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The Honorable Lily Lawrence Batchelder
Assistant Secretary
Office of Tax Policy
United States Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

The Honorable Brent Parton
Acting Assistant Secretary of Labor
United State Department of Labor
Employment and Training Administration
200 Constitution Avenue, N.W.
Washington, D.C. 20210

Dear Assistant Secretary Batchelder and Parton:

I have been asked to comment on the 2023 Green Book proposal to eliminate the employer tax credit provisions of the Work Opportunity Credit (WOTC) program for eligible employees who work more than 120 but less than 400 hours.

I have written about and analyzed the operation of the WOTC program at some length in the past. The fundamental argument used to create and sustain the program was and is to help individuals who struggle to get jobs to overcome the challenge of having no work experience and the additional disadvantage of trying to find a job when they do not already have one.

What WOTC is Not: There are often misconceptions about WOTC. It is not a program to create jobs for recipients nor is it a program to only support "good" jobs. While the ultimate goal of all workplace assistance programs including WOTC is to get participants into good jobs, those jobs are difficult to get: Many people want them, and they typically require skills and experience that not all candidates have. Short of an academic degree or specialized certification, it is extremely difficult for anyone to get a good job without already having had work experience. With few exceptions, WOTC-eligible candidates lack a record of recent work experience. WOTC can help address the lack of work experience and an employment record that are necessary conditions for having a chance at good jobs.

Why are employers reluctant to hire individuals with the attributes that make them eligible for WOTC? The simple answer is that they believe that these candidates are risky to hire for fear that they will not succeed in the jobs. It is costly to hire workers who do not succeed or who just leave: the administrative costs of bringing individuals into new jobs are considerable as is the lost work that comes while the job is vacant and the employer waits to fill it.
Some of the reasons that workers do not succeed may have nothing to do with them personally. They may have issues outside work that lead to absenteeism and life challenges such as family demands or resource constraints that limit their ability to get transportation to work. Others have difficulty holding a job just because they cannot handle the discipline of staying at work all day for an entire week, still others cannot get along with other workers, and so forth. If someone has a record of having succeeded in a job already, employers rightly believe the risk of hiring them is reduced.

A complaint one sometimes hears about WOTC and other tax credit programs is that it should not be necessary to subsidize employers to hire WOTC participants for the jobs for which they are considering them as candidates, which are often low quality in terms of pay and benefits. The simple rebuttal is that if WOTC was unnecessary, then the individuals with the disadvantages that WOTC recipients have would not be struggling to get jobs. It is also true that there is nothing unique about WOTC in using tax credits to encourage employers to take all kinds of actions useful for the public interests that might not otherwise be in their financial interest to do.

A Proposal for Changing the Tax Credit: At present, employers receive a tax credit up to 40% of the first $6,000 in wages paid to a qualifying WOTC hire if the individual remains on-the-job for at least 400 hours.[1] While there is nothing magical about the 400 hour figure, the idea is that 400 hours of work is at least long enough for a worker to learn the ropes and start to become valuable to an employer. If they stay in the job less than 400 hours but more than 120, the credit percentage is cut considerably, to 25% of eligible wages. The reason for allowing some credit below 400 hours is first that employers deserve some credit if they hire WOTC-eligible candidates even if they do not stay in part to cover the administrative costs of hiring them, which includes managing the WOTC process. Further, as described in detail below, when employees leave an employer, it is almost always because of their choice, not the employer's. But the employer bears the turnover costs of replacing them. That modest tax credit compensates them at least somewhat for taking the greater risk that hiring WOTC-eligible workers will not work out. The additional credit for remaining 400 hours also creates an incentive for employers to do all they can to keep WOTC-eligible employees on the job longer.

[1] There are exceptions that can raise the credit considerably for some limited groups, particularly Veterans under special circumstances.

The 2023 Green Book proposal is to eliminate the partial tax credit for hours more than 120 but less than 400 such that employers get no tax credit if their WOTC employees leave sooner than 400 hours.

Problems with the Proposal: The problem with this proposal begins with the question, *what problem is this trying to solve?*

There are several unstated assumptions implicit in the proposal.
The first of these is that turnover is caused by employers dropping workers. In fact, *the vast majority of turnover is caused by employees quitting.* The Bureau of Labor Statistics most recent data for February 2023, for example, finds that 70 percent of all turnover, or separations, come from employees quitting. Employers typically have no interest in employees quitting, hence the consternation over the post-pandemic "Great Resignation." Employee quitting is very common. The "accommodation and food service" category of jobs, where many WOTC candidates work, has a 70 percent annual quit rate.[2] If we thought that those quits were equally spread out over time, 15 percent of the workforce would have quit before hitting the 400 hour mark, which is the WOTC threshold for a full subsidy. Estimates of exactly when people quit come mainly from private sources, but they suggest that a remarkable percentage of those quits happens early in a job: 34 percent of white collar employees report that they have left a job in the first 30 days, and another survey finds that 28 percent who quit do so in the first 90 days.[3] In other words, in the absence of WOTC, many employees quit before 2.5 months or the 400 hour mark.

