

Why pay extra? Tipping and the importance of social norms and feelings in economic theory

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Abstract

Tipping is a multi-billion-dollar phenomenon that standard economic models find hard to explain. I discuss several aspects of tipping and divide tipping to six different categories: reward-tipping, price-tipping, tipping-in-advance, bribery-tipping, holiday-tipping and gift-tipping, and discuss the economics of each category. Often tipping has economic justification, because it solves some inefficiency and increases welfare. Analyzing the potential reasons for tipping illustrates the importance of social norms and feelings (e.g. embarrassment and unfairness felt when one does not tip) in motivating economic behavior. Retaliatory behavior that workers sometimes exhibit towards non-tipping patrons is then discussed, and ideas for future research are proposed.

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Introduction

The tipping custom is a challenge to standard economic modeling. People in numerous countries and in many situations leave tips voluntarily after the service was already rendered. This raises the puzzle why they leave money to strangers when they are not legally obligated to do so and do not derive a material benefit from it. The answer to this puzzle is important not only to understand why people tip, but also because of the insights it may suggest about other economic phenomena that result from social norms and feelings, such as donations and gift giving.

While recently the profession has become more receptive to the idea that utility of individuals may depend on social norms and feelings (e.g. Elster, 1989 and 1998; Rabin, 1998), models that incorporate social norms or feelings in the agent's utility are still controversial. Many economists criticize such models, arguing that if we allow the agents to care about social norms and feelings, we can explain everything. Tipping, however, shows that ignoring norms and feelings may lead to false predictions: Ben-Zion and Karni (1977), for example, obtain the result that tipping is consistent with self-interest seeking behavior only in the case of repeated customers. That is, ignoring social norms and feelings, we should expect one-time customers never to tip; this contradicts the behavior we observe in practice: most people tip regardless of whether they plan to patronize the establishment again. I hope that knowing more about tipping may convince additional scholars that feelings and social norms are important in explaining certain economic behaviors.

While the insights for general economic theory are already a sufficient reason to know more about tipping, tipping is also an important economic phenomenon by itself. Tips in US

restaurants alone are around \$27 billion each year (Azar, 2004a), and tipping is common in other industries and additional countries, so annual worldwide tips are likely to be a much bigger figure. In addition, millions of workers in the United States alone derive a significant portion of their income from tips.

Tipping is closely related to psychology, since the reasons why people tip are mainly psychological; indeed, most of the empirical research about tipping was done by psychologists. Yet, tipping is certainly an adequate topic for economic research. First, it is an economic transaction in which service is provided and paid for. Second, tipping has implications for different areas in economics: since tips are a major source of income for millions of workers, it has implications for labor economics. It is obviously related to the literature about social norms and economics, as well as to behavioral economics. Moreover, tips serve as a mechanism of consumer monitoring that provides incentives for higher service quality. The firm, in turn, can choose its monitoring intensity given that some monitoring is already done by the consumer, and can also choose between service charges and tips. These are examples for industrial organization and management strategy issues that tipping raises.¹

Better understanding of tipping can also help to address several policy questions. Should tipped workers receive minimum wages in addition to tips? Should their total income from tips and wages be at least equal to the minimum wage? Should tips be taxed differently than other sources of income, and which enforcement mechanisms can be used to ascertain that tip income is reported? Making the correct decisions requires an understanding of the tipping custom.

¹ The interested reader can find a more detailed discussion of the implications of tipping for various areas in economics and management in Azar (2003a).

From the firm's perspective, other questions arise. Take for example the case of restaurants. In addition to the choice of monitoring intensity and whether to impose service charges, as mentioned above, the firm may base the promotion of waiters on their tip income. Is such practice recommended? Should the firm invest in screening applicants for tipped jobs, or let tips screen the bad performers (who will earn low tips and quit)? In another context, can a firm that posts intellectual property on the Internet count on collecting revenues by means of tips, as was suggested by Woodhead (2000)? Once again, knowledge about tipping is a prerequisite to answer these questions correctly.

In what follows, the article discusses several important aspects of the social norm of tipping in an attempt to encourage the reader to think more about this interesting topic and potentially to contribute to the growing literature in the area. It also divides tipping to six different categories and analyzes the differences between the different types of tipping. The article gives special attention to the question why people tip, which is one of the major questions about tipping. The focus is on restaurant tipping, which is the most common tipping occasion; most of the ideas, however, are relevant for other tipping situations as well.

The tipping custom

The uniqueness of tipping compared to gift-giving and donations

Standard economic modeling assumes that consumers give up money only when they receive goods or services in return, in order to maximize utility subject to limited resources. The tipping custom violates this assumption, since consumers voluntarily pay more than they are legally obligated to. There are other examples for behaviors that violate this assumption, for example gift-giving and donations. However, gifts are usually given to family and friends, and

donations are often accompanied by naming a certain building or institution after the donor, or putting the donor's name on a list of contributors. Tips, however, are given to strangers, and result in no public recognition. Therefore, while the utility that people derive from emotions and from conforming to social norms is the main reason for these three behaviors, each has its unique characteristics. Gift-giving can be explained by the utility from having good relationships with family and friends and sometimes from the giver's utility being a function of the receiver's utility level (for example when a parent gives a present to his child, the parent is likely to derive utility from the happiness the gift brings to the child). Donations might be explained by the utility from pride and social status. Tipping, however, results from other reasons, which are discussed in more detail later on.

