

**The Work Opportunity Tax Credit
The New York State Experience
An Exploration of the Costs and Benefits
1996-2003**

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NYS Department of Labor**

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Executive Summary

This analysis is designed to provide a framework for discussions on the Work Opportunity Tax Credit (WOTC) as part of the current re-authorization efforts. WOTC expires on December 31, 2003. The study focused on the New York State (NYS) WOTC experience, from the program's creation in 1996 through the close of the current FY 2003 program year. Using WOTC activity in NYS, a cost-effectiveness review is developed that indicates net recurring taxpayer savings totaling approximately \$200 million from reduced Temporary Assistance for Needy Families (TANF), correctional services and vocational rehabilitation spending, enhancing the ability of the hard-to-employ to secure private sector employment, makes good budgetary sense.¹

Obtaining a job has a myriad of benefits for any job seeker, but especially for the economically disadvantaged facing barriers to employment. Increased self-esteem, family well-being and a reduced reliance on public services are concurrent benefits associated with finding work.

This study is by no means conclusive. Rather it raises several interesting research questions which merit further study. Specifically:

- Do taxpayer benefits outweigh the one-time costs of WOTC?
- Are focused education and marketing efforts needed to stimulate WOTC utilization for the nine WOTC target groups?
- Do WOTC participants remain in the workplace?

Questions on this study should be addressed to Hy L Dubowsky PhD, Principal Researcher at 518-457-6823.

¹ Additional savings would be generated from reduced Medicaid, Food Stamps and SSI costs that are not included in this study.

NYS WOTC STUDY

The NYS Department of Labor analyzed the WOTC and Welfare-to-Work (WtW) tax credits to provide an assessment of its public benefits relative to their direct and indirect costs. The study is designed to provide a statistical framework to assess the effectiveness of WOTC/WtW in encouraging private sector employers to hire economically disadvantaged and hard-to-employ individuals. Several questions, notably, the churning issue, have been addressed in a previous monograph issued in 1998.² This analysis revisits the cost-benefit review with the context of a maturing program. The study will also examine the effects of WOTC/WtW on retention periods compared to targeted employees who were hired without any tax incentive. Specifically the study will address:

- The benefits/costs of the WOTC;
- The characteristics of the WOTC employee;
- The effects of September 11 on WOTC hiring patterns of targeted workers; and
- The effects of the WOTC credit on TANF recipients transitioning to private sector employment.

STUDY METHODOLOGY

Datasets

Labor Department staff from the Economic Development Services Unit (EDSU) and the Division of Research and Statistics (R&S) developed datasets from the tax credit database, social services wage reporting system (WRS) and employer combined quarterly wage records. There are 235,936 employee records in the WOTC database. This raw data set formed the basis for the WOTC benefit-cost analysis.

Time Period:

The following periods are used for this analysis:

- 1996 (Q1) through 2003 (Q4) for the WOTC program;
- 2001 (3Q) through 2003 (4Q) for an assessment of the effects of September 11 terrorist attacks on WOTC utilization;
- 2001 (2Q) through 2003 (2Q) to explore the effects of WOTC on TANF employment.

² Hy L Dubowsky, "An Analysis of the Work Opportunity Tax Credit in New York State, October 1995-March 1998", NYS Department of Labor, (1998), Albany, NY.

Databases Used

- Tax credit application and processing database-NYSDOL;
- Welfare Management System-NYS OTDA;
- Combined Quarterly Wage Records-NYSDOL.

