the employer to pay less per-hour while maintaining the same effective wage. In designing the optimal mix, the employer would compare its own costs in providing frequent pay against the savings in direct wage payments.<sup>113</sup> If it is indeed the case that the employee's cost of infrequent pay is higher than the employer's benefit, even the asymmetrical powered employer would tend to favor more frequent pay because it would allow it to reduce paid wages while maintaining the same effective pay that is needed to retain employees.

113. The value of infrequent pay also includes savings on check-cutting costs and stronger leverage against the employee, issues that are analyzed *infra* Parts II.D and II.G.

Thus, even a selfish, dominant employer who is committed to profit-maximization may find it better to pay less but more frequently.

While asymmetric power fails to explain the payday phenomenon in general, there is one area in which it provides a more cogent explanation: minimum wage employees.<sup>114</sup> Potentially a design flaw, the minimum wage legislation does not consider effective pay, only nominal wages. Consider, an employer who—before the minimum wage—was paying \$7 an hour and still attracting enough workers. Now suppose the legislator requires a minimum wage payment of \$7.25 per hour. If the employer complies and pays more, the employee's effective wage is raised above the market clearing equilibrium. The employer can offset that increase and reduce effective pay by paying less frequently, thus still keeping compliance with the letter (but not the spirit) of minimum wage law. Hence, there is a theoretical possibility that, in the presence of minimum wages, employers would seek longer payment periods.<sup>115</sup> This possibility has not been investigated in the voluminous literature on the effects of minimum wages and should be analyzed in future research, because it is very worrisome.<sup>116</sup> Minimum wage employees are also most likely to suffer low access to liquidity and improving their liquidity should be an important policy consideration.<sup>117</sup>

As for lack of sophistication, it may have some explanatory power, but it does raise some questions. It may be that many employees lack the financial sophistication to properly classify  $K_2$  as a credit transaction. But what they lack in academic sophistication of this sort, they have in terms of skin-in-the-game. One does not need a degree in finance to understand that getting paid every day will make life easier than waiting a month to be paid. As workers viscerally feel the consequences of the payday, we would expect them to gravitate more toward employers who pay regularly. Indeed, one

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114. I emphasize that this is only a possible effect, as the literature on the effects of minimum wages is complex, nuanced, and hotly debated. Here I consider the classic wage model, noting that its applicability in different markets may be limited. See generally David Neumark, *The Employment Effects of Minimum Wages: Some Questions We Need to Answer 1* (Nat'l Bureau of Econ. Research, Working Paper No. 23584, 2017), <https://www.nber.org/papers/w23584.pdf> [<https://perma.cc/KX9J-2U2R>] (“[T]he debate among researchers about the employment effects of minimum wages remains intense and unsettled.”).

115. There are limitations on the frequency of pay, as discussed *infra* Part II.F.

116. There is empirical evidence that employers sometimes cut fringe benefits in response to higher minimum wages. Jeffrey Clemens et al., *The Minimum Wage, Fringe Benefits, and Worker Welfare*, 2 (Nat'l Bureau of Econ. Research, Working Paper No. 24635, 2018), <https://www.nber.org/papers/w24635.pdf> [<https://perma.cc/7HGY-ETMK>].

117. See, e.g., Jonathan Morduch, *Poverty and Vulnerability*, 84 AM. ECON. REV. 221, 221 (1994) (noting “the reasonably universal phenomenon by which the lack of collateral limits borrowing by the poor in bad times”).

consequence of the Covid-19 pandemic is the increased demand for daily pay.<sup>118</sup>

Overall, employers' market power and employees' lack of sophistication may explain some part of the practice of payday, although it seems unpersuasive as a general explanation—especially given the fact that we find prolonged payment periods even among higher-paid employees.<sup>119</sup> As a justification, however, both reasons fail. Both information gaps and market monopolies are types of market failures—and there is little appeal to market outcomes that result from market failures.

#### *D. Collateral*

A different reason for the existence of the payday grounds the practice in the need of employers to retain their employees. Employers worry that employees may decide to quit midstream, leaving the employer stranded without the personnel or skill necessary to produce their products or serve their clientele. Contract law can protect employers against this possibility—they can require the employee give notice. But such protection is quite weak, as employees can be judgment proof and the cost of litigation can be prohibitive.<sup>120</sup> Postponing pay thus creates collateral and, with it, leverage; if the employee disappears, the employer may threaten to expropriate this collateral.<sup>121</sup>

As an explanation, the idea of collateral faces a challenge in explaining why the payday is used even when there is little flight risk or when employees are not judgment proof. Indeed, the average worker stays with his or her employer for at least four years.<sup>122</sup> It may still be true that employers are reluctant to sue employees for reputational reasons, rendering

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118. See Ellen Sheng, *Companies Offer Cash-Strapped Employees Daily Pay Cards and Other Flex-Pay Options as a Lifeline*, CNBC (Mar. 30, 2020, 8:47 AM), <https://www.cnbc.com/2020/03/30/companies-offer-cash-strapped-employees-daily-pay-cards-as-a-lifeline.html> [https://perma.cc/NH5H-BADW]. As this Article was in edits in the midst of the pandemic, it is too early to determine its long-term labor market effects.

119. Matt Burgess, *How Frequently Do Private Businesses Pay Workers?*, 3 BEYOND THE NUMBERS 1, 5–6 (2014) (reporting that, in 2013, average hourly pay for semimonthly and monthly pay was “slightly less than \$30 an hour”; biweekly “slightly less than \$25”; and weekly “slightly less than \$20”).

120. See, e.g., 80 Fed. Reg. 62,958, 62,985 (Oct. 16, 2015) (to be codified at C.F.R. pt. 655) (Private employers asking, in the context of new rules on commissions, “that DOL permit employers to withhold a portion of wages as an incentive for the employee to complete the contract period and to discourage workers from leaving to work in other industries.”). A deeper problem is strategic judgment proofing through asset shielding. See generally Yonathan A. Arbel, *Shielding of Assets and Lending Contracts*, 48 INT'L REV. L. & ECON. 26 (2016).

121. On the historical use of collateral, see Redmount et al., *supra* note 70, at 1065.

122. BUREAU OF LABOR STATS., EMPLOYEE TENURE IN 2018 1 (2018), <https://www.bls.gov/news.release/pdf/tenure.pdf> [https://perma.cc/SC4C-ESPD] (based on the median).

the employment contract unprotective of the employer's interests. But the same logic, the same concern with reputational effects, would also lead employers to avoid sequestering the collateral.<sup>123</sup> In any case, collateral offers a plausible explanation for some of the practices of payday. As a justification, however, things are more complicated.

As a society, we decided that employers should not be allowed to sequester earned wages, even when the employee quits. Employers are legally prohibited from taking earned wages in retaliation for the worker quitting.<sup>124</sup> A large number of jurisdictions have enacted "final pay statutes," which compel the payment of all unpaid wages upon termination, or soon thereafter.<sup>125</sup> Final pay statutes are often accompanied by penalties and fee-shifting provisions to further compel employers to make timely payments.<sup>126</sup> State courts have likewise recognized the public policy imperative in favor of prompt payment.<sup>127</sup> The policy underlying these statutes is widely endorsed: the Supreme Court held that legislation requiring prompt payment upon discharge—i.e., payment without "abatement or deduction"—is constitutional.<sup>128</sup> The Department of Labor denounced any pay practices that have the effect of payment deferral.<sup>129</sup> In some jurisdictions, courts adhere to the "faithless servant" doctrine, which denies employees any pay (even in quantum meruit) if they are disloyal to their employers.<sup>130</sup> However, disloyalty is generally understood to mean unlawful competition with the employer or perhaps dissemination of trade secrets.<sup>131</sup> This doctrine is of little relevance, then, to employees who quit midstream.<sup>132</sup>

While collateral fails as a justification for withholding earned wages, it does provide justification to a subtly different issue—not the existence of payday but why payday is always in arrears. The reason that employers do not *prepay* employees is clearly rooted in the difficulty of recovering

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123. Reputational concerns may indeed push the employer to sue and sequester the collateral to develop a reputation for "toughness."

124. See, e.g., *Britton v. Turner*, 6 N.H. 481, 489–92 (1834) (establishing the duty to pay an employee for part performance); *Pineda v. Bank of Am.*, 241 P.3d 870, 877 (Cal. 2010).

125. William C. Martucci & Jennifer K. Oldvader, *Avoiding Another Wage-and-Hour Pitfall: State Late-Paycheck Laws*, 38 EMP. REL. TODAY 71 (2011).

126. See, e.g., ALASKA STAT. ANN. § 23.05.140(d) (West 2020); DEL. CODE ANN. tit. 19, § 1103(b) (West 2019); VA. CODE ANN. § 40.1-29(A)(2), (F) (West 2019).

127. See, e.g., *Pineda*, 241 P.3d at 877 ("[T]he public policy in favor of full and prompt payment of an employee's earned wages is fundamental and well established . . .") (quoting *Smith*, 137 P.3d at 220).

128. *St. Louis, Iron Mountain & St. Paul Ry. Co. v. Paul*, 173 U.S. 404 (1899).

129. See, e.g., 80 Fed. Reg. 62,957, 62985-86 (Oct. 16, 2015) (to be codified at 20 C.F.R. pt. 655).

130. See Charles A. Sullivan, *Mastering the Faithless Servant?: Reconciling Employment Law, Contract Law, and Fiduciary Duty*, 2011 WIS. L. REV. 777, 779 (2011).

131. See Alan Hyde, *What Should the Proposed Restatement of Employment Law Say About Remedies?*, 16 EMP. RTS. & EMP. POL'Y J. 497, 508 (2012).

132. See STEVEN L. WILLBORN ET AL., *EMPLOYMENT LAW: CASES AND MATERIALS* 609–12 (4th ed. 2007).

unearned wages from an employee who absconds. Anticipating this difficulty in recovery, some workers may want to assume positions just for the sake of prepayments, making the hiring process difficult and costly. Hence, “reverse”  $K_2$ , where the employer lends money to the employee, is not a general solution—a point worth remembering as we move to the normative discussion.

Overall, collateral may explain the practice of payday to some extent and may justify the absence of “reverse  $K_2$ ,” but it fails to justify  $K_2$  as a social practice. Employers, we have decided as a society, should not sequester earned wages.

#### *E. Behavioral Biases*

The reasons discussed so far were mostly concentrated on the employer. Another potential reason for the existence of the payday comes from the employees and their own well-being. While the question of the payday was mostly neglected in the legal literature,<sup>133</sup> economists Parsons and Van-Wesep recently published a theoretical explanation of the payday in the leading *Journal of Financial Economics*.<sup>134</sup> This explanation is rooted in psychology and suggests that the payday helps employees address their biases. While this account rests on familiar intuitions, I believe it fails both as an explanation and as a justification for the existence of the payday.

The idea goes as follows: people find it difficult to budget and control their expenses. When employers pay frequently, individuals are more likely to spend the money in their pockets due to behavioral biases such as “present-bias” that prevent them from considering the full, long-term implications of their behavior. The same way as some of us would benefit from a pizzeria that would only sell us a few slices, employees are said to benefit from having infrequent pay. Under this account, employers are delaying payments as a service to employees, sparing employees from their weak impulse control.<sup>135</sup>

This theory is not without evidence. The basic proposition—that households need help budgeting money—is consistent with some evidence showing that the timing of payments influences household money management. One study showed that pension recipients consume the fewest calories the week before the benefits are paid, perhaps suggesting a

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133. *See supra* note 3.

134. Parsons & Van Wesep, *supra* note 20.

135. *Id.* at 374.

difficulty in saving evenly across the entire pay period.<sup>136</sup> Similarly, another study showed that individuals make the most of their food and necessity purchases right after receiving benefit payments.<sup>137</sup> The authors and economists Parsons and Van Wesep further argue that their findings are consistent with the fact that low-paid employees are paid more frequently than higher-paid employees.<sup>138</sup> To them, this is simply the result of low-paid employees being more presently-biased than their wealthier counterparts and lacking a financial buffer, making their need for money exceed their desire to save.<sup>139</sup>

There is no doubt that saving money can be difficult, but this point should not be taken to mean that workers need their employers to help them save. If that were the case, we would expect to see at least some workers asking their employers to delay payments—so this dog doesn't bark. More generally, this behavioral explanation fails, both on theoretical and empirical grounds.

