

FIP-OTC:

A Proposal to Increase Economic Opportunity for the
Formerly Incarcerated Population in California

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February 23, 2019

Introduction

California's recidivism rate is among the highest in the nation. [Over 65%](#) (California Innocence Project) of individuals released from prison return within three years; 73% of recidivists commit a new crime within a year of release.

Steady employment is one of the [strongest](#) (Harvard) predictors that a formerly incarcerated individual will maintain a distance from crime. Employment provides both a reliable source of income and a predictable daily routine. Unfortunately, the stigma associated with having a criminal record remains a [significant barrier](#) (Harvard) to employment across industries. The unemployment rate among the formerly incarcerated is [27%](#) (Prison Policy Initiative) nationally, meaning over one in four of those once in prison are unable to find employment.

Improving employment prospects for those with criminal records can be done through two mechanisms — increasing in-prison job training or incentivizing employers to hire those formerly incarcerated. We see numerous drawbacks to vocational job training programs. First, many jobs exist that do not require additional job training; formerly incarcerated people are not being hired for these jobs due to prejudice not due to lack of training. Second, the current economy is dynamic, and job training programs, many of which focus on teaching prisoner skills that intersect with technology, will likely not be able change with the rapidly evolving technological economy. Third, vocational job training programs cost money up front, only saving money in the long-term, making them politically infeasible to implement in an environment that treats prisoners with apathy.

Employers tend to be wary of hiring the formerly incarcerated due in large part to prejudice. Initiatives such as “Ban the Box” have attempted to eliminate these stereotype-driven barriers, but they have had the adverse impact of [lowering employment among minorities](#) (Science Around Michigan). There are incentive structures, however, that would provide employers with an economic reason to hire formerly incarcerated individuals.

Proposal

We propose a California-based version of the federal Work Opportunity Tax Credit (WOTC) targeted to employers hiring the formerly incarcerated. The Formerly Incarcerated Persons Opportunity Tax Credit (FIP-OTC) would scale by county factors, targeting tax credits to areas where economic opportunity for the formerly incarcerated is most dire.

The Federal WOTC

The [Work Opportunity Tax Credit \(WOTC\)](#) (IRS) is a pre-existing federal tax credit available to employers who hire individuals from groups that traditionally face significant barriers to employment including qualified veterans, food stamp recipients, summer youth employees, and the formerly incarcerated. The WOTC scales between \$1,200 and \$9,600 depending on factors including length of time the new worker was unemployed, employee salary, and number of hours worked in first year. However, the WOTC benefits for felons is capped at \$2,400.

The WOTC has been found to be effective at counteracting employer prejudice. [RAND](#) found that under the current federal WOTC policy 59 percent of employers would consider hiring a formerly incarcerated individual.

The federal program, however, is severely deficient. It is set to expire at the end of 2019 unless it is reauthorized by Congress, placing it at the jeopardy of Congressional inaction and polarization and making it an unreliable policy for employers and employees. It is also not targeted to the formerly incarcerated, and the factors it takes into account do not maximize benefit for former offenders.

FIP-OTC

The size of the tax credit awarded will be tailored based on county-level factors. Each county has varying economic factors that impact ease and necessity of employment of formerly incarcerated people. For one, the more economic opportunity in a given area, the easier it is for a formerly incarcerated person to gain employment. Each county also has varying sizes of formerly incarcerated populations. The greater the formerly incarcerated population, the more jobs needs to be made available to these individuals. Thus, the FIP-OTC should be scaled by these two factors — incentivizing increased employment opportunities for formerly incarcerated individuals in places heavily populated by formerly incarcerated people and devoid of economic opportunity.

We estimate the need of a county, γ_i , where fip_i is the number of formerly incarcerated people released to a county, pop_i is the population of that county, and e_i is a reverse-scored measure of economic opportunity and health and ranges from 0 to 1. Thus, γ_i is scaled from 0 to 1, where large values of γ_i signal more need.

$$\gamma_i > \frac{fip_i}{pop_i} + e_i$$

The relative county-level need is then used to assess the available tax credit amount per county. This is calculated by taking the proportion of need relative to the other counties and multiplying it by the total amount of credit allocated.

$$county = \frac{\gamma_i}{\sum_{i=1}^N \gamma_i} (total)$$

Impact on recidivism

Some estimates indicate that recidivism of those who are employed is around 5%. Employment is a [turning point](#) (Corrections Management Quarterly) for formerly incarcerated people that allows them to gain a source of income as well as a sense of stability. Providing an incentive for employers to hire these formerly incarcerated individuals ensures the creation of not just jobs, but stable opportunities for advancement.

We calculated the new three-year recidivism rate after the implementation of this policy based on a \$5,000 base tax credit to be 59.3%. This is a rough estimate, but it gives a general idea that the recidivism rate will decrease under this new policy (steps described in the Cost/Benefit Analysis section below).