That leads to the question as to why we would punish an employer who agreed to hire a WOTC-eligible candidate if the candidate quits, as large numbers are likely to do.

Of course, under the realm of unintended consequences, employers could easily meet the 400 hour requirement with restrictive covenants such as non-compete agreements, something that is already common in the labor market even for low-wage workers. An employer could simply require that WOTC eligible workers agree to stay past the 400 hour window or pay some substantial penalty that could be enforced until that threshold is reached. Cutting any tax credit until a WOTC worker hits that 400 hour market vastly increases the incentives for an employer to prevent those workers from leaving.

Would it be in the public interest to encourage practices that prevent WOTC workers from leaving before 400 hours? Employees typically quit to move to another job. That is especially so for new entrants to the labor market. The literature on this topic is extensive and concludes, for example, evidence that even in a period when mobility across employers was low, one-third of all the growth individuals experienced over their careers came from changing employers (the rest came from advancement within an organization).[4] More recent research from 1997 to 2017

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[2] Bureau of Labor Statistics Economic News Release, Job Openings and Labor Turnover Survey. April 4, 2023.

[3] These estimates come from Zogby Poll's surveys of individuals. The first is result is: Job Seeker Nation Survey. Jobvite. https://www.jobvite.com/wp-content/uploads/2020/05/FINAL-Jobvite-JobSeekerNation-Report1_5-11.pdf. The second comes from Jobvite. 2018. https://www.jobvite.com/blog/onboarding/how-to-create-a-seamless-onboarding-process/. There are many similar estimates, https://www.linkedin.com/pulse/why-do-33-new-hires-quit-within-six-months-vultus-inc-.

[4] For a classic study, see Topel, Robert H. and Michael P. Ward. 1992. Job Mobility and the Careers of Young Men. Quarterly Journal of Economics. 108: 439-479.

supports that conclusion.[5] A post-pandemic study finds even more powerful evidence for low-wage, non-college workers of the kind targeted by WOTC, that changing employers was associated with significant increases in pay, more so than in earlier periods.[6] These studies and others like them arguably understate the effects of quitting because they measure all job changes, including layoffs and other separations, and we know that those lead to lower wages.

The evidence is clear that seeking better jobs is the primary motivation for quitting. Seventy percent of those who quit in 2021, for example, report that they did so either because their current pay was too low or because they saw no opportunities for advancement.[7] In tight labor markets, simply having a job already even if one has only been hired recently may be enough to give one a boost into another job elsewhere. Punishing employers by withdrawing all tax credits if their workers quit seems to be a perverse practice.

The second assumption is that it might somehow be *in the employer's interest to churn through WOTC employees to get the tax credit.* This is not a sensible assumption because the turnover costs greatly exceed the costs of the tax credit. The administrative costs of bringing on a new worker, setting them up in a payroll system, and so forth are roughly $4000. The productivity costs of losing a worker and then replacing them with a new, inexperienced candidate are likely considerably more. Even in the simplest jobs that have no formal training and where we think anyone could do it at a satisfactory level having never done it before, there are things to learn in each context to avoid making mistakes, some of which may be a simple as learning to coordinate with other workers. Accurate estimates of turnover costs in low-skill, hourly work find that the largest of these costs are lost productivity associated with other employees that begin as soon as a worker announces they are going to leave.[8] Further, when the employer separates an employee, their unemployment insurance costs rise, another cost of churning through employees.[9]

These turnover costs are the reason there has been so much employer consternation about retention, especially among low-skill, hourly workers where turnover has been so high after the pandemic.

One might argue that there must be situations where churning through workers to get the tax credit pays off. That implies situations where employers would create jobs with more than 120 hours but less than 400 hours just to get the reduced 25% tax credit. Critics sometimes suggest that the "temp" industry creates those situations. To understand the context, temporary agencies account for much less of the workforce than we typically think, 2% of the labor force.[10] Most

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[5] Jeffrey J., Yankow 2022. " The effect of cumulative job mobility on early-career wage development: Does job mobility actually pay?" *Social Science Quarterly*. 103: 709– 723.

[6] David Autor Arindrajit Dube & Anne McGrew 2023. The Unexpected Compression: Competition at Work in the Low Wage Labor Market. NBER Working Paper 31010 March.

[7] Pew Research Center. 2022. Top Reasons Why Employees Left a Job in 2021: Low Pay and No Advancement Opportunities. March 8th.

[8] Peter Kuhn and Lizi Yu. 2021. How Costly is Turnover? Evidence from Retail. Journal of Labor Economics, 2021, vol. 39, issue 2, 461 – 496.

[9] The practice of unemployment insurance taxes varying with layoffs, experience rating, is rooted in Federal policy but in practice varies by state.

