Prisons for Profit and Modern Bounty Hunters

How useful is it to pay private companies to confine prisoners and catch criminals?

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# Table of Contents

1. Introduction .............................................................................................................. 3

2. Theoretical underpinnings ......................................................................................... 3
   2.1 Public Goods Theory .......................................................................................... 3
   2.2 Privatization ..................................................................................................... 3
   2.3 Government and Market Failure ......................................................................... 4

3. Considerations about prison privatization............................................................... 5
   3.1 Costs and Efficiencies and Flexibility ............................................................... 5
   3.2 Quality Aspects and Incompleteness of Contracts ............................................ 6
   3.3 Security and Liability ....................................................................................... 8
   3.4 Accountability and Moral Issues ..................................................................... 8

4. Conclusions ..............................................................................................................10

References .......................................................................................................................11
1 Introduction

The main reason of delegating public tasks to the private sector are the cost discipline inspired by competition, and an institutional setting that affords superior motivation to discover better, cheaper ways to deliver value (Donahue 1989, p. 159). However, a review of the literature shows some major differences in privatization in the security sector compared to other institutions run by the government, such as schools or the health care system. Besides the arguments for privatization – which usually emphasize possible cost reductions – there are other important considerations linked to the privatization of security including the quality of service, the flexibility to adapt to new circumstances and the accountability of governments in general (see, for instance, Logan 1990, p. 38).

The paper starts with some theoretical underpinnings, including the Public Goods Theory and possibilities of privatization in this area. It continues with some main issues concerning this topic and highlights possible advantages and disadvantages of prison privatization. The final section eventually summarizes the arguments and concludes.

2 Theoretical underpinnings

2.1 Public Goods Theory

First of all, homeland security is a classic case of a pure public good, where the marginal cost of providing another agent with the good is zero, and where no one can be excluded from enjoying its benefits (Batina/Ihori 2005, p. 2). Providing security services such as the police is therefore comparable to other public goods such as national defence, clean air and water or scientific research. The private sector has difficulty providing such goods since it is difficult to charge those who benefit from the good and to exclude non-payers from enjoying the good once it has been provided. Therefore, the two main characteristics of public goods are fulfilled: in the case of homeland security – including the provision of prisons – there is neither rivalry nor excludability. Thus, to guarantee security in general, it has to be financed publicly, because no private company would provide this service as nobody would pay for it (referred to as the well-known “free-rider” problem).

2.2 Privatization

Furthermore, the term “privatization” can be confusing in the context of prisons. Privatization theoretically involves choices along two dimensions: financing (ownership), namely whether taxes (collective resources) or fees (individual resources) are to be used, and provision (operating authority), whether the service is to be delivered by a government or non-government organisation (Donahue
Following this concept, basically there are four possible types of prisons, as shown in Table 1.

<table>
<thead>
<tr>
<th>Ownership</th>
<th>Operating Authority</th>
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<tbody>
<tr>
<td>Public</td>
<td>Conventional public facility</td>
</tr>
<tr>
<td>Private</td>
<td>Contracted management and operations</td>
</tr>
</tbody>
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Table 1: Types of prison privatization (Merryman 2001, p. 17)

Following the arguments about public goods, the fully private possibility drops out as it would jeopardize the reliability of a country’s security system. Therefore, this paper discusses the choice between in-house provision and contracting out security services, especially the operations (contracted management) and building (lease purchase arrangements) of prisons. Advocates of privatization point out private suppliers deliver public services at a lower cost than public employees do. The critics of government contracting stress that the quality of public services that private contractors deliver is inferior to that delivered by public employees (Hart/Shleifer/Vishny 1997, p. 1127). Other possibilities of private participation include contracting of specific services (such as food preparation or garbage collection) and the provision of work for prisoners (Dickson 1994, p. 35).

### 2.3 Government and Market Failure

One of the most popular justifications for privatization is government failure. This term refers to any one of a range of potential shortcomings in the process and administration of government (Morris 2007, p. 322). There are particular difficulties in valuing output, limited competition and inflexibility through civil service protections are common arguments. When government builds and operates prisons there is no market competition to encourage efficiency. Furthermore, regulations add additional costs to services provided by the government.

Another important theoretical concept concerning privatization is that of market failure, including the non-excludability of public goods, natural monopolies and information asymmetry. Prisons are often defined as public goods (Savas 2000), long-term contracts create virtual monopolies, and prin-
Principal-agent relationships are common with information asymmetry (Breaux et al. 2002). Issues that are linked to these theoretical concepts will be highlighted in the next sections.

3 Considerations about prison privatization

3.1 Costs and Efficiencies and Flexibility

The major arguments for the privatization of prisons are usually cost effectiveness and flexibility. Advocates claim that the private sector can finance, build and operate prisons less expensively and more efficiently than government agencies without lowering the quality of services (see, for example, Logan 1990).

Following the line of argument in the last section, the least controversial aspect of private involvement in corrections is a private firm building the prison. It seems likely that private building contractors are able to build prisons more quickly and cheaply than the public sector. The estimated cost savings of using a private firm to build a prison is from 15 to 25 percent (Moore 1998).