1. Set the FIP-OTC amount to \$5,000, as that is a rough upper bound for the FIP-OTC.
2. Use [this study's](#) (RAND Corporation) prediction that, if the FIP-OTC were \$5,000, 77% of employers would consider employing a formerly-incarcerated person.

3. Add all counties' total formerly-incarcerated persons count together to find the total number of felons released (35,568).
4. Create a rough estimate of how many formerly-incarcerated peoples would be hired, assuming that about one third of the 77% of employers would actually hire formerly-incarcerated people. The estimate yielded a number of 9129.12 formerly-incarcerated people hired.
5. The recidivism rate among employed formerly-incarcerated peoples is 5%. Assuming that this recidivism rate remains the same among employed formerly-incarcerated peoples, and the current recidivism rate among all formerly-incarcerated peoples is 65%, we were able to calculate the recidivism rate among unemployed formerly-incarcerated peoples to be 78%.
6. Using the recidivism rate among employed formerly-incarcerated peoples, the recidivism rate among unemployed formerly-incarcerated peoples, the total number of formerly-incarcerated peoples released, and the estimated number of formerly-incarcerated peoples hired, we were able to calculate a projected recidivism rate among all formerly-incarcerated peoples: 59.3%.
7. With this projected recidivism rate, taking into account the marginal cost of a prisoner, average ratio of officers to inmates, the officer salary, and the current cost of California prisons, we were able to calculate that the state would save roughly \$220 million out of the \$12 billion in current total cost.

Cost/Benefit Analysis

In California, [\\$81,000 is spent per prisoner per year](#) (Legislative Analysis Office of California) 92% of this cost, however, is from fixed costs (i.e. security, prison administration, facility operations and records), making the marginal cost of a prisoner approximately \$6,586. It is important to note, however, that, as recidivism rates decline, the costs of operating a prison will also decline as security and administrative costs fall; hence, the benefit of the FIP-OTC will be compounded over time.

It is important to recognize, however, that the FIP-OTC actually costs the public money when we take into account the fact that many companies benefitting from the FIP-OTC may be hiring formerly-incarcerated peoples that are unlikely to recidivate regardless of employment. Therefore, we must consider the fact that the three-year recidivism rate is 65%, meaning that 35% of formerly incarcerated individuals who are the beneficiary of this tax credit will not recidivate regardless. Finally, we must take into consideration the fact that some employed formerly-incarcerated peoples will still recidivate. Studies have estimated the recidivism rate among the employed to be approximately [5%](#) (Real Clear Politics), therefore, only 95% employed will remain out of the prison system.

Considering these factors, for the credit to save the state money, we determined the target average using the following formula:

$$\overline{OTC} + Pr(Recid | OTC) \times (\overline{OTC} + MC) \leq Pr(Recid) \times MC$$

Thus, using a conservative estimate, the tax credit must be lower than \$3,763. Knowing this, we can calibrate the tax credits so that the marginal benefit of the tax credit will be roughly equal to the marginal cost of the tax credit (average tax credit awarded).

If the impact of this tax credit on recidivism is as large as we estimate, then overtime fixed costs will also fall as prison population falls. Thus, it may make sense for the state to make an initial investment that would make marginal cost greater than the initial marginal benefit of the tax credit. Depending on political capital and citizen investment, California could increase the amount of money dedicated to these tax credits.

Administrative Differences between WOTC and FIP-OTC

The federal WOTC has a high paperwork burden, which means the WOTC take-up rate tends to be low. Simply eliminating some of this burden would increase percent of employers interested in hiring formerly incarcerated people from [59% to 71%](#) (RAND) even if no other changes to the WOTC were made, according to a RAND study estimate.

This amount of paperwork is onerous and unnecessary. It could be simplified by both making forms electronic and decreasing the number of required forms. California has electronic filing for employment forms including the W-2, meaning the FIP-OTC filing process could be made electronic.

An employer also must complete forms during the hiring process to secure the WOTC. This is unnecessary requirement that will be removed in the FIP-OTC, allowing more employers and employees to benefit from the tax credit.

The case of Los Angeles

Los Angeles County is the largest county in the United States. It also has the greatest number of formerly-incarcerated peoples compared to all other California counties (10,360). With a population of 10.16 million, it is extremely economically diverse. In 2017, Los Angeles County had a [GINI Index of .499](#) (Propel LA), which is higher than that of the entire State of California. Moreover, the neighborhoods with the highest poverty rates are concentrated in specific geographical areas, namely in [South Los Angeles and Downtown adjacent areas](#) (LA Chamber of Commerce); therefore, for Los Angeles County specifically, it is important that we take into account the zip code-level variability. Currently, the zip code-level data is unavailable, but we believe that, in order to be most effective, the FIP-OTC should be tailored to regions of zip codes in Los Angeles County.

Concluding Statement

Implementing the FIP-OTC will not just decrease recidivism and, in the long-term, save the state money, but it will also provide a net impact to society by giving hundreds of thousands of formerly incarcerated people a second chance.