The magnitude of tips

Tipping is interesting not only because of its unique nature, but also due to its economic significance. As was mentioned before, estimated tips in US restaurants alone are about \$27 billion annually. Adding tips in other establishments such as hotels and taxis, and in additional countries obviously results in a much higher figure.

Moreover, not only the amount of tips is significant, but also the number of people for whom tips are crucial is large. In the United States alone in 2000 there were 192,342 full-service restaurants and 50,578 drinking places (of alcoholic beverages), employing 3,897,100 and 328,600 employees, respectively (U.S. Census Bureau, 2002, Table 1249). Most of these employees derive a significant portion of their income, often more than half, from tips (see Wessels, 1997). Moreover, tipping is common in many establishments except restaurants: Lynn, Zinkhan and Harris (1993), for example, considered 33 service professions that are tipped.

The origins and purpose of tipping

There are a few versions for the origin of tipping. Hemenway (1993) claims that tipping was known as far back as the Roman era and is probably much older. Schein, Jablonski and Wohlfahrt (1984) assert that tipping originated back in the days of feudal lords. When lords met groups of beggars along their way, they tossed the beggars coins in an attempt to buy a safe passage (it is arguable whether this sort of payment should be treated as tipping, however). Segrave (1998) suggests that tipping may have begun in the late Middle Ages. A master or lord of the manor might give his servant or laborer a few extra coins, from either appreciation of a good deed or compassion (for exceptional hardship arising from a large family, illness etc.). Brenner (2001) attributes the origin of tipping to England of the 16th century, where brass urns with the inscription “To Insure Promptitude” were placed first in coffee houses and later in local pubs. People tipped in advance by putting money in these urns. Frankel (1990) suggests a similar origin, London coffee houses, where customers who wanted special service dropped a coin in advance in a box labeled T.I.P. (To Insure Promptness). Frankel, however, dates the origin of tipping as the late 1700’s. The history of tipping after its origination is also very interesting and is described in detail elsewhere (Segrave, 1998; Azar, 2004b).

How has the custom survived so long? The common wisdom of economists suggests that tipping exists today because it is the most efficient way of monitoring and rewarding the efforts of service workers, since firms find it difficult to monitor and control the quality of intangible and highly customized services that are rendered by their employees (Lynn and McCall, 2000; Bodvarsson and Gibson, 1997). However, while this argument might suggest that tipping is socially desirable, it does not explain why people tip.

Income tax and tips

Another potential explanation for the prevalence of tips (compared to the alternative of a fixed service charge, for example) stems from tax reasons. In the United States, people have to report tip income for tax purposes, but in practice a big portion of this income is not reported. According to Hemenway (1993), the only type of revenue with a lower compliance rate is illegal income. The ability not to report tip income for tax purposes gives an incentive for waiters, and therefore also for restaurant owners (who compete for the good waiters) to prefer tipping to a fixed service charge. This incentive, however, is being eroded by the increasing usage of credit cards, since the Internal Revenue Service (IRS) can trace tips paid with credit cards. In addition, the IRS makes an effort to identify and evaluate unreported tip income, making tax evasion harder and more risky. Recently, the Supreme Court affirmed the legitimacy of using estimates by the IRS in order to catch unreported income (The New York Times, 2002).

I am not aware of any examination of the relationship between the easiness of evading tax on tips and the prevalence of tipping. Research on this topic may be very interesting. Comparisons can be made both across countries and across time. For example, one can examine the prevailing tax rates, tax laws about tips, enforcement level, punishment of tax evaders and usage of credit cards, and compare them to the number of occupations being tipped and the prevalence of service charges as a substitute for tips. Such research can show whether tax incentives are an important reason for the prevalence of tipping or not. This in turn can help to determine what is the optimal tax policy towards tips. For example, if tipping is desirable because it prevents the need for costly monitoring by employers, such research can suggest to what extent lower tax rates on tips can promote tipping.

Controversy about tipping

Even though tipping is ubiquitous in the United States (and in many other countries as well), it remains a controversial issue. Many people are not willing to give up their discretion about the tip, while others would be happy to replace tipping with service charges because they find the custom annoying. The first group wants to retain control over how it awards service workers, and often claims that tips indeed improve service quality significantly. The second group finds it annoying to compute the tip and to remember what is the appropriate tip in different situations. In addition, sometimes tipping has to be done in a skilled and discreet way, such as when tipping a maitre d', causing people to fear that they do not tip appropriately. In an on-line poll in a website dedicated to tipping, one of the questions was "Would you tolerate higher prices at a restaurant in order to do away with tips?" By January 25, 2004, out of 2143 voters, 25% answered positively, 57% negatively, and the rest answered "Maybe" or "Unsure."² While the majority prefers to retain the custom, a substantial portion of the population would prefer to abolish it.

