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Sanders-Khanna Bill Risks Unintended Side Effects That Could Hurt Lower-Income Workers and Spur Discriminatory Hiring Practices

Better Ways Exist to Achieve Its Goals

By Robert Greenstein, Sharon Parrott, and Chye-Ching Huang

Today's new legislation from Senator Bernie Sanders and Rep. Ro Khanna, which requires firms with 500 or more employees to make federal tax payments equal to the value of all Medicaid, SNAP (food stamps), rental subsidies, and free or reduced-price school meals that their employees and the employees' families receive, is well-intentioned. It seeks to induce large firms to raise the wages they pay, which is an important goal after decades of stagnant or falling wages for millions of hard-working Americans. But the legislation likely won't meet that goal, and it would have a series of adverse unintended consequences. Moreover, we have better ways to induce or require firms like Amazon and Walmart to raise their wages and bear more of the costs of core government functions, including basic nutrition assistance and health coverage for struggling families.

Among its problems, the legislation would create powerful incentives for employers to seek to minimize their hiring of workers who are in low-income families and, thus, more likely to qualify for Medicaid or nutrition or housing assistance. Since employers won't know definitively which prospective employees receive benefits (and are not allowed to ask under the bill), they will have an incentive to steer away from groups the employer believes will more likely qualify for benefits. That's likely to include workers with children (particularly single parents whose earnings often are lower than those of parents in married families) because families with children qualify for benefits like SNAP and Medicaid at considerably higher income levels than single workers. It's also likely to include workers with significant health issues or disabilities, who are more likely to receive Medicaid and have high Medicaid costs, and workers of color and women, because without information about a worker's family, the employer may assume that these workers are likelier to qualify for and participate in benefit programs.

In addition, some employers might pressure employees not to sign up for Medicaid or other benefits. And elements of the business community would likely lobby policymakers to reduce their tax bills by restricting eligibility and benefits for core low-income programs, which would be equivalent to a corporate tax cut. Large corporations also could become leading opponents of

efforts in states to adopt the Affordable Care Act's Medicaid expansion, which, if adopted, would become a large new cost to firms under this bill.

The legislation also likely would not do much to raise wages. Companies that raise wages would have to do so for *all* workers in particular job categories, not just those who receive public benefits. That would be more expensive to companies than paying the tax penalty. In addition, some employers would likely seek to evade the tax penalty by contracting out to smaller firms, or otherwise outsourcing, various functions that their low-wage workers (many of whom may be eligible for the benefits in question) currently perform. The protections in the bill against contracting out aren't likely to be very effective.

Moreover, the additional taxes that employers would pay under this legislation would *not* go to raise wages, unlike a minimum wage increase under which the additional cost to employers goes directly to raising workers' pay. The legislation also would prove extremely difficult for the Internal Revenue Service (IRS) to administer.

To be sure, the legislation seeks to address a serious and longstanding problem. For decades, wages have been stagnant for millions of workers who earn low or modest incomes, particularly those who lack more than a high school education. But the question is how best to help raise those wages and living standards. Fortunately, policymakers have more effective ways to raise wages and living standards and ensure that corporations pay their fair share to cover the costs of government. They could raise the minimum wage substantially and mandate paid leave, eliminate non-compete clauses that hurt workers seeking better pay at other firms, better enforce anti-trust law to ensure that very large corporations don't have an unfair ability to set wages, provide more protections for workers seeking to organize into unions, and require large, profitable corporations to pay their fair share of taxes.

Creates Incentives for Firms to Employ Fewer Low-Income or Disabled Workers

The bill would create powerful incentives for employers to minimize the number of workers they hire who likely qualify for Medicaid, SNAP, and the like — that is, workers in low-income families — and instead hire or retain people less likely to qualify for these benefits. Thus, *it would heavily favor hiring single individuals not raising children over parents with children, and favor married individuals over single parents with children* (since a married couple could have two earners in the family and thus a higher family income). That's because the affected programs' eligibility limits and benefit levels depend on a household's total income and its family size, *not* just a worker's wages.

For example, a single worker loses SNAP eligibility at income of about $15,700, while a family of four qualifies until its income reaches about $31,980. In Medicaid, eligibility varies by state; using Washington State as an example, a single individual qualifies for Medicaid if her income is below $16,753, but a parent in a family of three qualifies until her earnings reach $28,676, and her children qualify if their family's income is below about $44,700, which translates into a wage of about $22 an hour. Thus, while a single worker earning $25,000 qualifies for few if any benefits, a single mother with two children earning $25,000 can qualify for SNAP, Medicaid, and school meals.