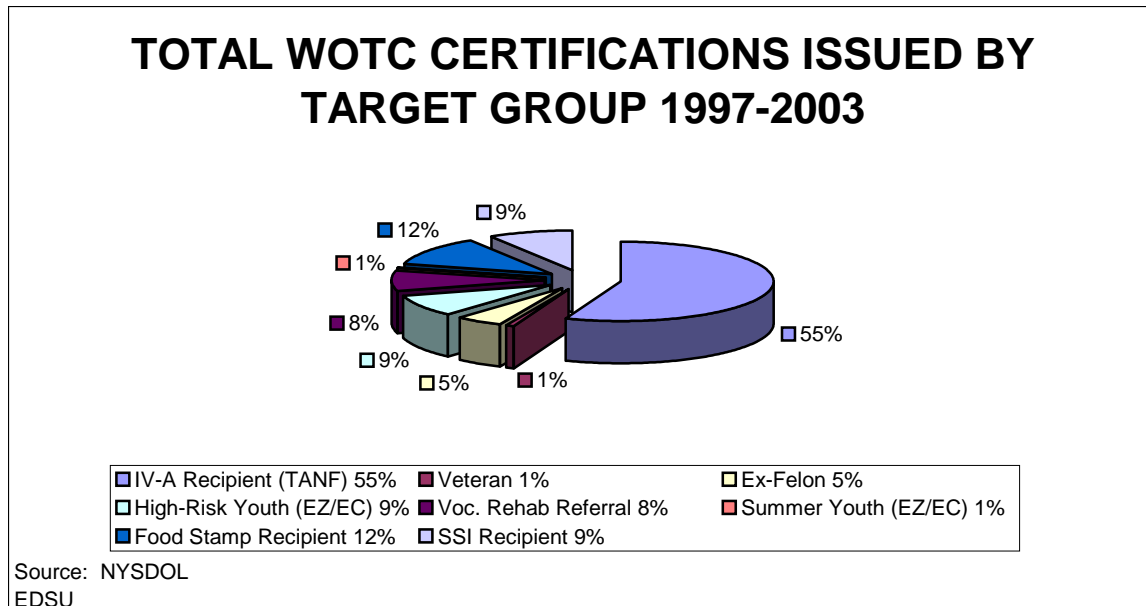
BACKGROUND

WOTC and Employment Data

WOTC recognizes nine target groups, each with its own distinct set of characteristics that, in and of themselves, form barriers to employment.

Figure 1 shows the composition of the WOTC employee population since the program's inception in 1996. Until 1997, WOTC recognized only eight target groups. In 1997 SSI was added. The WtW tax credit was also created in 1997. Sometimes referred to as the tenth WOTC group, it is a separate credit (Section 51a IRC) administered within the WOTC administrative frame.

Figure 1 WOTC Utilization by Certification



Since WOTC was first authorized in 1996, NYS has certified over 114,000 individuals with barriers to employment. The majority of the state issued WOTC certification activity derives from employing TANF and Food Stamp recipients. The emphasis on employability development for TANF recipients is the cornerstone of the Personal Responsibility of 1997, laying the foundation for the subsequent welfare reform efforts that swept the country. The policy shift that recognized the dependent nature of the existing welfare system focused resources and incentives towards independence through employment. Together, TANF and Food Stamp recipients comprise 67 percent of all WOTC certifications.

The remaining 33 percent of WOTC certifications are divided among the seven other target groups with mixed results. Despite an extensive employability network, the vocational rehabilitation community has yet to fully embrace the credit. Some have suggested that the success of the vocational rehabilitation efforts reduce the need for the added incentives. Still, others argue that identifying oneself, as a member of a target group may not only be self-denigrating but may dissuade an employer from making a job offer. Further study is necessary to more fully understand the complex nature of the hiring dynamic before a explanation as to why WOTC has not been more fully embraced by its other target communities.