Opposition to the tipping custom is not new: in United States of early 20th century many people opposed tipping so strongly that seven states passed anti-tipping laws between 1909 and 1918. All those laws were repealed by 1926, however (Segrave, 1998). Yet, despite the significant opposition to tipping, most people tip in US restaurants (Bodvarsson and Gibson, 1997).

² See <http://www.tipping.org>.

What is the norm?

The norm regarding the appropriate tip changes across occupations and countries, and sometimes across establishment levels (for example, staying at a hotel requires tipping much more than in a motel, and tips in upscale restaurants are a little higher than in family-style restaurants). Several books were written about how much is appropriate to tip in different occasions and in different countries (e.g. Frankel, 1990; Star, 1988; Schein, Jablonski and Wohlfahrt, 1984), and most etiquette books include information about appropriate tipping. In restaurants, Post (1997, p. 532) suggests in her popular etiquette book, “It wasn’t long ago that 15 percent of the bill, excluding tax, was considered a generous tip in elegant restaurants. Now the figure is moving toward 20 percent for excellent service. In ordinary family-style restaurants 15 percent is still the norm.”

The more controversial issue is not how much to tip when the service is good, but rather how much to tip when it is poor. Some people do not feel obligated to tip nicely for poor service, because tipping the same amount for poor and good service eliminates the incentive of the worker to provide excellent service, which is often quoted as the only justification for tipping in the first place. Others, however, feel uncomfortable not to tip or to tip poorly even after receiving bad service. In addition to feeling social pressure to tip regardless of service quality, they often justify such behavior by the dependence of waiters on tips for their income.

Post (1997, p. 532) expresses the approach that bad service should be punished by lower tips, saying, “I do believe firmly, however, that the tip should be merited. Where service is bad and the personnel is deliberately rude, inattentive or careless, the amount should be reduced. If it is bad *enough*, no tip should be left at all, and you should bring the situation to the attention of the manager. If everyone continues to tip at the same rate, regardless of the effort made to please,

there is no incentive to make any extra effort at all.” Frankel (1990) expresses similar opinion, whereas Star (1988) suggests that stiffing (not tipping) is an option only in the most extreme situations and “should be a once-in-a-decade occurrence.” Interestingly, however, even though most people express opinions in favor of punishing poor service, they usually feel pressured to tip regardless of service quality. For example, the question “Do you feel pressured to tip at a restaurant even if you feel you received bad service?” was posted in an online poll; 69 percent (of 3778 voters recorded by January 25, 2004) answered “Yes” (the only other option was “No”).³

Various types of tipping and their economic analysis

As opposed to the common wisdom that tipping is a single phenomenon (which occurs in various industries), I argue that when considering tipping from an economic perspective, the economics of some tipping occasions is very different from that of some others. I divide tipping to six different categories: reward-tipping, price-tipping, tipping-in advance, bribery-tipping, holiday-tipping and gift-tipping, and discuss the economics of each of these categories below.

Tipping as a unique economic transaction

Most economic transactions involve the exchange of goods, services, and money, between two or more parties. It is usually clear to all parties what they are entitled to receive in the transaction, and what they are obligated to give. Tipping, while still being an exchange of services for money, is less clear about the obligations of the parties. There is no explicit contract between the consumer, the worker, and the employer about the tip to be given.

³ See <http://www.tipping.org>.

Tipping has several different forms, each having a different economic characterization. The common feature of all forms of tipping is the voluntary and discretionary nature of the tip: the consumer is free to choose how much to tip, if at all. This definition excludes service charges that are sometimes added to the bill (for example in many European countries), imposed gratuities (US restaurants often impose a 15–18 percent gratuity for large parties – usually six diners or more), and imposed tips (for example some tour packages include a certain amount that the consumer has to pay for tips). Since payment in these cases is not voluntary, they have little in common with voluntary tipping; in what follows I limit attention to voluntary tipping. I categorize the different forms of voluntary tipping to six main groups:

1. Tips that are given after the service is rendered to induce good service, for example tipping waiters; I call it “reward-tipping.”

2. Tips that are given as the price of the service, for example tipping skycaps. I refer to it as “price-tipping.”

3. Tips that are given before the service is rendered to induce good service, for example tipping the hotel concierge in advance, which I denote as “tipping-in-advance.”

4. Tips that are given before the service is rendered as bribery, for example when tipping a maitre d’ to get a table when customers with reservations are waiting in line. This form of tipping is referred to as “bribery-tipping.”

5. Holiday-tipping: these are tips that are given once a year to workers who serve the consumer during the year, such as the newspaper boy or the building doorman.

6. Gift-tipping: tips that are non-monetary, for example giving chocolates to nurses who took good care of a patient.

Below, I discuss in more detail the economics of each of these forms of tipping.