First, consider how behavioral biases may work in this context in the exact opposite direction. By waiting until payday, employees receive a larger paycheck than they would if they were to be paid on an ongoing basis. This large payment can create a sense of windfall—a “full wallet” bias.<sup>140</sup> This behavioral bias may lead individuals to spend more on luxuries than when individuals operate under a sense of scarcity. Indeed, the concern with the full wallet bias was precisely the reason some legislators enacted frequent pay legislation: “[large payments] could mean . . . dissipation on payday of a large part of the accumulated sums by irresponsible employees

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136. Giovanni Mastrobuoni & Matthew Weinberg, *Heterogeneity in Intra-Monthly Consumption Patterns, Self-Control, and Savings at Retirement*, 1 AM. ECON. J.: ECON. POL'Y 163, 164 (2009); see also Jani-Petri Laamanen et al., *Once or Twice a Month? The Impact of Payment Frequency on Consumption Patterns* (Feb. 2019) (unpublished manuscript), <https://pdfs.semanticscholar.org/794a/c54611eeff7bd40efa93729cada5e0e03fa5.pdf> [https://perma.cc/24ND-DYMA].

137. Melvin Stephens Jr., “3rd of the Month”: *Do Social Security Recipients Smooth Consumption Between Checks?*, 93 AM. ECON. REV. 406 (2003).

138. Parsons & Van Wesep, *supra* note 20, at 389 (“Insofar as education and wealth correlate negatively with time-inconsistency, more educated and more wealthy workers should be, and are empirically, paid less frequently.”).

139. *Id.*

140. See Carlos Dobkin & Steven Puller, *The Effects of Government Transfers on Monthly Cycles in Drug Abuse, Hospitalization and Mortality*, 91 J. PUB. ECON. 2137, 2143 (2007) (Reviewing research on the full wallet effect). See also Hal R. Arkes et al., *The Psychology of Windfall Gains*, 59 ORGANIZATIONAL BEHAV. & HUM. DECISION PROCESSES 331 (1994) (finding higher propensity to spend money viewed as a windfall); C. Yiwei Zhang & Abigail B. Sussman, *The Role of Mental Accounting in Household Spending and Investing Decisions*, in CLIENT PSYCHOLOGY 65, 69 (Charles R. Chaffin ed., 2018) (noting the evidence of a higher propensity to spend windfalls on luxury items). Such debates are not new; in nineteenth-century Massachusetts, mill owners thought that moving to weekly pay would lead to more employee intoxication, but “our treasurer determined to give it a fair trial and the result exceeded our anticipations, for we found that instead of increasing drunkenness, it has had a contrary effect, so far as we could ascertain by the working days of our operatives.” Redmount et al., *supra* note 70, at 1069–70.



with consequent adverse effect on family and community.”<sup>141</sup> Empirical evidence suggests that this concern is not only theoretical. For example, research shows that individuals consider tax refunds to be “extra” money, leading them to spend it more easily than their “regular” money.<sup>142</sup> Similarly, when benefits are paid in a lump sum, one finds a spike in drug use, hospitalization, and mortality—as some individuals purchase excess drugs and alcohol.<sup>143</sup> One recent report notes a spike in child abuse on payday, as adults engage in excessive drinking.<sup>144</sup> Another study compared the expenditure profile of benefits recipients who receive payment twice a month with those who receive a larger payment once a month.<sup>145</sup> It found that the single payment leads to high within-month variability, with most of the money spent early, thus concluding that “two temporally separate payments might lead to smoother spending than just one payment.”<sup>146</sup> It is also possible that it is easier to save pennies than dollars, which is the business model of a few recent start-ups.<sup>147</sup>

Second, to explain why low-income workers are paid more regularly than higher-income workers, Parsons and Van Wesep posit that low-paid

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141. *Am. Mut. Liab. Ins. Co. v. Comm’r of Labor & Indus.*, 163 N.E.2d 19, 21 (Mass. 1959); see also Rebekah D. Provost, *Punishing and Deterring the Unknowing: Mandatory Treble Damages Under the Massachusetts Wage Act*, 18 SUFFOLK J. TRIAL & APP. ADVOC. 305, 311 (2013). Payday was a special occasion in turn of the century America, when mostly men engaged in communal binge drinking, spending a large portion of their payday wages. See also MADELON POWERS, *FACES ALONG THE BAR: LORE AND ORDER IN THE WORKINGMAN’S SALOON, 1870–1920* 52–53 (1998); COMMONS & ANDREWS, *supra* note 3, at 52 (noting that some states had special legislation mandating payment during pay hours, to avoid the payment bar-rooms). In contrast, some legislators expressed concern that too-frequent pay would lead to “frequent debaucheries.” See Robinson, *supra* note 76, at 33.

142. See William Adams, Liran Einav & Jonathan Levin, *Liquidity Constraints and Imperfect Information in Subprime Lending*, 99 AM. ECON. REV. 49, 49–50 (2009) (finding a sharp increase in auto purchases in the subprime market during tax refund season); Brian Baugh et al., *Disentangling Financial Constraints, Precautionary Savings, and Myopia: Household Behavior Surrounding Federal Tax Returns 2* (Nat’l Bureau of Econ. Research, Working Paper No. 19783, 2014), <https://www.nber.org/papers/w19783.pdf> [<https://perma.cc/R7C2-T32H>] (finding a large temporary increase in expenses following tax refunds, which is interpreted as suggesting myopic behavior).

143. Dobkin & Puller, *supra* note 140, at 2140 (“This evidence strongly suggests a causal relationship between cash aid and the cycle in drug related hospitalizations . . .”).

144. Martin Selsoe Sorensen, *Greenland Calls on Denmark to Help Fight Child Sexual Abuse*, N.Y. TIMES (Sept. 27, 2019), <https://www.nytimes.com/2019/09/27/world/europe/greenland-sexual-abuse-tasiilaq-denmark.html> [<https://perma.cc/AFM8-XVUP>] (“Pay days are the worst time for the children of Tasiilaq . . . . With their salaries or social benefits in hand, many adults tend to drink and parents become too inebriated to look after their children . . . . So on the last Friday of every month, officials open a sports hall in the district as a shelter to keep children away from sexual abuse.”).

145. Laamanen et al., *supra* note 136, at 4.

146. *Id.* at 20.

147. See, e.g., ACORNS, <https://www.acorns.com/> [<https://perma.cc/MR26-Y7GY>] (a micro-investing platform with corresponding app that allows customers to invest spare change into an aggregated portfolio managed by industry professionals). To be clear, I do not consider the windfall bias as necessarily stronger than myopia—but I note that both are equally plausible forces that operate in opposing directions.

workers are more prone to present-bias.<sup>148</sup> How likely is this assumption? Are middle-income employees necessarily more money conscious and less likely to overspend than their paycheck-to-paycheck counterparts?<sup>149</sup> And even if that were the case, low-paid employees are hardly a homogenous or static group. A large body of research documents earning mobility, suggesting that many (but of course, not all) employees are on their path to higher earnings in the future—think interns, students working a side job, or a manager-track employee working the ranks.<sup>150</sup> A dynamic view of low-wage employees renders such broad generalizations unpersuasive.

Third, there is a subtle legal point that belies this explanation. The entire utility of delayed pay is undermined if employees can ask employers to advance their wages—and if employees are indeed present-biased, they would be expected to do so. The authors themselves admit that wage advances “will cause our results thus far to unravel, implying a need for regulation.”<sup>151</sup> They argue, however, that the law prevents advances because “regulators in 45 U.S. states require wages to be paid at a minimum frequency.”<sup>152</sup> This is, however, not entirely correct. Pay frequency legislation does not require minimum pay frequency (but a maximum) and does not bar wage advances.<sup>153</sup> If workers are indeed blinded by present-bias, they could and would use wage advances to squander their pay.

The last problem with this explanation is that it overstates the difficulty of saving money. In practice, over 55% of households have liquid assets at their disposal, which they manage to save by themselves.<sup>154</sup> There is also some evidence that pay frequency does not affect savings rates; a recent study concludes that “pay frequency does not affect household’s savings” and that the amount of money that households spend over the month has no

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148. Parsons & Van Wesep, *supra* note 20, at 389 (“Insofar as education and wealth correlate negatively with time-inconsistency, more educated and more wealthy workers should be, and are empirically, paid less frequently.”).

At least in the aggregate data presented by the Bureau of Labor Statistics, the correlation between pay and pay frequency breaks if one excludes weekly paid employees—in fact, semi-monthly paid employees are paid somewhat more than monthly-paid employees. See BUREAU OF LABOR STATS., *supra* note 29.

149. Economists are divided on these questions. See Leandro Carvalho, *Poverty and Time Preference* 2–3 (RAND Labor & Population, Working Paper No. WR-759, 2010), <https://www.rand.org/content/dam/rand/pubs/workingpapers/2010/RANDWR759.pdf> [<https://perma.cc/CC65-V63F>].

150. See, e.g., Katharine Bradbury, *Levels and Trends in the Income Mobility of U.S. Families, 1977–2012* 2, 21 n. 21 (Fed. Reserve Bank of Bos., Working Paper No. 16-8, 2016) (“[F]or those starting poor, an average of 58 percent moved out of the poorest group . . .”).

151. Parsons & Van Wesep, *supra* note 20, at 382.

152. *Id.*

153. See Jim Hawkins, *Earned Wage Access and the End of Payday Lending*, B.U. L. REV. (forthcoming 2021) (manuscript at 32) (on file with author) (“Currently, no states specifically regulate [earned wage advance] transactions . . .”).

154. See Bricker et al., *supra* note 5, at 17. Conditional on having financial assets, the median family held \$23,500 in assets. *Id.* at 18.

relation to the frequency of pay.<sup>155</sup> Indeed, if this explanation were persuasive, we might expect to see workers asking their employers to *delay* payments, so they can save better—but of course, such behavior is rarely observed.

Overall, then, while the inability to save may explain a portion of the payday phenomenon, it fails as a general explanation. However, I want to make a stronger claim; present-bias also fails as a justification for the payday. To show this, I would like to take a step back from the question of whether employees need help saving and focus on the question of whether employers should be the ones who help them save.

The core of the problem is simple: employers are unreliable agents for the management of employee savings.<sup>156</sup> There is a reason why pension funds, such as 401(k)s, are not owned by employers.<sup>157</sup> Employers are not some neutral bank; in practice, wage theft—the withholding of pay due—is “rampant in the low-wage workforce.”<sup>158</sup> Employers (and the government is no exception) sometimes unilaterally suspend pay.<sup>159</sup> Moreover, keeping money with one’s employer also gives the employer leverage, and the employer may abuse it.<sup>160</sup> Worse, unlike banks, employers are not insured against bankruptcy.<sup>161</sup> Thus, using employers as vaults not only exposes employees to abuse but also to the risk of bankruptcy, a risk over which the employee has little control.<sup>162</sup> Bankruptcy risk also exposes another

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155. Inés Berniell, *Pay Cycles: Individual and Aggregate Effects of Paycheck Frequency* 19 (Apr. 2019) (unpublished manuscript), [https://inesberniell.weebly.com/uploads/9/1/2/2/91228902/paycycles\\_berniellines.pdf](https://inesberniell.weebly.com/uploads/9/1/2/2/91228902/paycycles_berniellines.pdf) [<https://perma.cc/4FH2-LGJ9>].

156. A key component of prudent financial planning is diversification. Tying one’s money with one’s place of employment is the opposite of diversification. *See, e.g.,* Sarah O’Brien, *Don’t Overlook the Risk that Comes with Your Employee Stock Options*, CNBC (Feb., 27, 2018, 11:57 AM), <https://www.cnbc.com/2018/02/27/employee-stock-options-can-come-with-expensive-risks.html> [<https://perma.cc/8SG4-3L4M>].

157. The Employee Retirement Income Security Act of 1974 (ERISA) was enacted to minimize “the looting and mismanagement that had previously plagued private pensions” by borrowing a trust law model. Natalya Shnitser, *Trusts No More: Rethinking the Regulation of Retirement Savings in the United States*, 2016 BYU L. REV. 629, 642.

158. Llezlie L. Green, *Wage Theft in Lawless Courts*, 107 CAL. L. REV. 1303, 1309 (2019); *see also* IMMIGRANTS’ RIGHTS/INT’L HUMAN RIGHTS CLINIC, SETON HALL UNIV., ALL WORK AND NO PAY: DAY LABORERS, WAGE THEFT, AND WORKPLACE JUSTICE IN NEW JERSEY (2011), <https://www.immigrationresearch.org/report/seton-hall-university-school-law/all-work-and-no-pay-day-laborers-wage-theft-and-workplace-ju> [<https://perma.cc/3MHZ-S5H7>].

159. The concern with suspended government pay is longstanding. *See, e.g.,* *Payless Payday*, WASH. POST, Aug. 17, 1949, at 10 (noting that “[y]ear after year, Federal employes [sic] face suspensions of income”).