The bill would also create an incentive not to hire workers with significant health issues or disabilities, particularly those only able to work part time. Such individuals are likelier to qualify for

certain benefits and, if they receive Medicaid, likelier to have high health-care costs that the employer then would have to pay for through the tax. (The legislation requires employers to pay for the actual Medicaid costs that the federal and state governments incur for their employees.)

Workers who receive these benefits would thus become *thousands of dollars more expensive* to employ than other workers who are paid the same wage but don't qualify for these benefits. This would create strong, problematic incentives for employers in deciding whom to hire — and whom to lay off when a firm's sales hit hard times.

The bill includes a provision barring an employer from asking job applicants about their benefit receipt. But an employer does not need information about whether a job applicant is receiving benefits to take steps that limit the hiring of workers *likely to receive* benefits. This is true even if employers aren't permitted to ask about a prospective employee's marital status, children, health conditions, and the like. That's because information about a worker's family and health often emerges in job interviews and even more so after an individual is employed. Some employers also get information about dependents for the purpose of administering various benefits or withholding the proper amount of taxes from paychecks. And the IRS' proposed tax-withholding forms to implement the 2017 tax law may lead employees to provide considerably more information to employers about their spouses and dependents than the previous forms.

Moreover, prospective employers that couldn't secure such family-related information directly could look for other indicators of whether an individual's household income is likely low and whether the worker and his or her family likely qualify for benefits — including, in particular, a worker's *race*, *gender*, and *neighborhood*. Some employers could seek to steer their hiring away from categories of workers whom the firms believe are likelier to have children and low household income, such as people of color and women (especially women of color).

Finally, some employers may pressure employees not to sign up for programs for which they qualify to reduce the tax penalty on the employer. Even without such pressure, some workers may decide that receiving benefits that their families need has become too risky. As noted above, the bill's tax penalties would likely influence employer decisions on which employees to let go when they trim their workforces to cut costs, such as during recessions. A firm would realize substantially larger savings by laying off a worker in a family that qualifies for benefits than laying off a similar worker who doesn't receive assistance. Many workers may conclude that they need to protect their job security by forgoing benefits for which their families qualify, such as Medicaid coverage for their children or food assistance. The chilling effect could be substantial.

Could Prompt Corporate Lobbying Efforts to Cut Assistance Programs

In addition, the legislation would likely lead to substantial corporate lobbying efforts to restrict eligibility and cut benefit levels for core low-income assistance programs, because doing so would reduce companies' tax bills — *effectively making a cut in Medicaid, SNAP, school meals, or rental subsidies akin to a direct corporate tax cut*. This lobbying could be directed toward both federal and state policy changes that affect eligibility or benefits. If successful, it would harm still more low-income households, including those in which the adults don't work for and haven't applied for jobs at a large firm, but who would lose needed assistance if cuts supported by these companies took effect.

These corporate lobbying efforts also would likely make it harder for states to adopt the Affordable Care Act's Medicaid expansion and could make it harder for some other states to retain it. That's because the tax penalty assessed on employers will be significantly larger for employers in states with the Medicaid expansion in place.

The legislation could even affect where companies locate. Amazon and other firms could have an incentive to locate their new operations in states that have not expanded Medicaid rather than in those that adopted the expansion, thus reducing their tax bills significantly.

Would Prove Difficult and Costly to Administer

It's hard to see how the tax penalty could be implemented accurately. The federal government doesn't have individual-level information about benefit receipt for most benefit programs. States maintain records for SNAP and Medicaid and school districts maintain them for school meal programs. (The Department of Housing and Urban Development holds more individual-level data.) And agencies administering benefit programs won't necessarily have complete and accurate information on the name of each worker's employer for each month in which the worker has received benefits. It's difficult to see how the IRS could receive and process accurate information on the precise level of assistance received by each individual who worked at least one month of the year for an employer with more than 500 workers nationwide.[1]

Unlikely to Raise Wages or Living Standards Substantially

Adding to these concerns, for several reasons the legislation would likely be of limited effectiveness in achieving one of its goals: raising wages and living standards. First, it's unlikely that employers would generally respond by raising wages substantially, as raising wages would entail raising them for *all* workers in various job categories, not just for those who receive government benefits. Moreover, even raising wages significantly wouldn't eliminate all of the benefits that a firm's workers receive, as many families with children would continue to qualify for benefits. Thus,

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[1] Under the bill, the tax penalty is based on the amount of benefits a worker and his family *receive*. Some may suggest that certain problems could be averted if the penalty were instead based on whether a worker and his family are *eligible* for a set of benefits, regardless of whether the family receives them. This could reduce the likelihood that a worker decides not to receive a benefit for which he or his family qualify. But other problems would remain and some new ones arise.