Reward-tipping

This is the most common form of tipping and the most significant in terms of the monetary amounts involved. In this form of tipping, the worker provides the service and then the consumer determines how much to tip him. Tipping of waiters, taxi drivers and barbers, in addition to many others, belongs to this group. The economic justification for reward-tipping is that it improves service quality. It can do so as long as the tips are positively correlated with service quality. Sources about tipping etiquette support such positive correlation, suggesting that tips should be reduced or not given at all when service quality is low (Post 1997; Schein, Jablonski and Wohlfahrt 1984). Moreover, empirical studies of tipping found that tips are indeed positively correlated with service quality, although the difference between tips given for good and mediocre service is small (Bodvarsson and Gibson 1997; Lynn and McCall 2000). Interestingly, when people are asked hypothetically how much they would tip for different quality levels, they report tipping significantly more for good service compared to bad service (Bodvarsson and Gibson 1999).⁴

Sisk and Gallick (1985) claim that tipping (reward-tipping according to the categories mentioned above) is an arrangement that protects buyers from an unscrupulous seller. Their interpretation and justification for tipping (with some complementary ideas of my own) is as follows. Often, what ensures the buyer that the good purchased would be satisfactory is the ability to return it to the seller if it is of inferior quality. It is usually impossible to return services, however. For services, one mechanism that ensures quality is the reputation of the firm. The firm does not provide low service quality because consumers will avoid purchasing again

⁴ It is an interesting question for future research to explore why people report large difference in tips according to service quality when asked hypothetically while in practice the effect of service quality on tips is small.

and may also inform other potential buyers about the low quality. If the worker who provides the service does not have enough incentives not to harm the firm's reputation, however, the worker is not likely to exert enough effort to provide good service. The firm can sometimes monitor the worker to ascertain that service quality is good; this may be too costly, however, meaning that the cost of monitoring exceeds the benefits from increased quality. For example, if the firm deals mainly with non-repeated customers who do not communicate with future potential buyers (a restaurant that caters to tourists, for example), the benefits from increased service quality are reduced. Consequently, monitoring and reputation might not suffice to induce good service quality.

Whenever the firm does not monitor the worker and the worker does not have incentives to provide good service, the buyer may be hurt by expecting and paying for good service and receiving bad service. When the cost of the service is high (e.g. in a service contract to maintain a big computer system), the buyer may find it optimal to use litigation in order to be compensated. When service quality is unobservable to a third party, or when service cost is low, the buyer usually finds it optimal to pay despite the unsatisfactory service. This gives unscrupulous sellers the ability to maximize profits by providing low service quality at low cost rather than good service quality. Of course, in equilibrium the buyer may expect bad service quality and the market for good service quality may collapse, as in Akerlof's (1970) seminal article about the market for lemons.

To overcome this potential problem, tipping makes part of the equilibrium price discretionary and contingent on service quality. The consumer no longer has to prove that service quality was bad; he can reduce his tip according to service quality without having to go to litigation. The worker has an incentive to provide good service because otherwise he may earn

lower tips. In a way, tipping may protect both the buyer and the seller from costly negotiation. For example, if service in a restaurant was bad, the buyer may not want to pay the full price of the meal, yet there is no natural agreement with the owner what the discount for the bad service should be. Tipping provides a focal point for the negotiation, in the form of the menu price: in most cases, if the consumer feels that service was bad, he still pays the menu price but he reduces the tip or does not tip at all. While the buyer can in principle abuse his position as the last mover and not tip even when service is satisfactory, such behavior is rare.

Conlin, Lynn, and O'Donoghue (2003) analyze the case of restaurant tipping (their analysis is applicable also to other forms of reward-tipping, however) and suggest that if efficiency requires the server to exert some effort, the server must have an incentive to exert this effort. While a service contract can provide this incentive, writing such contract between the customer and the server involves prohibitive transaction costs. Therefore, tipping serves as a substitute that economizes these transaction costs.

I agree with their view, and think that in fact tipping can save not only the costs of writing a contract, but also enforcement costs, the magnitude of which might be even higher than the costs of writing the contract. It is true that writing a contract between any possible combination of consumers and workers is prohibitively costly. One can imagine, however, that the firm could write a standard contract that applies to each of its workers and consumers; such contract has reasonable costs. The bigger problem, in my opinion, will be the enforcement of such contract: who will monitor the service quality? Will the consumer have to prove that service quality was not satisfactory, or the worker to prove that service quality was good? How can one prove what the service quality was when service is personal and depends to a large extent on the friendliness of the worker? I claim that society, by creating the social norm of tipping and making people

who stiff (who do not tip appropriately) feel embarrassed and unfair, provides an efficient enforcement mechanism. People then tip without the need for third party involvement in the evaluation of service quality, because their emotional disutility if they stiff after receiving good service exceeds the monetary gains.

While the interpretation of tipping of Sisk and Gallick (1985) and of Conlin, Lynn, and O'Donoghue (2003) is somewhat different, both views support the conclusion that what I denoted reward-tipping is an economic mechanism that addresses certain market inefficiencies using consumer monitoring of the service. Additional contributions to the economic analysis of reward-tipping include Azar (2004b), who introduces a formal model that shows that tipping improves service quality, and Azar (2004d), who presents a model of tipping and addresses the question whether tipping improves social welfare. He shows that tipping generally improves social welfare, but that the magnitude of the improvement depends critically on the specific social norm about tipping, and in particular on the sensitivity of tips to service quality according to the social norm.