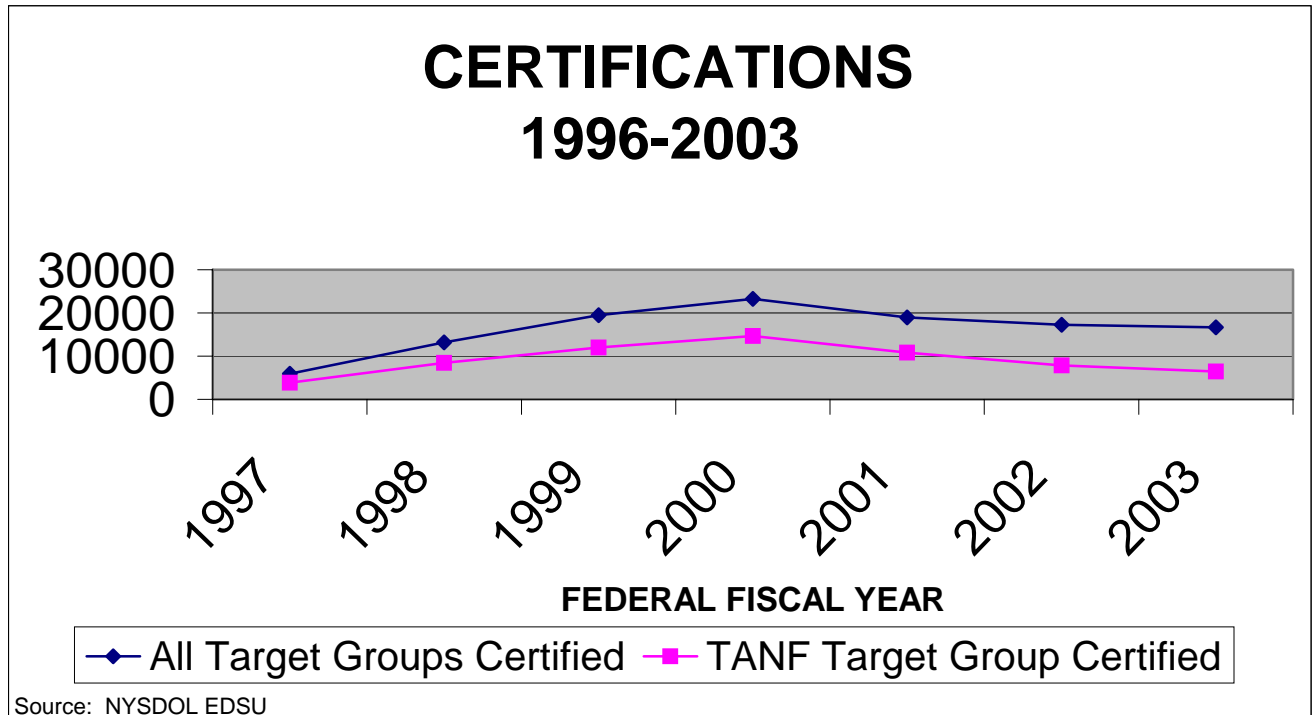
The sharp increase in WOTC, as shown in the Figure 2, started a year after the program's slow start, in 1997. Many in the WOTC community point to the widespread support by the employer community for welfare reform and the recognition of their critical role to provide jobs for people in need. These employer efforts were quite successful in NYS, supported in large part, by a partnership with Governor Pataki's welfare reform team.

The robust New York economy and the comprehensive welfare reform efforts led by Governor George Pataki had provided opportunity and the means to move those TANF recipients from the dependency of welfare into private sector jobs. Since July 1997, NYS has reduced TANF caseloads by nearly 60 percent: 219,496 cases representing over 679,000 individuals.³ While some TANF cases may have closed or aged out, many of these closures were due to the successful transition from welfare to work. The September 11 terrorist attacks, however, brought this economic growth to nearly a crawl and with it, a dramatic loss in retail and service jobs - the very first job opportunities available to those with barriers to employment.

³ TANF Caseload Data, BEAC Current News Reports, Office of Temporary and Disability Assistance, Albany, NY.

Figure 2 shows the trend in overall trend in WOTC utilization since the program's inception.