160. *See supra* Part II.D.

161. The Federal Deposit Insurance Act of 1950, Pub. L. 81–797, 64 Stat. 873 (codified at 12 U.S.C. § 1823(e) (2018)).

162. Aside from bankruptcy, letting the employer control more money provides it with leverage which it can use against the employee in various ways, making quitting, for example, more difficult. Employers are also less efficient than financial institutions at making periodical payments.

problem with employer-side saving. Employers, after all, are also humans and are inherently not immune to the same present bias that would lead employees to squander money. The manager may be tempted to spend the money on a new machine, a shiny business opportunity, or a private car, not leaving enough slack to pay wages.<sup>163</sup> Given these problems, even if employees are subject to a severe present-bias, having employers manage savings is counter-productive. At the very least, employees would benefit from having reliable, insured third parties manage their savings (such as their 401(k) retirement accounts), rather than having their bankruptcy-prone employer manage them.<sup>164</sup>

Besides this core problem, one must also consider that withholding pay from employees is a particularly severe form of paternalism. Proposing to withhold property from individuals because one thinks they are insufficiently responsible to handle it is a very strong claim that would require very strong evidence. But the evidence discussed in this section falls far short of this high standard.

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This section tackled the argument that the payday serves employees by helping them budget their own money. It showed why this intuitive idea fails as an explanation—among other things, it neglects to consider how larger paychecks can invite excess spending. More critically, this section argued that this theory also fails as a justification for the payday; this type of paternalism requires an excessive degree of trust in employers. Thus, whatever limited explanatory power this theory has, it is insufficient to justify this practice.

#### *F. Legislation*

Employment law is highly regulated at both the federal and state level, and the payday is no exception. As this section shows, the payday is affected by both federal and state legislation in ways both visible and invisible.

Legislation provides the most direct explanation of the payday in the public sector. As a result of extensive pay regulation, most public employees are paid on a biweekly or a semimonthly basis. Federal

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163. Even without present-bias, large debts can exacerbate risk taking by managers. *See, e.g.*, Zhiyao Chen & Ran Duchin, Do Nonfinancial Firms Use Financial Assets to Take Risk? 2 (May 1, 2019) (unpublished manuscript) (“A vast body of theoretical work predicts that firms will invest in riskier projects as they become distressed . . .”).

164. The authors foresee this objection but dismiss it: “[I]t is not particularly important *who* conducts the timing-welfare calculation, as long as *someone* does.” Parsons & Van Wesep, *supra* note 20, at 383. The fact that, despite the considerable risks, employers are the ones who supposedly save for employees is too important to be casually dismissed.

legislation sets a biweekly pay period.<sup>165</sup> State laws, similarly, will often set a biweekly or semimonthly pay schedule for state employees.<sup>166</sup> Local governments also pay twice a month. Of the 200 largest cities in the United States, 189 (94.5%) pay on a biweekly or semimonthly basis.<sup>167</sup> With 22 million Americans employed as government employees,<sup>168</sup> we thus find legislation to be a direct explanation for pay practices in this sector.

As for the private sector, the analysis is far more nuanced. In the private sector, no law sets pay frequency directly. Instead, states set payment frequency floors—the requirement that the employer will not delay pay for longer than, normally, two weeks. It is possible that the private sector simply imitates pay practices in the public sector, but this possibility seems weak, given the stakes involved. If employers could set lower pay with more frequent pay, then the analysis above suggests that it would be profitable for them to do so. To the extent that debt spirals also affect worker productivity, stability, and reliability, we would expect the private sector to be somewhat responsive to such pressures.<sup>169</sup>

Indirectly, however, legislation inadvertently incentivizes infrequent pay. Ironically, it is mostly pro-worker legislation that promotes infrequent pay.

Take minimum wage laws. We have already seen these laws fail to regulate the interaction of minimum wage and pay frequency—thus, allowing employers to cut back on pay frequency without violating the law.<sup>170</sup> Another problem emerges in the context of tipped and commission-based employees—an important part of the workforce, with approximately 4.3 million tipped workers in the United States.<sup>171</sup> For these employees, the

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165. 5 U.S.C. § 5504(a) (2018) (“The pay period for an employee covers two administrative workweeks.”); *see also* U.S. BUREAU OF THE CENSUS, STATISTICAL ABSTRACT OF THE UNITED STATES 1986 302 (106th ed. 1985) [hereinafter 1986 ABSTRACT] (noting that “most Federal employees are paid on a biweekly basis”).

166. *See, e.g.*, ALA. CODE § 36-6-1 (2020) (semi-monthly); N.Y. STATE FIN. LAW § 200(1) (McKinney 2018) (biweekly); WASH. ADMIN. CODE § 82-50-021 (2020) (semi-monthly).

167. CITY OF CHESAPEAKE, VA AUDIT SERVS. DEP’T, CITY PAYROLL CYCLES SPECIAL AUDIT 11 (2019), <http://www.cityofchesapeake.net/Assets/documents/departments/audit/department-audits/Payroll+Cycle+Full+Report.pdf> [<https://perma.cc/NVH4-4XMR>].

168. *Employment, Hours, and Earnings from the Current Employment Statistics Survey (National)*, BUREAU OF LABOR STATS. (Apr. 18, 2020), <https://data.bls.gov/timeseries/CES9000000001> [<https://perma.cc/8N8F-A2DS>].

169. A set of economic arguments involve nominal rigidity of wages or “sticky wages”—the failure of payments to adjust, mostly downward, to changing market conditions. This may further explain the pattern of biweekly pay, although even sticky wages are thought to adjust in the long run. *See generally* Alessandro Barattieri et al., *Some Evidence on the Importance of Sticky Wages*, 6 AM. ECON. J.: MACROECON. 70 (2014).

170. *See supra* Part II.C. Admittedly, Pay frequency ceilings mitigate some of this effect.

171. SYLVIA A. ALLEGRETTO & DAVID COOPER, ECON. POL’Y INST., TWENTY-THREE YEARS

Fair Labor Standards Act (FLSA) permits employers to pay below minimum wage, so long as the lower wage plus tips averages to the minimum wage *over the pay period*.<sup>172</sup> As a result, employers are induced to set a long pay period, so as to average daily variations in pay, as the following example demonstrates.

Suppose that an employee makes \$1300 in tips in one week and \$100 in the next. The average is \$700—well beyond the biweekly federal minimum of \$580—so the employer need not pay the employee any extra amount.<sup>173</sup> But what happens if the pay period is shorter? Suppose an employer instead paid on a weekly basis. The employee makes \$1300 the first week, well beyond the minimum wage, so the employer would again not need to compensate the employee. But in the second week, the employee only makes \$100, well below the weekly minimum wage of \$290. By making the payday shorter, the employer now has to pay the employee an extra \$190. As this example demonstrates, for tipped and commissioned employees, minimum wage legislation unwittingly incentivizes *longer* pay periods. Admittedly, for many tipped employees this harm is mitigated by the common practice of paying cash tips daily—but as many tips are paid on credit, this problem remains important.<sup>174</sup>

Overtime legislation presents a similar averaging problem, although to a lesser extent. If overtime obligations are tied to pay frequency, employers would want to prolong pay periods to smooth periods of high work. In a biweekly pay period, the employer could avoid paying overtime in the first week if there is less work in the second week. The Department of Labor and many courts have taken the view that employers are not allowed to average over more than one week and that overtime legislation is done on a weekly

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AND STILL WAITING FOR CHANGE: WHY IT'S TIME TO GIVE TIPPED WORKERS THE REGULAR MINIMUM WAGE 7 (2014), <https://www.epi.org/files/2014/EPI-CWED-BP379.pdf> [<https://perma.cc/ZSH7-LFZ6>]. This estimate does not cover commission-based employees.

172. See Fair Labor Standards Act of 1938, 29 U.S.C. § 203(m) (2018); 48B AM. JUR. 2D *Labor and Labor Relations* § 3108 (2020). See also DEP'T OF LABOR, FIELD OPERATIONS HANDBOOK CHAPTER 30, RECORDS, MINIMUM WAGE, AND PAYMENT OF WAGES 30b01(b)(1) (2016), [https://www.dol.gov/whd/FOH/FOH\\_Ch30.pdf](https://www.dol.gov/whd/FOH/FOH_Ch30.pdf) [<https://perma.cc/6ME9-UD3C>] (“[T]he salary is sufficient to meet the minimum wage requirements for all hours worked during the pay period . . . .”); *id.* at 30b05(c)(1) (“There is no requirement that wages be paid weekly, as long as some regular pay period (such as biweekly or monthly) is established . . . . The only requirement is that employees receive prompt payment of the minimum wage covering all hours worked during the pay period.”). In California, see CAL. CODE REGS. tit. 8, § 11010(4)(B) (2020) (“[M]inimum wage for all hours worked in the payroll period . . . .”).

173. The employer still owes the employee the federal minimum wage per hour for a tipped employee of \$2.13 per hour, which is not included in the example for the sake of clarity. 29 U.S.C. § 203(m) (2018). *Chisolm v. Gravitas Rest. Ltd.*, No. CIV.A. H-07-475, 2008 WL 838760, at \*2 (S.D. Tex. Mar. 25, 2008).

174. See *Should You Use Your Credit Card to Tip?*, CBS NEWS: MONEYTIPS (June 16, 2015, 1:34 PM), <https://www.cbsnews.com/news/should-you-use-your-credit-card-to-tip/> [<https://perma.cc/64EZ-ELUH>] (noting the time lag associated with credit card tips).

basis.<sup>175</sup> Some courts, however, have taken a different approach, as explained by Judge Easterbrook: “[I]t is unlikely that Congress meant to require employers to pay overtime in the lean weeks when the fat weeks more than make up.”<sup>176</sup> To the extent that employers are allowed to average pay over pay periods, they would have an incentive to prolong that period.

A much deeper problem with overtime legislation concerns the definition of salaried employees, who are a large minority of the working population.<sup>177</sup> A salary is a fixed payment that does not depend on actual hours worked.<sup>178</sup> The FLSA permits employers to avoid paying overtime to salaried employees.<sup>179</sup> Because employers might abuse this system by designating employees as salaried employees, the FLSA sets clear criteria as to which class of workers are exempt from overtime obligations, the “exempt” employee.<sup>180</sup> For example, if a worker is docked pay for working fewer hours, then the employer can no longer claim that the worker is exempt from overtime pay.<sup>181</sup>

The problem is that the FLSA also imposes a formal test, the “salary basis test”: an employee cannot be considered salaried “if the employee regularly receives each pay period on a weekly, or less frequent basis, a predetermined amount.”<sup>182</sup> This test links pay frequency and pay status, and it leads to the absurd result that an employer who pays employees daily will

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175. 29 C.F.R. § 778.104 (2018) (“[FLSA] takes a single workweek as its standard and does not permit averaging of hours . . . .”); *Overtime Frequently Asked Questions*, N.Y. DEP’T. OF LABOR, <https://www.labor.ny.gov/legal/counsel/pdf/overtime-frequently-asked-questions.pdf> [https://perma.cc/8YCB-QBPT]. See also *Fernandez v. Centerplate/NBSE*, 441 F.3d 1006, 1007 (D.C. Cir. 2006) (“FLSA requires employers to pay overtime compensation for time worked in excess of forty hours per week, but not for time worked in excess of eight hours per day . . . .”); *Freixa v. Prestige Cruise Servs., LLC*, 853 F.3d 1344, 1346 (11th Cir. 2017).

176. *Walton v. United Consumers Club, Inc.*, 786 F.2d 303, 307 (7th Cir. 1986). See also *Triple “AAA” Co. v. Wirtz*, 378 F.2d 884, 887 (10th Cir. 1967) (allowing for averaging over a year); *Forster v. Smartstream, Inc.*, No. 3:13-CV-866-J-PDB, 2016 WL 70605, at \*6 (M.D. Fla. Jan. 6, 2016); *Schwind v. EW & Assocs., Inc.*, 371 F. Supp. 2d 560, 568 (S.D.N.Y. 2005); *Gatto v. Mortg. Specialists of Ill., Inc.*, 442 F. Supp. 2d 529, 542 (N.D. Ill. 2006).

177. See BUREAU OF LABOR STATS., CHARACTERISTICS OF MINIMUM WAGE WORKERS 2018 (Mar. 2019), <https://www.bls.gov/opub/reports/minimum-wage/2018/home.htm> [https://perma.cc/3PB-D-SQYE].