Price-tipping

In this type of tipping the tip can be given either before or after the service is provided. In some cases the borderline between price-tipping and reward-tipping is not clear, but the idea behind price tipping is that tips are in fact the price of the service, not an incentive to provide better service. Tipping hotel bellman or airline skycap for carrying the luggage, or a doorman for stopping a taxi, belong to this group. Taking the example of the bellman, often the customary tip amount is specified as a certain amount per bag. The service is quite homogeneous, and therefore it is not likely that the reason for tipping is to ensure service quality. After all, the bellman just

brings bags from point A to point B. The tip is given to the bellman as the price of his services, not to induce him to provide higher quality of service.

Why then not have an explicit price? From efficiency point of view, tips can cut transaction costs. Tipping saves, for example, the need to issue a receipt. More importantly, however, the parties involved have several reasons to prefer tipping to explicit prices. Workers often underreport tip income to tax authorities, giving them a clear incentive to prefer tipping. The tax savings may in principle also benefit the employer and the consumer, through lower wages and prices. Moreover, the worker prefers tips because his total income is likely to be higher than if he would only receive a wage (even when wages for tipped workers are lower than wages to comparable workers who are not tipped). The reason is that since wages are often bounded from below (either by zero or by a positive minimum wage), tips may bring the worker's total income above his reservation wage, while without tips the employer just pays the worker's reservation wage. In other words, the lower bound on wages introduces a market friction that can lead to economic rents for the worker when tips are prevalent.

The consumer often prefers tipping because it enables him to show his gratitude to the worker. In addition, because of preference for income equality, the consumer may prefer tips to prices also because tips are likely to increase the worker's income while a price is going to the business (whose owner is probably wealthier than the worker). The owner has an incentive to charge prices rather than to allow tips, in order to eliminate the economic rents that the worker may enjoy. However, owners have to take into account what is appropriate in their industry, and clearly when they accommodate the desires of the consumer and the worker they derive from it benefits as well. A hotel owner is not likely to charge the customer when the doorman stops a

taxi for him, simply because it will be considered inappropriate; doorman services are free (do not involve an explicit price) anywhere in the industry.

Tipping-in-advance

According to several versions about the origin of tipping, tipping in advance was the original type of tipping in commercial enterprises (Frankel, 1990; Brenner, 2001). Brass urns with the inscription “To Insure Promptitude” were placed first in coffee houses and later in local pubs, and people tipped in advance by putting money in these urns. The purpose of tipping-in-advance from the consumer’s perspective is to commit the worker to provide good service quality. This form of tipping reverses the opportunism problem: instead of the consumer being able to stiff, here the worker is able to provide bad service despite the advance tip. Tipping experts, however, suggest that workers who get advance tips try very hard to justify the trust they received: Brenner (2001) claims, “The advance tip is the most effective method for assuring results... This strategy will insure that you’ll be taken care of with the highest degree of consideration,” and Star (1988) suggests about hotel concierge “If you want to be fawned over, tip the concierge upon arrival as you introduce yourself.” Just as the consumer finds it less costly to tip than to feel unfair and embarrassed in reward-tipping, the worker prefers to exert effort than to feel unfair and untrustworthy with tipping-in-advance.

Bribery-tipping

The idea of bribery-tipping occurred to me while reading the description of tipping a maitre d’ in Schein, Jablonski and Wohlfahrt (1984). Bribery-tipping is also done before the service is rendered, as in tipping-in-advance. The difference between tipping-in-advance and bribery-tipping is not always clear. Generally, I categorize tips in advance as bribery-tipping when

someone else (either other consumers or the employer) is hurt as a result of what the worker does, and as tipping-in-advance otherwise.

Tipping-in-advance is paying for something that is socially desirable: better service. Bribery-tipping is paying for something that is socially undesirable: getting preferred treatment without justification at the expense of others. For example, tipping a concierge in advance is not likely to hurt anyone and therefore is categorized as tipping-in-advance. Tipping a maitre d' in order to get a table without having a reservation in an overbooked restaurant, however, implies that other customers with reservations (or those without reservations who arrived before the tipper) will have to wait longer for their tables, and can be considered a bribe offered to the maitre d'. Tipping the maitre d' for a better table is somewhat more complex to categorize, but can still be categorized as bribery-tipping. If we assume that the customer is entitled to an average table, tipping the maitre d' to get a better table hurts the other customers who get less-than-average tables.

Another example for bribery-tipping in which the employer is hurt rather than other customers is when a guest tips the reservation manager to get a free upgrade of a hotel room. The owner of the hotel would prefer to sell the better room for a higher price rather than giving it as a free upgrade, and is hurt by the tipping transaction. As with other cases of bribery, both the giver and the taker (the consumer and the worker) can be blamed. Despite the negative connotations of bribery, however, bribery-tipping can be welfare enhancing. For example, it allocates the good tables to those who value them the most, if we assume that everyone can tip to get the better tables. If some customers are less willing "to bribe" not because of the monetary cost but because they believe that this behavior is inappropriate, however, bribery-tipping can also reduce welfare.