Figure 2
WOTC Certification Activity



The figure shows WOTC certification activity utilization reached its peak in 2000 as welfare reform efforts became integrated into corporate America's human resource's strategy and the national and state economies provided ample job openings. As New York successfully reduces its able-bodied TANF population through its combination of training and work first initiatives, the remaining TANF cadre requires greater concentration of services and job-readiness training. Within a year the national economic slowdown trickles down to the state and the catastrophic events of September 11 put a halt to the progress made in assisting job seekers with barriers to employment.

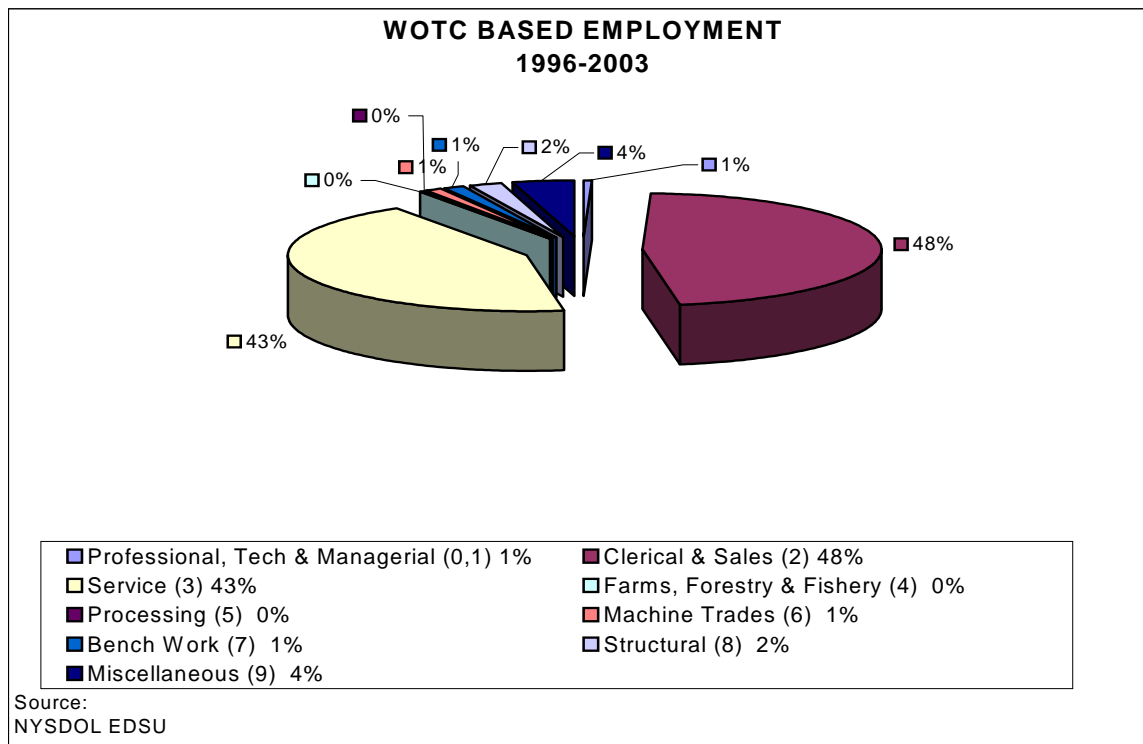
Wages and Positions

During the study period, 2001 (2Q) through 2003 (3Q) WOTC certified employees have earned in excess \$90 million in private sector wages.⁴ These wages, for many, represent the first paychecks ever received while for others it signifies a break from the vicious cycle of poverty. As shown in Figure 3, the majority of positions are

⁴ Data extrapolated using New York State Department of Labor, Research and Statistics Division, Combined Quarterly Wage reports.

either in the retail or service sectors of the economy, the traditional place where first and low skill jobs are located. Many of these employers offer career pathways and encourage new employees to remain and grow with the company. While not all represent career paths, securing a job is the essential first step.