178. Garrett Reid Krueger, *Straight-Time Overtime and Salary Basis: Reform of the Fair Labor Standards Act*, 70 WASH. L. REV. 1097, 1103 (1995) (“Typically, salaried employees do not ‘punch a clock,’ are not paid by the hour, and are not docked pay if they do not work forty hours in a given week.”).

179. Fair Labor Standards Act of 1938, 29 U.S.C. § 213(a)(1) (2018).

180. Robert L. Levin, *Salaried or Hourly: Do Your Exempt Employees Meet the “Salary Test” Under the FLSA?*, 11 LAB. L. 25, 25 (1995). When employers pay employees who work in a “fluctuating workweek” arrangement, they need to pay only one half of the regular hourly rate, rather than 1.5 of that rate. The hourly rate, oddly, is lower the more overtime hours the employee clocks, a practice approved by the courts. See generally C.W. Von Bergen, *Using the Fluctuating Workweek Compensation Method to Reduce Overtime Expenses in Public Organizations*, 40 PUB. PERSONNEL MGMT. 165 (2011).

181. *Brock v. Claridge Hotel & Casino*, 846 F.2d 180, 184–85 (3d Cir. 1988).

182. 29 C.F.R. § 541.602(a) (2018).

also have to pay overtime, whereas an employer who chooses infrequent pay can also avoid overtime pay.<sup>183</sup> This outcome directly contradicts FLSA's purpose to protect workers from "labor conditions [that are] detrimental to the maintenance of the minimum standard of living necessary for [the] health, efficiency, and general well-being of workers."<sup>184</sup> By tying pay frequency to legal protections, the law deters employers from paying employees daily, lest they be considered unsalaried.

In these various ways, legislation explains pay practices. In the public sector, the explanation is simple fiat; but why not pay public sector employees more often? The low return on treasury bonds shows that the government can easily borrow at low rates.<sup>185</sup> Private employers may conform to public sector standards and are, in any case, incentivized to delay payments because of well-intentioned but poorly-drafted legislation. And while fiat and bad legislative design may explain the payday, they do not justify it.

### *G. Check Cutting Costs*

Paying workers is expensive. This section explores the various costs involved in paying workers and highlights how these costs can be an obstacle to regular pay. Schematically, paying involves four different stages: (1) determining pay due; (2) calculating withholding for compliance purposes; (3) transferring payments; and (4) receiving payments. The first two stages involve costs that are affected by payroll technology; the latter two involve costs due to money technology.

The first cost is that of the determination of payment due. This is mostly a technological problem, and it has largely been resolved. Determining due pay for salaried employees is almost trivial in modern times.<sup>186</sup> For other types of employees, the determination may be somewhat more complex—but not by a large margin. The employee time clock was patented in 1891,<sup>187</sup> and with the broad integration of computers and mobile devices in the

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183. To the best of my knowledge, this topic was never litigated, so it is an open question how the courts would rule. My conversations with practitioners suggest a general belief that courts would be willing to divorce pay frequency from the actual definition of salaried employees, although given the plain language of the text, it is unclear how they would reach this outcome.

184. 29 U.S.C. § 202(a) (2018).

185. *Daily Treasury Yield Curve Rates*, U.S. DEP'T OF THE TREASURY, <https://www.treasury.gov/resource-center/data-chart-center/interest-rates/pages/textview.aspx?data=yield> [<https://perma.cc/RT6G-6CGB>].

186. The biweekly pay is simply given by dividing the annual salary by twenty-four for a semi-monthly paid employee. Withholdings and deductions can complicate the calculus, but with payroll software, these issues are generally easily resolved in practice.

187. U.S. Patent No. 452,894 (filed May 26, 1891).



modern workplace, most time-tracking today is automated.<sup>188</sup> True, employers want to verify every reported work hour, a task that does not scale up well. However, this difficulty is inherent to the employment relationship for reasons other than pay frequency, and as we shall see, this concern can be effectively resolved with careful design of pay obligations.<sup>189</sup>

A seemingly more serious cost is compliance. Even after assessing the employees' wages, the employer must still verify that it is properly assessing compulsory and voluntary deductions, that levies are effectively put aside, that child support and alimony payments are correctly computed, and that any wage garnishments are deducted. Then, the employer must verify compliance with all minimum wage and overtime legislation. Finally, the employer must keep a record of hours worked and communicate this information to the employee. These challenges may have been enormous in the past, as properly computing withholding manually is a long, arduous, and error-prone process. But today, none of these challenges are especially onerous with the advent of the modern computer and payroll software. The per payroll cost of paying an employee in medium-sized companies appears to be between \$1 and \$5, although companies differ significantly in their pricing methodologies.<sup>190</sup> Completing a payroll "run" may involve a real cost, but this cost is no longer prohibitive.<sup>191</sup>

Despite the availability of software, employers still want to verify the accuracy of all payments, because failure to comply can result in criminal, civil, and ethical sanctions. The FLSA, for example, imposes criminal fines and even imprisonment for failures to comply.<sup>192</sup> This liability also extends

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188. See *Workplace Time Tracking Habits Revealed*, INTUIT QUICKBOOKS <https://www.tsheets.com/resources/time-tracking-survey> [<https://perma.cc/9NSR-KUXJ>] (finding in a survey of 954 employees that only 25% track time with paper or a timesheet).

Roughly 2.9% of US employees are reportedly working remotely at least half of the time, requiring alternative arrangements (such as salary or software tracking). Brie Weiler Reynolds, *The State of the Remote Job Marketplace*, FLEXJOBS (Mar. 27, 2018), <https://www.flexjobs.com/blog/post/state-of-the-remote-job-marketplace/> [<https://perma.cc/GNQ8-M55S>].

189. See *infra* Part IV.

190. See *Real-World Payroll Services Prices from BuyerZone Buyers*, BUYERZONE, <https://www.buyerzone.com/hr-personnel/payroll-services/ar-prices-payroll-large/> [<https://perma.cc/HX32-TFCW>]. See also *Easy, Modern Payroll Starting at Just \$45 \$25/month*, GUSTO, <https://gusto.com/product/pricing> [<https://perma.cc/CX2L-8XWL>]; *Our Prices*, CORPORATE PAYROLL SERVICES, <https://www.corpay.com/pricing/> [<https://perma.cc/7EKG-C8N3>]; *Compare Online Payroll Service Prices*, PRICE IT HERE, <https://priceithere.com/online-payroll-cost/> [<https://perma.cc/994N-6HPD>].

191. As I discuss later, the compliance cost would remain largely the same under my proposal, because the verification process will only take place once every two weeks. See *infra* Part IV.

192. Fair Labor Standards Act of 1938, 29 U.S.C. § 216(a) (2018) (setting a fine of up to \$10,000 and imprisonment of up to six months for willful violations).

to corporate officers.<sup>193</sup> The consequences can also be disciplinary for some professionals. One lawyer was put on probation for eighteen months for failure to file and pay various federal, state, and local payroll tax obligations on a timely basis.<sup>194</sup> The FLSA also includes a civil sanction: failure to pay wages can result in liquidated damages equal to all unpaid wages<sup>195</sup> and attorney fees.<sup>196</sup> Given the costs of mistakes, the employer will want to include safeguards—such as manual revision of at least some of the paystubs. Under the current system, these safeguards should be employed at every pay cycle, and because they do not scale well, increasing the pay frequency can drastically increase costs. Illustrative was the momentary expression of horror when, in an interview with a payroll director for a large organization, I mentioned the possibility of moving to a daily payday.<sup>197</sup>

Overall, payroll technology is sufficiently mature to resolve the basic aspect of calculating pay; however, an outstanding issue is the problem of verification and compliance. These processes do not scale well and become increasingly costly with higher-frequency pay.

Moving to money technology, for most employers and employees, transferring money is a largely invisible process. Roughly 87% of households are paid using direct deposit,<sup>198</sup> a money transfer technology that involves the Automated Clearing House (ACH) system. Normally, there are no charges on the employee side; but employers are charged roughly \$0.26–\$0.50 per transfer.<sup>199</sup> Employers also incur an additional administrative cost (in terms of personnel and IT) of \$0.11–\$0.25, suggesting a total cost of \$0.37–\$0.75 per single employee payment for one pay period.<sup>200</sup> These costs are not substantial by themselves, although moving from biweekly to daily payments can increase costs by \$5.18–

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193. *Erwin v. United States*, 591 F.3d 313, 320 (4th Cir. 2010); Hina B. Shah, *Broadening Low-Wage Workers' Access to Justice: Guaranteeing Unpaid Wages in Targeted Industries*, 28 HOFSTRA LAB. & EMP. L. J. 9, 30 (2010).

194. *In re Finestrauss*, 32 A.3d 978, 979 (Del. 2011).

195. See 29 U.S.C. § 216(b) (2018). The liquidated damages can be reduced if the employer shows good-faith and reasonable grounds for underpayment. 29 U.S.C. § 260 (2018). The standard norm, however, is double damages. See *Kinney v. D.C.*, 994 F.2d 6, 12 (D.C. Cir. 1993) (quoting *Walton v. United Consumers Club, Inc.*, 786 F.2d 303, 310 (7th Cir. 1986)).

196. 29 U.S.C. § 216(b) (2018) (“The court in such action shall, in addition to any judgment awarded to the plaintiff or plaintiffs, allow a reasonable attorney’s fee to be paid by the defendant, and costs of the action.”).

197. Interview with anonymous payroll director (Nov. 19, 2019) (details on file with author).

198. FED. DEPOSIT INS. CORP., *FDIC NATIONAL SURVEY OF UNBANKED AND UNDERBANKED HOUSEHOLDS 12* (2017), <https://www.fdic.gov/householdsurvey/2017/2017report.pdf> [<https://perma.cc/239V-XYEF>].

199. ASS’N FOR FIN. PROF’LS, *PAYMENTS COST BENCHMARKING SURVEY 8–9* (2015), <https://www.bottomline.com/application/files/faster-cost-effective-afp-payments-cost-benchmark-survey-gen-us-srr-1510.pdf> [<https://perma.cc/RXY7-26EF>].

200. *Id.*

\$10.50 per two weeks.<sup>201</sup> Even for a minimum wage employee, this is roughly the cost of another hour of work—a real, but not prohibitive, cost.

The problem is the “Other America.”<sup>202</sup> In 2017, 14.1 million adults were unbanked, meaning they did not have either a checking or a savings account.<sup>203</sup> In addition, 48.9 million were “underbanked,” i.e., they were using non-banks for financial products (such as check cashing, payday lending, or money orders) despite having a bank account.<sup>204</sup> As a consequence, 27.6% of households receive some of their payments in a paper check or money order, and 7.9% receive payments in cash.<sup>205</sup> The under- and unbanked are also poorer on average.<sup>206</sup>

Employees not paid via direct deposit are mostly paid by check or money orders—two dated, lengthy, unreliable, and expensive money technologies. For the employer, the simple cost of writing a check is estimated by one source at upwards of \$4 per check.<sup>207</sup> Checks are also physical objects, which add friction and costs related to security and delivery. Even the delivery of checks is unreliable; one employee described her experience: “the checks were delivered by oft-delayed trucks that, living paycheck-to-paycheck, sometimes left her family in dire financial straits.”<sup>208</sup>

Checks must be cashed somehow, and cash checking services flourish around the nation.<sup>209</sup> These services offer immediate money for checks, but because checks are such a slow and unreliable technology, these businesses

201. The range of total costs per-transfer is \$0.37–0.75. Moving from biweekly to daily pay multiplies the number of transactions by (at most) fourteen, giving the estimate above.

In addition, ACH only recently (in 2016) started moving to a same-day process, a transition that is still on going.

202. MICHAEL HARRINGTON, *THE OTHER AMERICA: POVERTY IN THE UNITED STATES* (1962) (documenting the spread of poverty in the United States).

203. FED. DEPOSIT INS. CORP., *supra* note 198, at 1.

204. *Id.*

205. *Id.* at 12. Note that the percentages do not add up to 100% as households may be paid in more than one method.

206. See FED. DEPOSIT INS. CORP., 2011 FDIC NATIONAL SURVEY OF UNBANKED AND UNDERBANKED HOUSEHOLDS 18 (2012), <https://www.fdic.gov/householdsurvey/2012unbankedreport.pdf> [<https://perma.cc/HPZ6-PHVJ>].

207. Vipal Monga, *U.S. Companies Cling to Writing Paper Checks*, WALL ST. J. (Mar. 10, 2014, 7:49 PM), <https://www.wsj.com/articles/u-s-companies-cling-to-writing-paper-checks-1394494772>. Another estimate suggests a per-check cost of \$1.22. See ADAM J. LEVITIN, CONSUMER FINANCE LAW: MARKETS AND REGULATION 348 (2018).