[10] What Happened to Temps? 2021. Changes Since the Great Recession. Monthly Labor Review. February.

temps are engaged as independent contractors, not as employees and as such are not eligible for the WOTC program. Only agencies that have regular employees are eligible for WOTC payments, and those employers have all the turnover costs noted above. Individual projects for temp agencies may be relatively short, just as accounting and consulting projects are short, but employees in those fields work on a stream of assignments just as temp agencies with employees move their employees onto other projects. The assertion is that rather than keep WOTC workers on until the 400 hour mark and claim the full tax credit (at 40% of up to $6,000 in wages), for some reason they drop them after 120 to get the reduced 25% credit. (Churning through three employees to get a reduced tax credit makes no sense as compared to keeping one worker for 400 hours and getting the full potential credit.)[11]

Most temp agencies with employees now are not being used to meet short-term staffing needs in any case. They have become "leasing agencies" and their employees as leased in long-term relationships to a client organization: The US Bureau of Labor Statistics defines leased employees as those that work for a client for at least a year.

It is also worth noting that temp agencies are themselves a separate pathway into regular jobs. A recent survey of companies with more than one thousand employees found that 10 percent of their temp agency workers were turned into their regular, full-time employees.[12] Those workers are offered jobs that are a step up from what they had been doing because they have work experience doing the same tasks presumably successfully. Such jobs are arguably better than the WOTC participants could have secured without that work experience. It is in the interest of an agency for their employees to transition to regular employment with a client because the clients then are required to pay the agency fees, which can be substantial. But it is also in the interest of public policy for that to happen.

Is there any scenario where any employer might need labor for short-term assignments less than 400 hours but more than 120 and might not want to go to a temp agency to get them? Most employers meet those tasks with a separate category of employees called "On-Call" workers, regular employees who are often with employers for a long period of time but paid by the hour. Most of these on-call workers have a long-term relationship with the employer. They may be retirees returning for special projects or workers with family care or health issues that prevent them from working regularly. The huge advantage of on-call workers is that they know the organization, they likely know the regular employees, and they know the job. It is hard to see an advantage in replacing on-call workers with new hire WOTC candidates who have no track record of successful employment.

If for some reason an employer had short-term assignments and did not want to use on-call workers or temp agencies, the popular alternative now is to engage "gig" workers, independent contractors who come in to perform a specific task for a short period of time. Doing so avoids all the administrative costs of hiring and employing a worker.

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[11] It should be noted as well that WOTC is designed to discourage churning. Under the statute no credit is available for an employer with respect to any individual who previously had been employed by the employer at any time.

[12] "Temp-to-Perm Conversion Ratio," Contingent Workforce Strategies, cwstrategies.staffingindustry.com/temp-to-perm-conversion-ratio/ (accessed January 30, 2023).

The proposal to drop the tax credit for 120 hours of work therefore would therefore target only regular employers who had jobs that they know in advance would require more than 120 hours but less than 400 hours of work; where they decide not to use "on-call" workers or gig workers; where the administrative costs of using the WOTC process, the costs of turnover, and the greater risk of using WOTC-eligible candidates combined is less than the reduced 25% credit. There is no evidence that such employers exist, but one might argue that even if there is a single employer doing so, we should design the program to prevent it.

One problem with doing so is that eliminating the partial credit for employees who leave before 400 hours defeats the purpose for which it was designed, to provide some compensation for the much more common situation where employees leave or simply cannot perform the job. Aside from the question as to whether it is fair to punish employers in that situation, removing the credit changes the employer view about WOTC: Is the tax credit enough of a benefit to cover the additional risk of hiring a WOTC candidate knowing that if they do not stay for 400 hours, I get nothing? This proposal reduces the expected value of the WOTC tax credit and in turn the chance of giving the nod in hiring to WOTC-eligible individuals over other candidates.

The final assumption is that jobs that end in less than 400 hours are bad jobs. That is fallacious. First, the 400 hour requirement refers only to when a WOTC-employee leaves employment and not whether the job ends or continues and is filled by someone else. As the evidence above showed, employees can and do leave good jobs. Their time in the job does not define its quality. Second, there can be jobs that we know will have short tenure – seasonal jobs at resort locations for example - that can be attractive despite not having the prospect of continuing.

If we return to the opening question, what problem would be cutting the tax credit for employees who stay more than 120 hours but less than 400 solve, there is no compelling answer. We can clearly see the downsides of doing so, which will affect every potential employer considering a WOTC hire. There are no apparent benefits. It is difficult to see given the examples above why employers would knowingly put themselves in the situation of creating actual jobs of more than 3 weeks but less than 400 hours when they could instead combine them and have fewer jobs lasting longer and capture the bigger 400 hour tax credit. The idea that there is a cohort of employers creating such jobs is implausible.

Again, what this proposal would therefore rule out would only be situations where an employer knew going in that they had work that would not continue (which is not the case for a temp agencies) and would last longer than three weeks but less than 400 hours and that could not be linked together to create 400 hour jobs securing the bigger tax credit; that a reduced 25% credit was enough to offset the hiring costs and administrative costs of the WOTC program; and finally, that the common alternatives of gig work or temporary help that avoided hiring and employment costs altogether was not preferable. We have no evidence that such situations even exist. In return, it reduces the willingness of any employer to take on a WOTC-eligible candidate.

In short, this proposal is a solution in search of a problem.

Sincerely,

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cc: Members of Congress