Figure 3
WOTC-Employment Categories

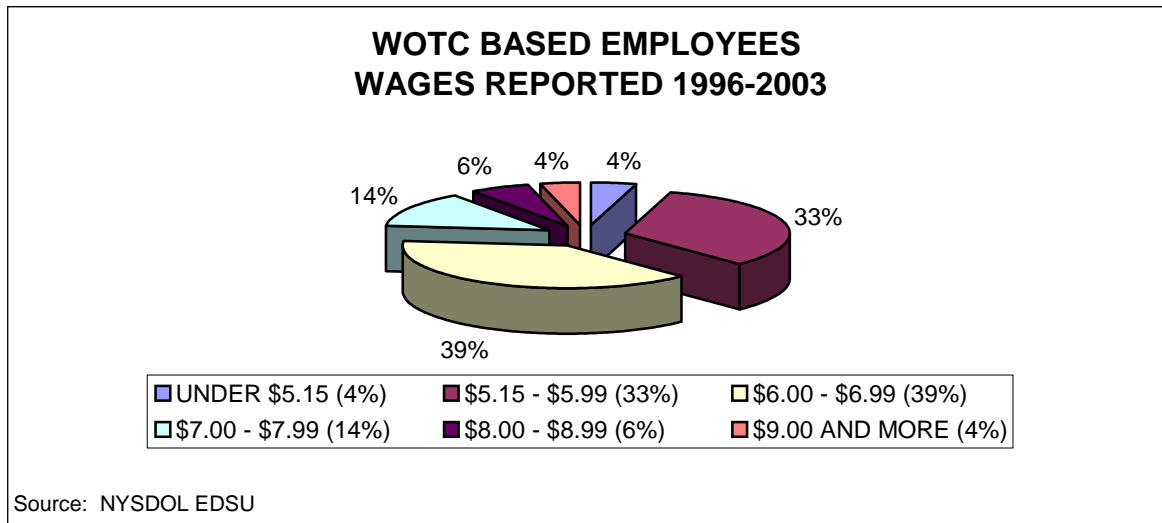


WOTC certified recipients earn slightly more on average than the federal and state minimum hourly wage, \$5.15 per hour, largely reflecting regional salary patterns. Seventy-two percent of the certified recipients earned between \$5.15 and \$8.99 per hour. Fifty-seven percent earned hourly wages totaling \$6.00 or more⁵.

⁵ NYS Department of Labor, EDSU database as reported on the ETA 9061 Individual Characteristics form. .

Figure 4

WOTC-Employment-Wage Groupings



The number of WOTC-eligible jobs remained fairly constant following its decline starting in 2000 and accelerating after the September 11 attacks. The effects of the loss of higher paying financial service and tech positions ripped through the retail and service sectors, displacing tens of thousands of entry level workers and spilling further into neighborhoods through the City and throughout the state. With fewer employment openings, there are fewer opportunities for the hard-to-employ. This in turn necessitates the need to provide employer incentives to modify their hiring decision in order to encourage employing the economically disadvantaged hard-to-employ job seekers who face barriers to employment.

The Effects of WOTC

Business

WOTC provides a one-time federal tax credit totaling up to \$2,400 for each qualified hire. The credits are a loss of federal business tax revenue shown as tax expenditures by the Treasury Department and Office of Management and Budget. The one-time tax expenditures affect market behavior by lowering the effective wage of qualified WOTC/WtW employees, offsetting the inherent costs associated with hiring workers with barriers to employment.

In New York, employers have earned approximately \$275 million in potential WOTC credits since 1996. The net value of the credit is somewhat less after incorporating tax code offsets such as tradeoff of the payroll deduction for the credit on salaries paid to targeted workers roughly \$183 million. Examining these potential tax savings in terms of potential sales and business services translates into increased economic activity in excess of \$1.8 billion.⁶ This is a powerful economic stimulus from these one-time

⁶ Assumes a effective 35 percent federal tax rate and the gross value of the WOTC credit,

employment tax credits. No firm escapes these benefits, though the net benefit is a function of the unique nature of each firm's production and operating costs.