208. Michael M. Oswald & César F. Rosado Marzán, *Organizing the State: The “New Labor Law” Seen from the Bottom-Up*, 39 BERKELEY J. EMP. & LAB. L. 415, 453 (2018). In 1908, a similar report emerged: the “pay car” containing payments was delayed, suspending all of the employees’ monthly pay. *Missouri Pacific Postpones Payday, Gives No Reason*, ST. LOUIS. POST-DISPATCH, Feb. 17, 1908, at 12.

209. Check cashing is not unique to the unbanked. See Michael S. Barr, *Banking the Poor*, 21 YALE J. ON REG. 121, 144 (2004).

assume a considerable risk for their services.<sup>210</sup> A check can be easily forged and, even if authentic, can still bounce. Cash checking services provide a real service, but they charge high rates. One study reports a range of 1.5%–3.3% of the check’s face value.<sup>211</sup> This means that, on average, there is a cost of \$40 *per paycheck* for typical households with full-time workers to even access their earned money.<sup>212</sup> If used regularly over one’s career, the household will spend \$41,600 in fees—money that could otherwise be used to build wealth for retirement.<sup>213</sup> Indeed, some of these fees are avoidable by cashing the check at the bank of issue (i.e., the employer’s bank), but this involves the time and cost of travel to the bank.<sup>214</sup> Getting to the location, safely carrying the check, and waiting in line are non-trivial costs; especially since paydays tend to be synchronized, leading to congestion.<sup>215</sup>

Finally, the use of cash presents its own difficulties. Roughly 8% of households are paid in cash.<sup>216</sup> Paying with cash requires carrying large amounts, which involves administrative overhead. More importantly, the perfect liquidity of cash invites theft risk, both for the employer and for the employee. Carrying large amounts of cash exposes one to risks, and there is little wonder why most people prefer to carry small amounts of cash on their person.

In conclusion, while money technology has improved dramatically over the last century, many employees are still being paid using dated technologies—checks and cash. These dated payment methods impose significant costs, making daily payment prohibitively expensive. While digital money exists and offers important efficiencies, it still has to overcome the under-banking gap and other issues of implementation.

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210. See, e.g., *Beware of Fake Checks*, FED. DEPOSIT INS. CORP. CONSUMER NEWS (Aug. 26, 2019), <https://www.fdic.gov/consumers/consumer/news/august2019.pdf> [<https://perma.cc/EA3N-ZUG> E].

Anecdotally, an online user reported his experience running a check cashing service as “Check Cashing Business is a Big NO . . . . [I]t will ruin you . . . .” V. Sheth, *Answer to “Does Check Cashing Business Bring Good Profit?”*, QUORA (June 20, 2019), <https://www.quora.com/Does-check-cashing-business-bring-good-profit> [<https://perma.cc/H6E9-T8EJ>].

211. Barr, *supra* note 209, at 146–47; see also Robin A. Prager, *Determinants of the Locations of Alternative Financial Service Providers*, 45 REV. INDUS. ORG. 21, 24 (2014).

212. MATT FELLOWES & MIA MABANTA, METRO. POLICY PROGRAM AT BROOKINGS, BANKING ON WEALTH: AMERICA’S NEW RETAIL BANKING INFRASTRUCTURE AND ITS WEALTH-BUILDING POTENTIAL 3 (2008), [https://www.brookings.edu/wp-content/uploads/2016/06/01\\_banking\\_fellowes.pdf](https://www.brookings.edu/wp-content/uploads/2016/06/01_banking_fellowes.pdf) [<https://perma.cc/49G6-F7JC>].

213. *Id.* at 14.

214. Barr, *supra* note 209, at 145 (“[A] large portion of the unbanked manage to avoid paying high costs for at least some of their financial services.”).

215. The concern with congestion is a longstanding one. See, e.g., *Congested Payday*, WASH. POST, May 13, 1941, at 8 (“Residents of Washington . . . always know when payday arrives. For twice each month they are subjected to major and minor inconveniences . . . .”). At one point, President Roosevelt ordered the spreading of payday to twenty days for this reason. *Federal Paydays to Be Increased*, WASH. POST, Oct. 17, 1942, at 1.

216. *Beware of Fake Checks*, *supra* note 210.

### III. ABOLISHING THE PAYDAY

The payday is a common feature of employment contracts. The payday implicates a credit transaction ( $K_2$ ), but this credit transaction is not motivated by the logic of credit. Instead, the investigation of this practice suggests that it owes a large part of its vitality to outdated legislation and money technology. Even the most sympathetic justifications of the payday—those which are rooted in employee psychology—still leave the current arrangements in a poor light.

The goal of this Part is to explain why abolishing the payday and moving to daily streams of payment is critical, valuable, and more effective than some intermediate solutions that are currently being proposed. If abolition initially strikes one as radical, recall that in the nineteenth century, weekly payment systems were already in place<sup>217</sup>—during a time in which one had to do all calculations by hand and transport a chest with coins between work locations.<sup>218</sup> Daily payments are well within reach today.

#### A. *The Stakes of Abolishing the Payday*

Suspending for a moment the *how*, let us consider the implications of abolishing the payday and moving to daily streams of payment.

In the first instance, the current biweekly payday harms workers. True, paying employees more frequently will not make households wealthier, but it will make them more capable of meeting life challenges as they come. Over the last few years, interest rates were at a historic low; but the stakes of abolishing payday will only increase if interest rates revert to their historical rates.<sup>219</sup> Lack of liquidity is associated with a variety of negative health outcomes.<sup>220</sup> Abolishing the payday would help ease some of this pressure. The stress of thinking about how to pay for groceries the next day, whether one should skip the next dentist appointment, or the arguments with one's partner can be alleviated with greater control over one's finances. Indeed, the records from the nineteenth-century move to weekly payments suggest a marked increase in reported employee well-being.<sup>221</sup>

Greater liquidity also allows one to seize opportunities as they present themselves. Some of these opportunities are humdrum, although consequential for one's financial health, like buying discounted items in

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217. See *supra* note 65 and accompanying text.

218. See Redmount et al., *supra* note 70, at 1069.

219. MACROTRENDS, *supra* note 25.

220. See Lorraine T. Dean & Lauren Hersch Nicholas, *Using Credit Scores to Understand Predictors and Consequences of Disease*, 108 AM. J. PUB. HEALTH 1503, 1504 (2018).

221. Redmount et al., *supra* note 70, at 1083.

bulk. Other opportunities can have even larger effects, like buying a ticket to fly out to an interview with another employer. It is perhaps natural for a well-off reader to discount the difficulty insufficient liquidity imposes on life choices, but even the cost of dry cleaning or a haircut can prevent some from attending a job interview.<sup>222</sup>

One potential negative aspect of abolishing payday is that it will restrict credit access to businesses. Firms today borrow at cheap rates through the withholding of pay and abolishing the payday might limit their access to credit, especially if the firm is a small business. This issue should not be overstated. Worker wages should not be an open line of credit. When the firm taps into this source of credit, it exposes workers to the risk of its own bankruptcy, and it imposes on them the costs associated with low liquidity. While Walmart enjoys the float from withholding pay, the costs endured by its employees far exceed this benefit.

Small businesses are often under more severe credit pressures, and for many of them, access to credit is even more essential.<sup>223</sup> This consideration, however, does not mean that workers' wages should be the solution. In fact, it may suggest more caution with exposing workers' wages to business risks. If the small business is over-extended, using unpaid wages to finance operations jeopardizes workers. As a society, we face a basic choice as to who should be the source of liquidity for small businesses—should it be workers with their salaries or sophisticated credit markets, which are capable of evaluating, monitoring, and pricing risk. Keeping the payday to finance business operations is a policy choice that is available to us—but it appears a bad one: workers should not be in the business of lending money to their employers.

Another related negative consequence of abolishing the payday is the elimination of the wage premium associated with it. As discussed, one might expect a wage premium for longer paydays for two reasons. First, the employer receives the benefit of holding (and using) the money until the payday, and second, the employer saves the costs of making more regular payments. Now, for those who think that employees do not receive a meaningful wage premium today for  $K_2$  loans, this consequence is largely irrelevant. Even for those who believe that there may be a wage effect, there is some reason to doubt its magnitude, if not its existence. The single study that evaluated the effect of moving from the monthly payday to the weekly

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222. *A Good Impression Begins with the Way You Dress*, JAILS TO JOBS, <https://jailstojobs.org/free-interview-clothes/> [<https://perma.cc/62LC-8C8F>]; Amelia Ward, *Barber Gives Homeless People Free Haircuts and Trains Them to Work in His Shop*, LADBIBLE (Dec. 21, 2019, 4:55 PM), <https://www.ladbible.com/news/daily-ladness-barber-gives-homeless-people-free-haircuts-and-trains-them-up-20191220> [<https://perma.cc/5PR4-W82D>].

223. Claire Kramer Mills et al., *Growing Pains: Examining Small Business Access to Affordable Credit in Low-Income Areas*, 1 CONSUMER & COMMUNITY CONTEXT 22, 23–24 (2019).

payday—while admittedly dated and incomplete—found that this move actually led to an *increase* in the effective pay and well-being of employees.<sup>224</sup> This is, in part, because workers chose to work more when pay was more frequent. This finding should not be overstated because of various methodological and data issues, but it at least suggests that the effects of abolishing the payday may be more nuanced than what appears at first sight.

Whatever the case might be about the wage premium, daily pay would also have strong positive effects. Most directly, more frequent pay would remove workers from the unnatural position of lending money to their employers. The employer's benefit from retaining this money is more than offset by the worker's need for the money. In a very early decision, the Supreme Court clearly recognized this point: “[t]here [is] certainly . . . an advantage to those who work for a living of a ready purchasing power for their needs over the use of credit.”<sup>225</sup> The lack of purchasing power manifests itself in many ways—most painfully, in the cost of short-credit solutions. The average American has \$5673 in revolving credit card debt,<sup>226</sup> on which they pay 16% APR (\$580 per year, roughly).<sup>227</sup> Credit cards appear cheap relative to the burgeoning installment loans industry, which charges an effective APR of 40%–90%.<sup>228</sup> The installment loans industry serves ten million Americans annually and earns over \$10 billion in finance charges.<sup>229</sup> And this industry is still cheaper than the payday lending industry, which charges a typical 400% APR.<sup>230</sup>

I do not mean to argue that abolishing the payday would abolish either the payday industry or the short-term credit industry.<sup>231</sup> People borrow for many reasons—smoothing consumption, pursuing opportunities, bracing shocks, etc.<sup>232</sup> The demand for short-term credit solutions is based on real

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224. Redmount et al., *supra* note 70, at 1083.

225. *Erie R.R. Co. v. Williams*, 233 U.S. 685, 704 (1914).

226. Jeff Herman, *Average Credit Card Debt Statistics*, CREDITCARDS.COM (July 16, 2019), <https://www.creditcards.com/credit-card-news/credit-card-debt-statistics-1276.php> [<https://perma.cc/9VFQ-X97P>].

227. See Dilworth, *supra* note 52. This is not an exact calculation, as the households do not carry the same balance throughout the year, and it does not account for monthly compounding.

228. PEW CHARITABLE TRS., STATE LAWS PUT INSTALLMENT LOAN BORROWERS AT RISK 2 (2018), <https://www.pewtrusts.org/-/media/assets/2018/10/installment-loansreport.pdf> [<https://perma.cc/6DR5-RB6R>].

229. *Id.* at 1.

230. See *What Is a Payday Loan?*, *supra* note 53.

231. *Cf.* Hawkins, *supra* note 153 (manuscript at 7) (“[E]arned wage advances have the potential to end payday lending . . .”).