A tax penalty based on whether a worker and his family were eligible for a benefit would still create large incentives for employers to discriminate against certain groups, such as single parents, who employers believe are more likely to meet the eligibility requirements for benefits. Moreover, such a proposal would be even more unworkable administratively. Eligibility rules for Medicaid and SNAP are complex and vary by state, and the IRS lacks the ability and necessary data to make an accurate determination of the eligibility and the benefit levels for which families would qualify. The IRS would have to require millions of families to provide substantially more information on such matters as their rent, the value of various assets, and the like — and the IRS would need that information on a monthly basis. Substantial errors — and challenges to the eligibility determinations that the IRS would have to make — would be inevitable, and the resulting administrative costs would be very substantial.

Compounding these problems, calculating tax penalties based on eligibility for rental subsidies would cause extreme distortion. Those subsidies aren't an entitlement, and three-fourths of all low-income households who qualify for them don't receive them.

the employer would have to pay the costs of the wage increase *plus* significant tax penalties. Raising wages would almost certainly be costlier for employers than just paying the tax penalties that the bill would impose.

In addition, when employers paid the tax, the dollars wouldn't go to raising the wages or living standards of their workers. This contrasts with a minimum wage increase, where the additional cost to employers goes directly to raising workers' pay.

In response to the tax penalty, many employers would likely seek to reduce the number of low-wage workers they employ, such as by contracting out (or otherwise outsourcing) various functions where a large share of the employees are paid low wages. The bill tries to limit such maneuvers by applying the tax penalties to some contractors under certain conditions. But such limits are difficult to make work effectively, and the bill's guardrails appear to unintentionally leave significant room for employers to lessen or avert the tax penalties by contracting out to smaller firms various pieces of work that a company currently does in-house.

Workers who would have been hired as a regular employee but work instead for a contracting firm often are paid less for the same work than if they worked for the lead firm.[2] The bill also would increase employers' incentives to "misclassify" workers who should be considered employees as independent contractors, a widespread practice that the relevant federal agencies lack the resources to combat effectively.

Better Alternatives Exist

Fortunately, better alternatives exist to raise workers' wages and living standards and ensure that large, profitable corporations pay their fair share of government costs. A more straightforward and effective approach would include:

- Substantially raising the minimum wage and mandating paid leave — policies that avoid increasing incentives to discriminate and contract out and that directly improve worker pay and benefits;
- Eliminating non-compete clauses that harm workers seeking better pay at competing firms and better enforcing anti-trust laws, which can ensure that large employers do not gain undue market power to set wages;
- More protections for workers seeking to organize into unions, which can lead to increases in wages and enable workers to share more equitably in companies' success; and
- Tax reforms that require large, profitable corporations to pay a more equitable share of public costs, coupled with measures to use part of those increased revenues for such purposes as expanding child care assistance for parents with low or modest earnings, strengthening job training, providing more adequate subsidies for individual health insurance, and providing a stronger Earned Income Tax Credit (particularly for low-wage

[2] For example, one study found that working for a contractor firm reduces wages by 4-7 percent for janitors and by 8-24 percent for security guards, while reducing health insurance benefits for both. See Arindrajit Dube and Ethan Kaplan, "Does Outsourcing Reduce Wages in the Low-Wage Service Occupations? Evidence from Janitors and Guards," *Industrial Labor Relations Review,* Vol. 63, No. 2, 2010.

workers not raising children, whose current EITC is a very small fraction of the credit for workers with children).

Even if policymakers decided they wanted to impose tax penalties on firms that pay low wages, other approaches would avoid creating many (though not all) of these problematic incentives. Legislation introduced by Senator Sherrod Brown (S. 1788) would impose fees on large firms to the extent that they pay wages below certain levels; because the bill ties its fees to the wage level paid — rather than to whether an employee or his family receives or qualifies for Medicaid, SNAP, or other benefits — it avoids creating the new discriminatory hiring and firing incentives noted above. This approach also avoids creating a chilling effect on employee use of benefits or incentivizing the formation of corporate campaigns to cut programs like Medicaid and SNAP. The Brown bill would, however, create incentives for firms to reduce their employment of workers paid low wages, such as by contracting out or outsourcing. And the added costs to employers from the bill's tax penalties wouldn't go directly to improving workers' incomes. The more straightforward alternative outlined above thus provides the better route.