Holiday-tipping

Tipping workers around Christmas is customary in many occupations, such as the newspaper boy, babysitter, doorman in an apartment building and housekeeper, among others (Star 1988). Since the tip is given once a year, it provides less incentives for good service than reward-tipping, yet it might provide such incentives if it is clear to the worker that the holiday tip reflects the level of service provided during the year. This form of tipping is somewhat between a tip and a gift. When the tip reflects the level of service given during the year, it is somewhat similar to reward-tipping.

Gift-tipping

In some occupations, tips are considered inappropriate, yet customers often want to show their gratitude by something beyond saying “thank you.” One of the common ways to do so is to give a gift, for example flowers, a box of chocolates, or a fruit basket. For instance, such gifts are often given to nurses and doctors as a symbol of gratitude. This form of tipping provides little incentives for good service by itself. That is, nurses may provide excellent service because they are rewarded by the gratitude of the patient, and the patient may want to show his gratitude by sending a box of chocolates, but it is not likely that the box of chocolates is itself the reason nurses provide excellent service.

Gift-tipping may also take place in countries where monetary tips are not customary or even illegal, for example in China (Star 1988). Gift-tipping in these cases is again a method for the consumer to show his gratitude to the worker, although here the incentives provided by tipping may also be significant, and therefore promote better service.

Tipping and social welfare

I argued above that tipping is not a single phenomenon, but rather that tipping in various occasions can be very different from one another. I divided tipping customs to six categories: reward-tipping, price-tipping, tipping-in advance, bribery-tipping, holiday-tipping and gift-tipping, and discussed the economics of each of these categories. The discussion suggests that in many cases the social norm of tipping has economic justification, as it solves some inefficiency and increases welfare. In particular, it can promote good service where other mechanisms fail to do so. This suggests that the relationship between economics and social norms is indeed complex; not only social norms motivate economic behavior, but also economic reasons may promote the establishment of certain social norms.

The economic justification for tipping also confirms the view expressed by Arrow (1971, p. 22), who wrote about social norms more generally, “I want, however, to conclude by calling attention to a less visible form of social action: norms of social behavior, including ethical and moral codes. I suggest as one possible interpretation that they are reactions of society to compensate for market failures.” Two paragraphs below Arrow adds, “There is a whole set of customs and norms which might be similarly interpreted as agreements to improve the efficiency of the economic system (in the broad sense of satisfaction of individual values) by providing commodities to which the price system is inapplicable.” Tipping seems to belong in this set of customs and norms.

Why do people tip?

When people are asked today why they leave tips, most of them reply that they tip to reward workers for services rendered (Lynn and McCall, 2000). The question remains, however, why do

people want to voluntarily reward workers for services that were already rendered by the time the tip is given? (The focus in what follows is on restaurant tipping and other forms of reward-tipping). If one adopts the standard paradigm of a selfish agent, tipping is rational only if tippers expect to derive some benefit from it.

One such benefit that was suggested by Frank (1988) is that a person may behave in a trustworthy manner in order that habits of civility and commitment will become automatic and spontaneous for him. This communicates to others that he is a person who can be trusted and makes him a preferred partner for transactions, benefiting him in the long run even though myopic action (of not tipping, in the context considered here) could give him some temporal benefit (saving money). I agree that stiffing in the presence of people whom the stiffing person is likely to encounter again may be somewhat harmful for him. I do not think, however, that when someone stiffes, his character changes in a way that is observable to others who were not present at the stiffing occasion.

Future service

The common justification for tipping by selfish consumers is that people tip in order to receive good service in the future. Future service, however, cannot be the only reason for tipping: the observation that most people tip also in places they are not likely to ever come back to (for example when traveling) demonstrates it. Some evidence, however, suggest a stronger conclusion, that future service is not even a partial reason for tipping. Kahneman, Knetsch and Thaler (1986) interviewed people over the phone with two alternative questions. One question was “If the service is satisfactory, how much of a tip do you think most people leave after ordering a meal costing \$10 in a restaurant that they visit frequently?” and the other question started the same but ended “... in a restaurant on a trip to another city that they do not expect to

visit again?” The mean responses were \$1.28 and \$1.27. These answers indicate that people do not think that frequent patrons tip more, suggesting that future service is not one of the reasons for tipping.

Other studies, however, found that frequent patrons tip more (Lynn and McCall, 2000; Conlin, Lynn, and O'Donoghue, 2003). The difference is small, however: Conlin, Lynn, and O'Donoghue, for example, report a coefficient of 0.192 in a regression of percent tip on “times tipper frequents this particular restaurant (monthly)” (and other variables). That is, the difference between the tip of a customer who dines in the restaurant every week and another customer who does not visit the restaurant on a regular basis is less than one percent of bill size, on average. Since the average tip in their data is 17.84 percent, it is clear that patronage frequency (and therefore future service) does not play an important role in explaining tipping.

Moreover, tips of frequent patrons are not more sensitive to service quality than tips of non-frequent patrons (Lynn and Grassman, 1990; Azar, 2003b; Conlin, Lynn, and O'Donoghue, 2003). Azar also presents a theoretical model that suggests that this finding is not consistent with future service being a reason for tipping. The intuition is that if people tip because of future service, frequent patrons' tips should be more sensitive to service quality, because this sensitivity is what gives the waiters incentives to provide good service in the future.