232. See Robert B. Nielsen et al., *Consumer Finances of Low-Income Families*, in HANDBOOK OF CONSUMER FINANCE RESEARCH 167, 169 (Jing Jian Xiao ed., 2016) (“Credit can help low-income consumers smooth consumption, invest in human capital, and build assets, but the high cost of credit can crowd out current consumption and saving . . .”).

need, and the lack of liquidity due to the payday is but one of them. Still, there is little doubt that short-term credit solutions are very expensive and can often lead to inescapable debt spirals. Thus, achieving even a meaningful reduction in the *demand* for these services is a worthy social goal. To get a sense of the potential impact, consider the results of a study that examined the effects of an unexpected \$600 tax rebate on payday borrowing. Using a variation in the timing of the rebate, the researchers found a large and marked effect on the demand for payday loans. In their analysis, payday borrowers were roughly 16% less likely to borrow from payday lenders within two pay cycles of receipt of the rebate.<sup>233</sup> This effect, unfortunately, disappeared after two pay cycles.<sup>234</sup>

Another important potential effect of abolishing the payday is that it may also lead to the abolition of the wasteful monthly utility payment practice. As noted, households consume daily but pay monthly. In consuming now and paying later, households are essentially borrowing from utility providers. And of course, this credit transaction comes at a cost; utility providers charge for offering credit services. This credit transaction is artificial; it may be an artifact of the payday itself. With greater liquidity, perhaps service providers can be made to charge households on a daily basis as well. By moving to daily payments, the cost of utilities can decline by what is now the cost of the interest payments that are implicit in the monthly bill. If the technology is ripe—and to a large extent it already is—then the costs of these additional transactions would be trivial. This means that removing this unnecessary credit transaction *may* result in dramatic savings—think about a household that borrows a few hundred dollars every month and its annual cost of doing so, multiplied by almost all households.<sup>235</sup> How much of the savings will actually be passed on to households is an important question, and while there is no reason to assume that all of the savings will be passed to households, there is also no general reason to assume that none of the savings will pass. It is enough for now to note that even if some of the savings will pass, the effect of abolishing the payday on households can be significant.

Overall, paying workers more frequently would have an important positive effect on their well-being and reduce the demand for short-term credit solutions.

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233. Marianne Bertrand & Adair Morse, *What Do High-Interest Borrowers Do with Their Tax Rebate?*, 99 AM. ECON. REV. 418, 422 (2009).

234. *Id.*

235. As noted, millions of households default on utility payments, and the costs of default are spread, at least in part, among all other consumers. *See supra* note 103.



### B. Alternatives to Abolition

At this point, I hope, the question is no longer whether the payday is worth preserving, but rather what the viable alternatives are. As I propose the abolition of the payday in favor of daily streams of payment, I should explain why other more “moderate” solutions are ill-advised.

What is perhaps the leading alternative to dealing with the problem of the payday is the use of wage advances. Today, there is a flurry of activity in this space by Fintech companies that compete over a variety of wage advance solutions.<sup>236</sup> These products go by different names—wages on demand, earned income access, advance wage payment—but they all share a basic structure: the employee is paid ahead of the payday as part of the anticipated pay.<sup>237</sup> The advance is paid by either the employer or a third party which specializes in making advances against the employee’s wages. In a strict sense, these are not really advances, as they mostly apply to *earned* wages. Hence, the employee is not paid *early* but is instead lending *less*. But whatever the terminology, the effect is the same—bridging the gap between earning one’s pay and the payday. Thus, the concentration of activity in this sector is a good indication of the size of the problem of  $K_2$  and vividly demonstrates  $K_2$ ’s inefficiency.

Such advances can offer a response to short-term liquidity shocks, such as a car that suddenly needs a costly repair or an emergency hospital visit. Nonetheless, advances are a flawed, incomplete, and potentially harmful solution to the underlying problem—justified only if deeper solutions are unavailable but otherwise a band-aid for a lost limb.

The central objection is cost. Paying employees in advance involves cost on the side of either the employer or the third-party company. Someone has to hold sufficient capital, handle requests, and create mechanisms to ensure proper deductions come payday. Few would be willing to bear this cost for free.

While Fintech and terms such as “wage on-demand” sound novel, the history of employer advances is longstanding, and it is not wholesome. The first wage payment laws emerged as a response to concerns with “employers that took improper deductions from worker wages or forced them to borrow from employers.”<sup>238</sup> The effect of these issues is reflected in the memorable

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236. See Hawkins, *supra* note 153 (manuscript at 5–6); Nakita Q. Cuttino, *The Rise of “FringeTech”: Regulatory Risks in Early Wage Access*, 115 NW. U. L. REV. (forthcoming 2020) (manuscript at 8) (on file with author).

237. Stephen T. Middlebrook, *What Business Lawyers Need to Know About Wage Advance Products*, AM. BAR ASS’N (Sept. 5, 2019), <https://businesslawtoday.org/2019/09/business-lawyers-need-know-wage-advance-products/> [<https://perma.cc/JJQ9-EWTT>].

238. Willborn, *supra* note 82, at 40.

“Sixteen Tons,” written by Merle Travis in 1946 and modeled after his father’s experiences working in the coal mines:<sup>239</sup>

You load sixteen tons, what do you get?  
 Another day older and deeper in debt  
 Saint Peter don’t you call me ‘cause I can’t go  
 I owe my soul to the company store<sup>240</sup>

To combat abuse, states passed legislation that regularized paydays and limited employers’ ability to deduct fees and interest from employees’ wages.<sup>241</sup> It is not without irony, notes Professor Steven Willborn, that “the payday loan industry had arisen to do almost exactly what employers were doing prior to the state wage-payment laws.”<sup>242</sup>

Today, there is still great regulatory uncertainty regarding advances.<sup>243</sup> While some view these as services that provide the consumer with much-needed credit, others see them as opportunities to profit at employees’ expense.<sup>244</sup> The relevant framework, even at the federal level, is complex— involving the interpretation of the Truth in Lending Act (TILA), the Equal Credit Opportunity Act (ECOA), the Fair Credit Reporting Act (FCRA), the Fair Debt Collection Practices Act (FDCPA), and the Consumer Financial Protection Act (CFPA).<sup>245</sup> Article 9 of the Uniform Commercial Code (UCC) also adds complexity, as it views the sale of accounts (i.e., future payments) as a secured transaction, thus subjecting it to its burdensome framework.<sup>246</sup> Some state laws also require licenses to lend, limit wage assignments, and impose usury limits.<sup>247</sup> This results in a very complex regulatory landscape, and employers explain their reluctance to offer advances in this complexity.<sup>248</sup>

Third-party advance companies are for-profit companies, and they turn a profit by charging fees, commissions, and, oddly, tips. One such product is called Earnin, where users are encouraged to leave a tip of \$0–14 per \$100 advanced; failure to leave a tip is believed to restrict the user’s access to

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239. *Sixteen Tons: The Story Behind the Legend*, TENNESSEE ERNIE FORD, <https://www.ernieford.com/sixteen-tons> [<https://perma.cc/9HSZ-B3GF>]. The song touches on other problems of the time— payment in script and company credit and wage theft.

240. MERLE TRAVIS, *SIXTEEN TONS* (Capitol Records 1947).

241. Willborn, *supra* note 82, at 40.

242. *Id.* at 41.

243. See Cuttino, *supra* note 236 (manuscript at 39–45).

244. For the debate, see Hawkins, *supra* note 153 (manuscript at 36–40).

245. Adam Levitin, *What Is “Credit”? AfterPay, Earnin, and ISAs*, CREDIT SLIPS (July 16, 2019, 1:31 PM), <https://www.creditslips.org/creditslips/2019/07/what-is-credit-afterpay-earnin-and-isas.html> [<https://perma.cc/CG8U-B5T7>] (arguing that, inasmuch as no finance charges are levied, some advance products are exempt from TILA but subject to other forms of credit legislation).

246. U.C.C. § 9-109(a)(3) (AM. LAW INST. & UNIF. LAW COMM’N 2001).

247. Hawkins, *supra* note 153 (manuscript at 15–24).

248. *Id.* at 42, note 142.

cash.<sup>249</sup> A \$14 charge per \$100 is very close to the typical cost of payday lending (\$15).<sup>250</sup> Another study of Fintech companies finds that the average APR ranges from 20% to 145%.<sup>251</sup> It is damning with faint praise to say that these products, “although [expensive] in absolute terms, appear[] clearly superior to [short-term loan] alternatives.”<sup>252</sup>

Some of the costs are less visible. Professor Jim Hawkins recently reviewed the contracts used by market players. He found that despite Fintech companies’ self-attestation to being “concerned with their social impact” and notwithstanding the intense regulatory scrutiny, their contracts are “surprisingly unfriendly” to the consumer.<sup>253</sup> Arbitration, disclaimers of warranties, unilateral contract amendments, and high fees are some of the more common issues.<sup>254</sup> It is highly likely that, even if permitted to operate, purveyors of advances will be held under strict regulation.<sup>255</sup>

Reforming laws to facilitate advances would result in a complicated and costly patchwork of legislation. It is inevitable that some advance companies will go the way of many lenders in the past: resorting to abusive terms, one-sided “mistakes,” and excessive rates. The issue is not so much that companies seek to profit; it is that the problem they seek to solve is an artifact of badly-designed legislation and dated money technology. Treating this problem directly can resolve the liquidity problem directly without requiring the development of a newly-regulated industry. Although the focus should be on eradicating the payday entirely, advance payments are a step in the right direction. They highlight, quite clearly, the unreasonable burden  $K_2$  imposes on workers. They also develop technologies and solutions for regularizing payments. And, to the extent the solutions provided here would take time and political will to implement, wage advances can serve as an interim solution.

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249. Kevin Dugan, *Cash-Advance App Earnin Gets Subpoenaed by NY Regulator*, N.Y. POST (Mar. 28, 2019, 4:09 PM), <https://nypost.com/2019/03/28/cash-advance-app-earnin-gets-subpoenaed-by-ny-regul-ator-source/> [<https://perma.cc/R6MR-N8MJ>] (“Earnin encouraged users to leave a tip of anywhere between zero and \$14 on a \$100 weekly loan. Users who don’t leave a tip appear to have their credit restricted. Meanwhile, a \$14 tip would equate to a 730-percent APR—nearly 30 times higher than New York’s 25 percent cap.”). In evaluating the costs, one should consider the regulatory uncertainty; if it would ever be resolved, one might expect greater competition in this space.

250. CONSUMER FIN. PROT. BUREAU, *WHAT ARE THE COSTS AND FEES FOR A PAYDAY LOAN?* (Jun 15, 2017) <https://www.consumerfinance.gov/ask-cfpb/what-are-the-costs-and-fees-for-a-payday-loan-e-n-1589/>.

251. Todd H. Baker, *FinTech Alternatives to Short-Term Small-Dollar Credit: Helping Low-Income Working Families Escape the High-Cost Lending Trap* 46 (Harvard Kennedy Sch., M-RCBG Associate Working Paper No. 75, 2017), [https://www.hks.harvard.edu/sites/default/files/centers/mrcbg/files/75\\_final.pdf](https://www.hks.harvard.edu/sites/default/files/centers/mrcbg/files/75_final.pdf) [<https://perma.cc/Z8SF-FEDY>].

252. *Id.*

253. Hawkins, *supra* note 153 (manuscript at 23–24).

254. *Id.* (manuscript at 23–31).

255. *Id.* (manuscript at 43–48) (proposing regulation).

#### IV. A WORLD WITHOUT THE PAYDAY

The abolition of the payday requires steps that are far more conservative than the goal might seem to imply. Indeed, while the problems caused by the payday are severe, the solutions are fairly mild. This suggests a low-hanging policy fruit: large effects with small changes—ones that do not risk complex, unanticipated systemic effects. With sufficient goodwill, this policy can be implemented in a very short time span, dramatically improving the welfare of millions of Americans. In this Part, I will present a workable alternative to payday and then move to discuss several complementary ways to implement it. Each method has somewhat different benefits and costs, and much can be achieved even if only some of these methods are implemented.

Let us first reflect on the two most important barriers to regular pay: compliance costs and money technology for the underbanked. Both of these issues create a scale problem: while payroll software can fairly accurately estimate pay, the costs of inadvertent compliance errors are high, thus requiring human supervision and authorization for each payment. Whereas ACH money transfers provide a fairly cheap solution, even with daily payments, it is inapplicable with respect to the unbanked and underbanked who must rely on inefficient alternative money instruments, such as checks.

In consideration of these issues, I propose the following.<sup>256</sup> At the end of each day, employers will be required to pay employees at least 93% of a good-faith estimate of their earned income.<sup>257</sup> The payday will be replaced by an “accounting day,” or a true-up, once every two weeks when the employer must complete a final calculation of the employee’s full earned income for the period. After making this calculation, including all adjustments for unclaimed deductions, bonuses, commissions, etc., the employer will adjust the daily pay to reflect outstanding amounts. If no adjustments are necessary, the employer will pay the employee the daily 7% shortfall, which would come to an extra day’s worth of pay, once every two weeks. As long as the employer makes a good faith estimate of the daily pay, the employer will not be held liable for regulatory compliance issues

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256. The mode of reform can be legislative, but it is worth noting that the Restatement of Employment Law also recognizes the possibility of changes to employment law through the common law. See RESTATEMENT OF EMP’T LAW § 3.01 (AM. LAW INST. 2019) (“[W]age-payment laws . . . do not generally preclude common-law development because they are based on contract principles found in the common law.”).