Taxpayers

As targeted workers transition from TANF and other public programs, recurring budget savings are generated. Freeing taxpayers' funds provides the Governor with greater discretion in allocating scarce state resources. Entitlement spending, notably TANF, is mandated by law. Ending the cycle of TANF dependence has multiple beneficiaries with the NYS taxpayers saving approximately \$6,600 in federal and state taxes for each case closed.⁷

Transitioning other targeted individuals to work has similar benefits. Direct, state vocational rehabilitation savings total approximately \$340 on average, per employee, as consumers leave direct VESID services and enter employment.⁸ The VESID support network is comprised of a myriad of private and not-for-profit partners who use the tax credit as an employability tool. WOTC is often combined with other incentives such as on-the-job training, to further enhance the job seekers ability to obtain employment.

Ex-felons generate the greatest taxpayer savings should they succeed in finding work and remaining out of prison. According to a report on the costs of prison costs, the daily cost to incarcerate an adult in New York State is approximately \$96.72, per day, annualizing to \$34,800.⁹ As ex-felons are released from state prisons, they face tremendous barriers to employment. Failing to obtain employment is a leading cause of recidivism. Efforts of the New York State Division of Parole, Department of Labor, Department of Corrections and numerous community-based organizations dedicated to serving this targeted population, have resulted in New York enjoying the Country's lowest recidivism rate, roughly 40 percent.¹⁰ Of those returning to prison, however, approximately 89 percent were unemployed at the time of their arrest.¹¹

Each successful private sector placement results in recurring societal benefits and taxpayer savings. Additional savings from reduced levels of government support, including food stamps, health-care, and SSI services are also generated by the placements.

Cost-Effectiveness

Comparing the cost of WOTC as measured by the value of the tax expenditures compiled by the Treasury Department, there is a net measurable benefit. Table 2

⁷ Average taxpayer savings from closing a TANF case for a NYS family of three using a median between 1998 and November, 2003 case cost estimates,

⁸ NYS VESID, Memorandum of Support to the Legislature, 2002, Albany, NY.

⁹ New York State Department of Corrections, Albany, New York, in Connecticut Office of Legislative Research, "Department of Corrections Issues", Report 2003_R-0469 Kevin E McCarthy, principal analyst, June 2003.

¹⁰ New York State Department of Corrections, Albany, New York

¹¹ New York State Division of Parole, Albany, New York.

provides information on the potential taxpayer cost of the WOTC credit compared to the overall benefits provided to New York State taxpayers.

TABLE 2
Potential Cost (Taxpayer Savings)
WOTC-based Employment
(Dollars in millions)

WOTC COSTS	
Potential Value of WOTC tax credit certifications issued	\$275.39
Adjusted Value to Employers ¹²	\$183.59
Direct appropriation for administration	<u>\$ 9.05</u>
Total Costs	<u>\$192.59</u>
WOTC Potential Savings	
TANF Cases Closed	\$423.21
VESID Services Reduced	\$222.75
Reduced jail spending	<u>\$ 3.28</u>
Total Gross Potential Recurring Savings	\$649.24
Adjusted Potential Recurring Savings ¹³	\$392.48
Cost Recurring Effectiveness: Net Savings/(Costs)	<u>\$199.89</u>

The recurring benefit stream generated by transitioning the hard-to-employ to the world of work exceeds the one-time cost of the WOTC credit. As the table indicates, the total tax expenditure, as measured by the net federal tax revenue loss is lower than the recurring taxpayer savings. The WOTC program provides net benefits to the taxpayer. The additional benefit from the addition of new wages to the Gross Domestic Product (GDP) or reduced reliance on Medicaid and other public support programs provides further benefits.

Economic Benefits

Economic benefits are realized from the economic stimulus caused by the inclusion of the additional wages paid to targeted workers. The \$90 million in wages paid to WOTC workers since its inception in 1996, generated roughly

¹² Adjusted for the loss of corresponding deductions for payroll expenses.