A potential explanation for why frequent customers tip more but their tips are not more sensitive to service quality is that they want to avoid embarrassment in future encounters with the waiter. There is a significant probability that the waiter will remember the stiffing customer and will be in the restaurant when the customer returns. Such situation can be uncomfortable for the customer, especially if the same waiter serves him again or tells about the previous stiffing to the current waiter. I distinguish between this reason for tipping, which might be called “future

embarrassment,” and “future service,” which means tipping in order to get good service in the future.

Social pressure and fairness

The reasons that seem to be the major motivation for tipping are social pressure and fairness. In “social pressure” I mean the uncomfortable feeling and even embarrassment that might result from stiffing when others – in particular other people who dined at the same table and the waiter – know about the stiffing. I include in social pressure what I called earlier “future embarrassment.” In “fairness” I mean the willingness to be fair and honest, and to fulfill the implicit contract that dictates that good service will be rewarded by a certain tip. Not tipping the appropriate amount is likely to cause the stiffer to feel guilty and dishonest.

The fairness motivation is intrinsic, while the social pressure motivation is more extrinsic, as it depends on the opinions of others about the customer, not just about his own feelings about himself. Both reasons are rooted in the social norm that dictates to tip in certain situations. For example, since it is not a social norm to tip flight attendants, people do not feel social pressure to tip them, nor do they feel unfair by not tipping them. The importance of the social norm in affecting tipping behavior implies that the exact social norm may affect the incentives faced by the waiter and the service quality he chooses to provide. In particular, if the norm is to tip a certain percentage of the bill (or a certain amount) regardless of service quality, the incentives of the worker to provide good service are eliminated.

To make clear the distinction between social pressure and fairness, suppose that instead of tipping by leaving a tip on the table, the customer has to go to an isolated room, put his tip in an envelope and put the envelope in a safe that is opened once a week. In this case, no social pressure of any kind exists, but one still feels unfair or dishonest if he does not tip. In fact, such

experiment can contribute to our understanding of the reasons for tipping, and is an interesting topic for future research. The amounts that will be tipped represent the portion of tips given because of fairness. The difference between the tips in the experiment and the regular tips in the current form of tipping is due to social pressure, future service, and future embarrassment.

Another example that might illustrate the distinction between the two reasons is the following: in some places the customer is requested to pay the bill to the cashier. Many people choose to leave the tip on the table in cash and pay the cashier with a credit card. The credit card receipt usually includes the total bill, a blank line for the tip, and the total payment. People sometimes feel uncomfortable to fill zero in the line dedicated for the tip. Clearly, they do not incur any feeling of dishonesty, since they know they left a tip. They feel uncomfortable because the cashier does not know they already left the tip on the table, and this raises the social pressure kind of uncomfortable feeling.⁵

Crespi (1947) provides an interesting historical comparison by presenting poll results about tipping. The results suggest that most people approve of tipping “by and large” but only because wages are inadequate for certain service workers. The custom itself is disliked, and people tip because of social pressure, and not because of any incentive or ego value. Most urbanites tip frequently, widely, substantially, and unwillingly. They do not consider tipping undemocratic⁶,

⁵ Paying the tip with the credit card together with the bill does not solve the problem. Then, the person might feel uncomfortable because the waiter does not find a tip on the table and does not know whether the customer tipped or not at the cashier’s station. While this arrangement makes tippers a bit more uncomfortable, servers can actually benefit from it: when they do not tip, neither the cashier nor the waiter knows for sure they did not tip, unless the two communicate with each other.

⁶ At the beginning of the 20th century one of the main arguments of those who opposed tipping was that it is undemocratic as it makes the tip-takers inferior to the tip-givers (Segrave, 1998).

but would rather have a service charge included in the bill. Crespi suggests a plan (an anti-tipping league with a card to be left instead of a tip) towards ending the custom.

Another potential reason for tipping is the utility from feeling generous that some people experience, and a utility from showing off generosity or economic status in the presence of others (in particular when the tip is especially large). An additional reason is that sometimes the customer believes that waiters earn too little for their hard work and therefore he feels empathy for the waiter and wants to reward him. Moreover, where tipping is common, customers often feel obligated to tip because tips are a major source of income for the worker. This reason for tipping creates a cyclical mechanism that reinforces the establishment of tipping where it starts: people start to tip certain workers, the employers of these workers reduce their wages (they can do so because the worker receives part of his reservation wage from tips), people feel more obligated to tip because they know that the worker depends on tips to complement his wages, more people tip and possibly each tip becomes higher, and so on. While the reasons mentioned for tipping differ in many ways, they all (except future service that was ruled out as an important explanation for tipping) share the characteristic that people tip because of social norms and different feelings. Both negative feelings from stiffing (embarrassment, feeling unfair) and positive feelings from tipping (feeling generous, showing off) can motivate people to tip (for a theoretical model of norm evolution that supports the latter argument see Azar, 2004c).