257. The choice of 93% is meant to create enough reserve to capture a full day’s wage. So if the employee works ten days in a fourteen-day period and earns \$1923, the employee’s daily pay will be \$137.60, and the biweekly adjustment will pay the employee an additional \$134.60.

for daily pay—such liability will only follow if, as is today, the employer fails to pay in full on accounting day.<sup>258</sup>

Under this proposal, employers will not pay their workers their full daily pay but only an estimate of part of it. The reason why employers will not be required to pay in full is grounded in a few considerations. It is very difficult to know the total amounts due to employees, given all the possible deductions, taxes, and levies. Hence, some estimation may be unavoidable, and this means that there will often be errors, either of over- or underpayment. If employers are not afforded some margin of error, that would require them to carefully review each payment—and the costs of doing so daily may be prohibitive.<sup>259</sup> Another important consideration is that it is arguably harder for the employer to collect money owed from the employee than vice versa, given the greater mobility of the employee and lack of collateral. Leaving 7% of the income to the last day of the fourteen-day period is calculated to create a buffer that, on the one hand, allows the employee to keep most of the daily pay and, on the other hand, accounts for potential errors in daily estimates. Subject to further experimentation, this margin should be sufficient to allow employers to make offsets against mistakes in overpaying employees.<sup>260</sup> It also means that the employee is receiving on the last day of the biweekly period an extra day's pay (which is deducted from their on-going payments). The extra paycheck may appeal to those who think employer-based budgeting is helpful.

The design of biweekly pay is meant to address two concerns: wage monitoring and compliance-cost control. Wage theft is an important concern, and monitoring daily payments may be harder than monitoring the transfers of larger lump sums.<sup>261</sup> Of course, once the employee grows accustomed to daily pay, he or she could detect deviations by comparing actual payments to normal payments. Still, with possible daily fluctuations, deviations are harder to detect. To deal with this problem, on accounting day, the employer would produce a pay stub that accounts for all of the biweekly payments. The employee can then compare this amount to amounts paid, just as easily as can be done today.<sup>262</sup> The second function is controlling compliance costs. As noted, a large part of the cost of making

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258. Given the predictability of pay for most professions and the low profit from underpaying every day, this duty is not expected to generate considerable friction or litigation.

259. See *supra* Part II.G. (discussing costs of payroll).

260. In most industries, a much smaller buffer would be needed—and perhaps no buffer is even needed for salaried employees with fix wages. Still, it is prudent to start with a moderate buffer in experimenting with the implementation of this proposal.

261. On wage theft, see *supra* note 158 and accompanying text.

262. It may be necessary to add in the bank's user-interface support for easy comparisons of employer-pay per wage period. Such technology is already implemented in the apps and websites of most banks, which allow users to filter deposits by recipient per period.

payments is due to the need to verify compliance with a variety of different laws. Because the final accounting is only done once every two weeks, the employer would not need to engage in more compliance than it does today, besides the fairly trivial calculation of 93% of the expected daily pay. Note that the employer does not bear liability for small or unintentional deviations, making it unnecessary to verify daily payments with the same degree of attention as the biweekly pay.

One remaining issue is the control of money-transfer costs. As noted, this is not an issue for the majority of workers, who are banked and can benefit from ACH transfers, but it is still a pressing and painful issue for the under- and unbanked. The solution here is technological, and I explore in greater length the use of pay cards as a viable solution to this problem.<sup>263</sup> In addition to pay cards, others have proposed non-technological alternatives, such as postal and public banking, which can also mitigate these issues.<sup>264</sup>

An optional addition to this proposal would be to allow employees to elect a biweekly payday. That is, the daily pay would be presented as an option alongside biweekly pay, and employees could elect which payment option they prefer. In terms of preserving employee choice, this would seem superior, as those employees who find biweekly pay more manageable would elect it. Such a choice may be preferred by some—if the worker has no need for liquidity or finds it difficult to budget otherwise. But for the reasons I laid out earlier, I believe employer-side savings is a bad idea due to the counterparty risk.<sup>265</sup> If employees need help budgeting, bank-side savings programs are a superior alternative. And if employees want to lend money, they can always do so in explicit capital markets, where there is more robust competition for their money. Hence, there is legitimate concern that presenting this option may be a trap for the unwary and will serve little other function.<sup>266</sup>

The final part of this proposal is that it envisions a transition and experimentation period. Wages and payments are systemic issues; they affect every part of the economy. The urgent need for reform should be tempered with patience and understanding that immediate implementation may be harmful. Instead, an announcement of a target date for daily pay in a few years, perhaps coupled with a transition to weekly pay, is likely the most prudent course of action.

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263. See *infra* Part I.D.

264. The U.S. postal banking system was abolished in 1966. On its history and for a proposal to reinstate it, see MEHRSA BARADARAN, HOW THE OTHER HALF BANKS 183–226 (2018); see also *Postal Banking: Know the Facts*, CAMPAIGN FOR POSTAL BANKING, <http://www.campaignforpostalbanking.org/g/know-the-facts/> [<https://perma.cc/GW9R-XJKB>].

265. See *supra* Part I.E.

266. A more compelling reason to favor biweekly pay is if the check-cutting costs are high, the employee could be paid more by being paid less frequently. However, this is a transitional issue until the money and payroll technology are sufficiently advanced.

Implementing this reform would require some legislative changes. The key changes are focused on changing labor laws that impede more frequent pay; changing our money infrastructure; improving market education; and changing the market by leadership. Each of these interventions, summarized in the Table below, is developed in the following subsections:

<i>Promoting Frequent Pay</i>		
Method	Type of Change	Notes
Information	Demand-side pressure by making implicit interest transparent	Least intrusive
Leading/flat	Changing legislation to encourage and mandate frequent pay	Requires political will but can have cascading effects
Fixing employment law	Removing inadvertent incentives to reduce pay frequency	Requires political will but involves relatively few partisan issues
Money technology	Making payments cheaper, especially to the underbanked	Long-term investment with positive externalities

#### *A. Changing by Information*

One reason why the payday persists is related to the employer's power in employment negotiation. Perhaps employees are insufficiently aware of the credit nature of  $K_2$ . If that is the case, employees would also be unaware of the true cost of  $K_2$  and would not demand an appropriate wage premium. This imbalance of information or sophistication tilts the balance in favor of the employer and leads to inefficiently infrequent pay periods.

This idea—that individuals misprice credit transactions—is a central impetus for the enactment of TILA. Congress diagnosed that consumers engage in “uninformed use of credit” and prescribed “meaningful disclosure of credit terms.”<sup>267</sup> By conspicuously disclosing credit terms using a uniform standard, TILA hopes to improve consumer finance decisions.<sup>268</sup>

267. Truth in Lending Act § 102(a), 15 U.S.C. § 1601(a) (2018).

268. See generally Hosea H. Harvey, *Opening Schumer's Box: The Empirical Foundations of Modern Consumer Finance Disclosure Law*, 48 U. MICH. J.L. REFORM 59 (2014).

The logic of TILA can be brought to bear on payday.<sup>269</sup> If employers want to borrow money from employees through the payday, they might be required to disclose the fact that payday is a credit transaction. This can be done in the written employment contract or in a separate disclosure. More importantly, the employer might be required to display the (implicit) interest rate in this transaction. Using the same language as that used when consumers borrow—the so-called Schumer’s Box—the employer will be required to disclose how much the employee receives in exchange for the extension of credit. This disclosure would allow workers, subject to the general caveats about disclosure in general,<sup>270</sup> to better understand the meaning of the credit element of the payday and to “shop” effectively—that is, to understand how pay frequency compares to the cost of borrowing from other sources and choose, if given the option, a shorter pay period. The following figure illustrates using a typical employee who earns \$1923 biweekly.<sup>271</sup>

Figure 3 – An Illustration of “Schumer Box”

Interest Rates and Interest Charges			
Annual Rate for Biweekly Pay	Percentage (APR) for	5%	This the amount of interest paid to you. Compare to your cost of borrowing.
Biweekly Charges to Employee	Interest Paid to	\$4	This is the amount of interest the employer pays you for delaying your payments by two weeks
Total (Biweekly)	Wage	\$1923	\$1919 base + \$4 interest

The use of disclosure also has one substantive implication in the context of the minimum wage. If an employer borrows money, it should identify the portion of the pay that is the wage premium. The remaining pay is the pay-for-work portion of the wage paid to the worker. A prolonged pay period undercuts the minimum wage obligations of the employer; paying \$7.25 hourly with a daily payday is not the same as paying it monthly. In the latter case, the effective pay is much lower, and the employer is arguably failing to meet the minimum wage obligations, at least in spirit. That federal legislation does not account for this difference suggests a serious blind spot, even among legislators and judges. Once advertised, courts could start

269. For illustration, see Figure 2 in Part I.C, which illustrates how effective pay is comprised of both per-hour wages and frequency of payments.

270. See generally Yonathan A. Arbel & Andrew Toler, *All-Caps*, J. EMPIRICAL LEG. STUD (forthcoming 2020) (providing evidence of the failure of the most common mode of conspicuous disclosures, disclosure via all-caps).

271. Wage data based on *Measures of Central Tendency for Wage Data*, SOC. SEC. ADMIN., <https://www.ssa.gov/oact/cola/central.html> [<https://perma.cc/QM3L-FENF>].



paying better attention to determine the proper baseline envisioned by the FLSA—is it daily pay, weekly pay, or something else?

### *B. Changing by Leading*

Another potential explanation for the persistence of the payday is that government employees are paid biweekly.<sup>272</sup> Social norms can have a significant effect on market outcomes, and if the government declares a certain pay period to be the standard, then this pronouncement might have downstream effects on private employers.

If this explanation carries any explanatory power, it opens the road to straightforward intervention. Under Title 5 of the United States Code, all federal employees are to be paid once every two administrative workweeks.<sup>273</sup> This period could be changed to a daily payment of 93% of the daily pay, subject to a biweekly accounting. Notably, the change will not infringe on any employee's rights. Nor will this reform require large substantive changes. Admittedly, changing federal legislation is not easy, and I do not mean to discount the political and procedural challenges, especially because state law is so diverse and will also have to be amended. However, the importance of the goal and its non-partisan nature promise some optimism.

### *C. Fixing Employment Law*

One impediment to abolishing the payday is, ironically, minimum wage legislation. As I have noted, the FLSA makes employers average the minimum wage payments over the entire pay period.<sup>274</sup> This incentivizes employers to extend the pay period as much as possible so they can benefit from averaging. If a tipped employee is making above minimum wage in week one and below minimum wage in week two, the employer could avoid compensating the employee for week two by setting a biweekly payday. We also saw that overtime legislation, at least in theory, does not have this flaw.

The faulty legislative design opens the door to a number of potential interventions. The key to all of these options is to divorce the averaging period from the pay period. Hence, the option with the least effect on the status quo would permit employers to choose their accounting periods. The accounting period would substitute today's payday and would be the day on which the employer will average the employee's pay and see if any amounts

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272. See *supra* Part I.F.

273. 5 U.S.C. § 5504(a) (2018).

274. See *supra* II.F.

are still due to meet the minimum wage requirement for the accounting period. The length of the accounting period could be regulated by the same limitations set today by state legislation on pay periods. This way, the employer would pay the employee each day of the week and then, come accounting day, make sure that a minimum wage was paid. If there was any shortfall in payments, the employer would add it to that day's pay. Over a two-week period (or however long the accounting period is) the employee would be paid *the exact same amount* the employee would have been paid under the payday—but at more frequent intervals. This aspect of the proposal means that neither employee nor employer rights are harmed by this transition, yet the indignities of the payday are avoided.

Similarly, overtime legislation should divorce pay frequency from the definition of who is a salaried employee; there is no reason to tie the definition to the (in)frequency of pay.<sup>275</sup> A daily-paid employee can equally be salaried or unsalaried, and the frequency of pay need not reflect on this determination.

Finally, employers' compliance with wage and hour laws should be evaluated at the accounting period. Thus, if an employer makes a compliance error on a specific day, this should not be a cause for a lawsuit. The goal is to reduce ongoing compliance costs, and allowing lawsuits to proceed based on random errors would undermine this goal. At the same time, employers are still under a duty to make a good-faith estimate of the 93% pay the employee deserves. This means that employers do not have a *carte-blanche* right to underpay employees daily. While one-off or even occasional mistakes should not be grounds for a lawsuit, the employee should be allowed to sue for systematic mistakes if they are done in the employer's favor. Hence, the proposal does not derogate in any way from minimum wage laws or overtime laws under the status-quo; it neither increases pay nor reduces it. The only effect is on pay frequency.