¹³ Assumes 42 percent of WOTC-TANF certified employees and both 35 percent of WOTC-VR certified and Ex-felon certified employees, respectively, will terminate their employment and return to government supported services or be incarcerated thereby reducing the recurring taxpayer savings.

\$225 million in increased economic activity in the NYS economy using a “2.5 times” economic multiplier¹⁴. Encouraging employers to hire targeted workers with barriers to employment increases the GDP when projected across the nation. Entitlement payments are excluded from the GDP while wages are included. Providing incentives for hiring targeted workers and, therefore, not only makes good business sense but also offers elected officials to make a sound good public policy choice.

Additional Savings/Benefits

The Rockefeller Institute of Government released a report in 2002 that attempted to provide information on the outcomes of TANF families in NYS that affected by the welfare reform program started with the passage of the Personal Responsibility Act of 1996 and the NYS Welfare Reform Act of 1997 (which codified the state’s plan). The study tracked TANF recipients who entered into employment indicating that roughly 70 percent received some type of employee benefits package above the base salary. Of the sample populations studied, in excess of 60 percent of those working received health insurance benefits, paid vacation and sick days.¹⁵ These benefits generate even greater taxpayer savings as with the reduced reliance on publicly supported Medicaid as the health insurer of last resort.

The Report indicated that nearly 61 percent of the study’s respondents reported that employment was the main reason for leaving TANF. Most importantly, perhaps are the findings of “family well-being”.

“The Rockefeller study reported that “individuals with positive perceptions of post-welfare life experience, had, along with the better off group, higher levels of food security (though they were most likely to use a food bank or shelf) and were the least likely to have used a homeless shelter. They also reported the lowest use of domestic violence services, and no relatively lower levels of drug/alcohol counseling than either the status quo or the group with negative perceptions.”¹⁶

These family well-being indicators, while difficult to quantify, clearly have positive societal benefits. Similar satisfaction outcomes are also associated with the transition from supported services, direct government subsidy or incarceration by the state to the world of work.

Retention-Further Findings

The notion of welfare reform was transformed in 1997 from direct support to focused employability development leading to employment and independence. Using a sample of NYS TANF recipients who were certified as WOTC eligible during 2001 (2Q), indicate that WOTC has had a contributing effect on transitioning individuals from welfare to work. Examining NYS Welfare Management System (WMS) records and wage reports, roughly 58 percent of the TANF recipients who entered private sector

¹⁴ NYS Department of Labor, Research and Statistics, Albany, 2003.

¹⁵ “Leaving Welfare, Post-TANF Experience of New York State Welfare Families”, The Rockefeller Institute of Government, March 2002, Albany, NY.

¹⁶ *ibid*

employment with the assistance of WOTC were found not to receive any public assistance benefits when their cases were later examined in 2003. This is consistent with the findings in the Rockefeller study cited above.

Nearly 23 percent of the study group had remained with the original employer, two years after first being hired. This, despite turnover rates in the service and retail sectors totaling almost 100 percent. The credits apparently have had an effect on retention, especially the long-term Welfare-to-Work credit. Of this group, combined quarterly earnings increased by 27 percent over the two-year period-a rate well above inflation and changes in the minimum wage.¹⁷

Conclusion

The Work Opportunity Tax Credit program provides a one-time financial benefit to encourage employers to hire individuals with barriers to employment. In turn for this one-time benefit, recurring taxpayer savings are generated, community and family “well-being” is enhanced, and positive economic effects take place on a macro-economic basis. The program pays for itself and should be continued as integral part of the Nation’s workforce development strategy.

Further research is warranted on proposals to extend the program to other target groups. Consideration should also be given to broadening the study to include other large WOTC states in an attempt to create a national cost-benefit model.

¹⁷ NYS Department of Labor, Research and Statistics, Albany, 2003.