Retaliation by stiffed workers

Revenge by tipped workers when they are stiffed is another behavior that is hard to explain unless we incorporate feelings in the individual's utility function. Since tips are given at the end of the service, the ability to revenge on one-time customers is limited. Yet, Ginsberg (2001)

reports about a few cases in which waiters ran after customers who did not tip and yelled at them. I also heard about movers who try to get their tip a little before they are completely finished, and if they are not tipped, something bad usually happens, for example a mirror “accidentally” breaks in the last few minutes of moving stuff inside the apartment.

The incentive to ask for the tip before the work is completely done is rational: it improves the bargaining position of the mover, who still has an implicit threat at that point (to reduce the quality of the service that still has to be provided – and possibly to actually make a damage). Moreover, it makes the option not to tip more uncomfortable for the customer, who realizes that he will have to face the movers for some more time, rather than just close the door behind them.

The revenge itself, however, of both waiters and movers, is not rational. The chances to receive a tip after such retaliatory action are very small, and the worker takes the risk of a customer’s complaint that may lead him to lose his job (this is what happened in one of the cases that Ginsberg reports about, for example). The reason for the revenge is likely to be either to discipline the customer for the sake of future colleagues (so the motivation is altruism towards colleagues – the desire that future servers will enjoy tips, for example), or a desire to retaliate against someone who hurts us. In both cases, the revenge suggests that people care not only about their consumption bundle, and that we should consider feelings when thinking and modeling certain behaviors.

The ability to revenge on repeated customers is more extensive, as it can take place in the next encounters rather than at the end of the current encounter. Ginsberg, for example, claims, “Tip-challenged customers [customers who stiff] who frequent the same spot get not only the worst service but leftover bread, dirty glasses, and plates that have been prodded at and sometimes eaten off... And yes, I have seen servers spit in food and drinks.” I also encountered

similar descriptions in chats on the Internet. The most striking example of waiters' revenge belongs to economic history: in 1918, a hundred waiters were arrested because they used certain powder in the dishes of known opponents to the tipping system (Segrave, 1998).

While revenge on repeated customers has the potential motivation of improving the tips the customer leaves, this is not likely to be the reason for such revenge. If the customer knows that something was done to his dishes or food, the server is in great risk of losing his job and maybe being sued. If the customer does not know, he is not likely to change his tipping behavior. Once again, the motive to retaliate against someone who you think hurts you seems as the more plausible explanation for this behavior. This is another example for the willingness of individuals to retaliate against unfair treatment even when doing so is costly for them (see also Rabin, 1998; Fehr and Gächter, 2000; Fehr and Falk, 2002).⁷

Conclusion

A common criticism against economic models that incorporate utility from conforming to social norms or from feelings is that every phenomenon can be easily explained if we do not require the agent to be selfish and rational. Such criticism implicitly means that since it is harder to explain economic phenomena with selfish agents than it is with agents who have feelings, the conclusions of a selfish-agents model are more valid than those of an emotional-agents model. An approach that requires the economic agent to be fully rational and absent of feelings, however, results in one of two undesired results. One possible result is that we do not try to model behaviors in which social norms and feelings are important, greatly limiting the range of

⁷ On the behavior of restaurant waiters see also Barkan and Israeli (2004).

phenomena that are subject to economic analysis. The alternative result is that we try to explain such behaviors without incorporating social norms and feelings in the model, which is likely to lead to false predictions.

Tipping provides an illuminating example for the latter result. Using a rational and selfish agent to explain tipping, one reaches the conclusion that the agent should never tip if he does not intend to visit the establishment again (Ben-Zion and Karni, 1977). Yet, this prediction is sharply violated in practice: most people tip even when they do not intend to ever come back to the same restaurant or hotel. The existence of tipping proves that people care about being fair and about conforming to social norms. This lesson should be applied to other economic behaviors as well. Models that incorporate feelings or social norms should not be discarded when they explain phenomena in which social norms and feelings are in fact important.⁸

Some ideas for future research were mentioned in the previous sections, but there are many other promising research opportunities in this field: almost all the research so far focused on restaurants. While tipping in restaurants is the most common form of tipping, tips are often given in taxis, hotels, barbershops, valet parking and dozens of other occasions. Exploring those is a worthwhile endeavor. In addition, almost all the literature on tipping so far focused on reward-tipping, but as was discussed above, there are other types of tipping that are different from reward-tipping, and research on these types is also called for.

Another promising subject for future research is the efficiency of tipping as a mechanism that promotes excellent service. What happens to service quality when a restaurant decides to impose service charges that replace tipping? Is service in countries where tips are common better than in countries without tipping? When waiters agree to pool tips (every waiter shares the tips of

⁸ See also the discussion “Homo Economicus Will Become More Emotional” in Thaler (2000), pp. 139-140.

all other waiters) and the personal incentives to increase the tip are reduced, is service quality lower?

Also interesting is how the norm of tipping evolves. How is a norm created to tip in a situation that was not tipped before? How does a norm to tip certain workers cease to exist? How does the norm of tipping move from one country to another?

Some policy questions arise as well. Should tipped workers be paid minimum wage in addition to their tips? Should we prohibit employers from imposing tip-out arrangements, in which tipped workers share their tips with other workers (such arrangement can cut the labor costs for the firm)? Tipping provides many research opportunities for everyone who finds interest in this fascinating subject.

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