#### *D. Improving Money Technology*

Transferring money is more difficult than would appear at first glance. I have already noted the various costs associated with bank transfers, the difficulty of storing and handling cash, and the many costs of writing and liquidating checks.<sup>276</sup>

Digital money is clearly the future, and, to a growing extent, it is the present.<sup>277</sup> In particular, employers are now increasingly using payroll

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275. If one believes that this definition tracks any meaningful practical distinction, it is possible to use the accounting period instead of the current pay period as the measure of the period.

276. See *supra* II.G.

277. An estimated 4% of Americans hold only a prepaid card. Analysis based on data presented in Bricker et al., *supra* note 5, at 18–19.

cards.<sup>278</sup> A payroll card is akin to a debit card and is issued by a bank or another financial institution. The account is not attached to any depository account, and thus, the card owner is spared the cost and difficulty of opening a bank account. Instead, the owner charges the card against the available balance. In 2017, roughly 3.4% of households reported receiving income with a payroll card,<sup>279</sup> and one projection estimates a \$50.9 billion-dollar market in 2021.<sup>280</sup> In 2015, nineteen state governments were already using payroll cards,<sup>281</sup> and one survey suggests that seven million workers were using them in 2014.<sup>282</sup>

Payroll cards are convenient and safe, and they allow the immediate use of the funds paid. Importantly, the employee does not have to have a bank account to use a payroll card. This means that one's creditworthiness and legal status are not hurdles. Moreover, the employee need not maintain a minimum balance in his or her bank account or pay fees. The cost of depositing funds is also reportedly low: \$0.35 in deposit costs.<sup>283</sup> It is not surprising, then, that many low-paid employees view payroll cards positively.<sup>284</sup>

There are also various concerns with payroll cards, many of which will be familiar to users of bank accounts.<sup>285</sup> One concern is the insurance of amounts deposited on these cards—what prevents a “run on the card”? Then there is the issue of fees: ATM-use fees, point of sale fees (i.e., a transaction fee), overdraft fees, and even balance inquiry fees.<sup>286</sup> By one estimate, the

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278. On the other hand, a survey by the FDIC found that usage of prepaid cards by households ranged between 7.9% (2013), 9.8% (2015), and 9.2% (2017). FED. DEPOSIT INS. CORP., *supra* note 198, at 7. 9.2% of households using a prepaid card reported receiving it as a payroll card. *Id.*

279. *Id.* at 12.

280. *What Percentage of the Prepaid Market Are Payroll Cards?*, PAYMENTS JOURNAL, (Sep. 16, 2019), <https://www.paymentsjournal.com/what-percentage-of-the-prepaid-market-are-payroll-cards/> [<https://perma.cc/2KNU-PXAP>].

281. NAT'L CONSUMER LAW CENTER, RATING STATE GOVERNMENT PAYROLL CARDS 3 (2015), <https://www.nclc.org/images/pdf/pr-reports/payroll-card-report.pdf> [<https://perma.cc/WY33-A8MW>].

282. Gregg Gelzimis et al., *How Workers Get Paid Is Changing: Consumer Protections Need to Catch Up*, CTR. FOR AM. PROGRESS (Jan. 17, 2019, 12:01 AM), <https://www.americanprogress.org/issue/economy/reports/2019/01/17/465223/workers-get-paid-changing-consumer-protections-need-catch/> [<https://perma.cc/DN9K-NJD5>].

283. N.Y. STATE ATT'Y GEN., PINCHED BY PLASTIC: THE IMPACT OF PAYROLL CARDS ON LOW-WAGE WORKERS 3 (2014), <http://www.ag.ny.gov/pdfs/Pinched%20by%20Plastic.pdf> [<https://perma.cc/9EG4-9DVC>].

284. Oswald & Marzán, *supra* note 208, at 453.

285. Payroll cards do not bear interest, but given the typical rates in checking accounts, this concern is of little practical consequence. See Liran Haim & Ronald Mann, *Putting Stored-Value Cards in Their Place*, 18 LEWIS & CLARK L. REV. 989, 1008 (2014).

286. *Id.* at 1009–18.

average per-employee fees were \$5 to \$11 per month.<sup>287</sup> To make things worse, the fees are badly disclosed,<sup>288</sup> among other concerns.<sup>289</sup>

Federal legislation partially covers payroll cards. Under the Electronic Fund Transfer Act (EFTA) and Regulation E,<sup>290</sup> financial institutions that offer payroll card accounts must make account information available to consumers by specific means, but they are exempted from providing periodic statements.<sup>291</sup> In addition, the financial institution must allow consumers to report errors and limit customers' liability for unauthorized transfers.<sup>292</sup> In April 2019, a new CFPB rule came into effect, expanding the fraud, error, and unauthorized charges protections to these cards; requiring simplified disclosure; and providing for easy access to information.<sup>293</sup> State legislation in this area is developing. Roughly half of the states have some laws that regulate payroll cards.<sup>294</sup> The regulations usually permit the use of these cards but impose some limits on fees and set rules on proper fee disclosure.<sup>295</sup> Finally, a series of class actions were filed against employers who offered payroll card programs for failing to obtain employee consent and for violating wage and hour laws.<sup>296</sup> In one of these cases, a court in Pennsylvania ruled that the mandatory use of pay cards that impose fees is illegal.<sup>297</sup>

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287. Stephanie M. Wilshusen et al., *Consumers' Use of Prepaid Cards: A Transaction-Based Analysis*, FED. RES. BANK OF PHILADELPHIA 41 (Aug. 2012), <https://www.fdic.gov/news/events/consumersymposium/2013/papers/wilshusen.pdf> [<https://perma.cc/7ASE-96DR>].

288. Haim & Mann, *supra* note 285, at 1014.

289. Jessica Silver-Greenberg & Stephanie Clifford, *Paid Via Card, Workers Feel Sting of Fees*, N.Y. TIMES (June 30, 2013), <https://www.nytimes.com/2013/07/01/business/as-pay-cards-replace-pay-checks-bank-fees-hurt-workers.html> [<https://perma.cc/7D6C-T39D>].

290. Electronic Fund Transfer Act, 15 U.S.C. § 1693 (2018); Prepaid Accounts Under the Electronic Fund Transfer Act (Regulation E), 12 C.F.R. § 1005 (2018).

291. FED. RESERVE, ELECTRONIC FUND TRANSFER ACT 18, <https://www.federalreserve.gov/boarddocs/caletters/2008/0807/08-07attachment.pdf> [<https://perma.cc/XL2T-72P5>].

292. FED. RESERVE, REGULATION E: ELECTRONIC FUND TRANSFER ACT 6 (2013), <https://www.federalreserve.gov/boarddocs/supmanual/cch/efta.pdf> [<https://perma.cc/48JL-EHDY>].

293. *See generally* CONSUMER FIN. PROT. BUREAU, PREPAID ACCOUNTS UNDER THE ELECTRONIC FUND TRANSFER ACT (REGULATION E) AND THE TRUTH IN LENDING ACT (REGULATION Z), [https://files.consumerfinance.gov/f/documents/20161005\\_cfpb\\_Final\\_Rule\\_Prepaid\\_Accounts.pdf](https://files.consumerfinance.gov/f/documents/20161005_cfpb_Final_Rule_Prepaid_Accounts.pdf) [<https://perma.cc/39SE-Z67J>].

294. Rachel Blakely-Gray, *Pay Card Laws by State and Regulations*, PATRIOT SOFTWARE (June 5, 2019), <https://www.patriotsoftware.com/payroll/training/blog/pay-card-laws-by-state/> [<https://perma.cc/KMQ8-LHAG>].

295. *See generally id.* (surveying state laws); *see also* Sarah Jane Hughes & Stephen T. Middlebrook, *Are These Game Changers? Developments in the Law Affecting Virtual Currencies, Prepaid Payroll Cards, Online Tribal Lending, and Payday Lenders*, 70 BUS. LAW. 261, 265 (2014).

296. *See, e.g.*, Joint Stipulation of Class Action Settlement and Release at ¶¶ 42, 47, *Chavez v. PVH Corp.*, No. 13-CV-01797-LHK (N.D. Cal. Dec. 18, 2015); First Amended Complaint at ¶¶ 1–4, *Lapan v. PVH Corp.*, No. C 13-05006-YGR (N.D. Cal. Dec. 9, 2013); Plaintiffs' Original Petition at ¶¶ 14, 16, 19, *Branson v. Destiny Foods, Inc.*, No. D-1-GN-14-001131 (419th Judicial District Court of Travis County, Tex. May 13, 2014).

297. *See Siciliano v. Mueller*, 149 A.3d 863 (Pa. Super. Ct. 2016).

Facilitating the use of payroll cards is an important step towards the abolition of the payday. The recent CFPB regulation offers an initial framework, safeguarding certain employee rights, although more experimentation is needed.<sup>298</sup> Still, the fragmented nature of state legislation impedes much innovation.<sup>299</sup> Admittedly, it is difficult to design a fee structure that would make payroll cards profitable to operate and yet not encumber poor households with additional expenses. Still, others have made the case that increasing access to banking through public subsidies can be justified both as a matter of redistribution and efficiency.<sup>300</sup>

Against this regulatory backdrop, positive steps can be taken to promote payroll cards, at least for an initial period of adoption, such as offering certain tax subsidies or requiring all employers to offer this option.

A less obvious hurdle in the way of payroll cards is pro-employee regulation that mandates that employers offer the choice of payment methods. The Electronic Fund Transfer Act and Regulation E prohibit employers from forcing employees to receive wages via pay card.<sup>301</sup> New York law requires employers to obtain advance written consent to pay employees with payroll cards.<sup>302</sup> This choice creates unanticipated problems: if, when setting a daily payday, employers must pay some employees in cash or check, this cost could be significant. Employee choice, then, can undermine the viability of payment streams.

The solution, however, is straightforward. The daily pay option can be made open only to employees who are willing to use pay cards or bank transfers. Relative to today, where all employees are paid on long intervals, employees who favor cash will not be harmed by having this additional option. But for all other employees, this option would greatly advance their wellbeing.

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298. See Haim & Mann, *supra* note 285, at 1014–19.

299. See Benjamin Lo, *Fatal Fragments: The Effect of Money Transmission Regulation on Payments Innovation*, 18 YALE J. L. & TECH. 111 (2016).

300. Barr, *supra* note 209, at 237 (“[N]etwork externalities in electronic payments systems and distribution networks suggest that net social benefit could be obtained through further expansion.”).

301. See Letter from Richard Cordray, Dir., Consumer Fin. Prot. Bureau, to Sen. Richard Blumenthal, Sen. Charles E. Schumer & Sen. Joe Manchin, III (Sept. 12, 2013), <http://goo.gl/KOqFzB> [<https://perma.cc/3KCJ-2QSN>]; CONSUMER FIN. PROT. BUREAU, CFPB BULLETIN 2013-10: PAYROLL CARD ACCOUNTS (REGULATION E) 1–2 (Sept. 12, 2013), <http://goo.gl/98d8I6> [<https://perma.cc/FM77-RZJS>].

302. N.Y. LAB. LAW § 191 (McKinney 2007). See also Letter from Maria L. Colavito & Jeffrey G. Shapiro, N.Y. STATE DEP’T OF LABOR (Oct. 29, 2009), <https://labor.state.ny.us/legal/counsel/pdf/Direct%20Deposit%20of%20Wages/Payroll%20cards%20Letter%2010-29-2009.pdf> [<https://perma.cc/57T7-D4ZY>].

#### V. THE DAY AFTER PAYDAY: CONCLUDING THOUGHTS

A complicated dynamic of dated legislation, path-dependence, and inefficient money technology has contributed to the economy-wide practice of paying employees in arrears. This dynamic puts employees in the absurd position of lending money to their employers.

This feature of the modern economy is clearly a software problem, not a hardware problem. We can, and should, pay workers in at least the same frequency we pay overseas vendors. Instead, our antiquated system of payments creates significant financial stress, leading households to borrow from payday lenders and other providers of short-term credit products.

Abolishing the payday might take time, as it will face resistance. No change is easy. However, the case for paying people for their work is too compelling to ignore. Paying employees late may have made sense when we had to compute wages by hand and carry coin chests between worksites. But it makes little sense when sending digital money has become so ubiquitous that our vocabulary includes new verbs to describe instantaneous money transfers—e.g., “I will Venmo you the money tomorrow,” and “I just Paypaled you.”

With our new hardware, it is time to update our legal software.