The two other forms of privatization are more controversial. In both forms, contracted management and the fully private prison receive payment by the state for running the prison. Estimates assume that privately operated prisons are about 10 to 15 percent cheaper, per prisoner, than public prisons (Donahue 1988; Logan 1990; Logan and McGriff 1989; Sellers 1989). However, contracting creates other costs for negotiating and managing the contracts as well as monitoring contractor performance (Logan 1990, p. 45).

While most of the studies mentioned above have been case studies, Merryman (2001) examines the systematic difference between public and private prisons in terms of costs, quality, and efficiency on an econometric basis. He concludes with similar results (see Figure 1).

“The short-run labor costs are significantly lower in privately managed prisons. The results are consistent with the general theoretical implication that the incentive to earn profit will change the behavior and performance of firms.” (Merryman 2001, p. 91)

Furthermore, the results indicate that the facilities experience increasing returns to scale with respect to labour, both in private and public prisons.
However, critics argue that any cost savings will come through a deterioration of quality, leading to more prisoner lawsuits for which the state is ultimately responsible. The private prison will be under pressure to reduce costs, which may also cause it to reduce quality (Merryman 2001, p. 47). Additionally, some analysts fear that private facilities will not produce high quality prisons but only take the least troublesome prisoners. The problem with such “cream skimming” is that it creates a two-tier prison system making comparison between public and private facilities misleading.

Furthermore, even if private operators are able to reduce costs, it does not automatically follow that these savings will be passed on to the government, since the efficiency of private prison operators depends on the nature of competition in the industry (Chan 1994, p. 49).

3.2 Quality Aspects and Incompleteness of Contracts

An especially crucial area when considering the privatization of prisons is the quality aspect. Although advocates of privatization argue that contracting may add new expertise and specialized skills (Logan 1990, p. 42), other authors question whether the potential of innovations and cost savings in the correctional sector reduce quality (see, for instance, Merryman 2001, p. 47).

Another argument for privatization is that contracting allows for comparisons and, therefore, motivates both governmental and private prisons to compete on quality as well as cost (Logan 1990, p.
43). However, this argument is questioned by several scholars, including Morris (2007) and Merryman (2001). Their arguments are based on the principal-agent theory.

“Often defined as a market failure, the principal-agent problem concerns the steps necessary to ensure that the agent carries out its duties in the best interests of the principal.” (Morris 2007, p. 327)

In the case of prisons, government acts as an agent of society. When government enters into a privatized arrangement, however, government becomes a principal, and the private contractor becomes the agent. Government’s role becomes less clear and more complicated. Moreover monitoring mechanisms must be in place to discourage or prevent behaviour of the agent that is not in the interest of government. Another issue is, as mentioned before, that the market may lack competition which would simply replace public monopolies with private monopolies.

“The paradox, of course, is that the perceived benefits of privatization (addressing government failures) may be lost in an effort to prevent market failures in the same relationship.” (Morris 2007, p. 333)

Another problem is the incompleteness of contracts. Proponents of privatization argue that contracting does not jeopardize the due process because private and public wardens are equally subject to the rule of law and accountable to the same constitutional standards (Logan 1990, p. 41). Although contracts can address some quality issues, in several important areas incompleteness is evident, and could in principle compromise the quality of service delivered by a private contractor. The two crucial areas are use of force and quality of personnel (Hart et al. 1997, p. 1150). It seems that there are significant opportunities for cost reduction that do not violate the contracts, but that can substantially reduce quality. Furthermore, effective monitoring is expensive and the cost could absorb much of the savings from prison privatization (Dilulio 1991). The state will therefore have a disincentive to devote sufficient resources to the monitoring of private contractors (Brown 1994, p. 109). Another problem is that the contract usually does not require the contractors to make their financial records available to state auditors, thus creating an asymmetry of information. Considering the problems of measurement the output of prisons (costs and quality), the asymmetry of information may be seen as market failure, as well as a consequence of the terms of the principal-agent relationship (Morris 2007, p. 331). Shichor (1998, p. 92) hits the nail on the head by explaining the paradox of privatization:

“It is somewhat ironic that privatization advocates claim that monitoring by government agencies and their officials will be an effective measure to ensure that correctional corporations will fulfill the contract provisions completely, since one of their main contentions is that government is inefficient and its agents lack the ability, talent, initiative, and motivation to do good work.”
Furthermore, as mentioned before, there is evidence of “cream-skimming” (Kettl 1988) taking place in these facilities, with the private contractors keeping only the least costly, least troublesome inmates. The state must assume responsibility for the most costly, most troublesome inmates. In this aspect, it seems that the principal-agent problem and the measurement of outputs are closely linked (Morris 2007, p. 332). Moreover, this “cream-skimming” effect will spuriously make the private prisons look better by comparison (Logan 1990, p. 46 and Moyle 1994, p. 54)

3.3 Security and Liability

Critics of privatization further claim that it may jeopardize public and inmate safety through inadequate staff levels and training (Harding 1994, p. 66). Although a certain level of staff training can be included in the contracts, the profit motive of private corporations may contradict some objectives of the government. Moreover, contracting may cause high employee turnover at transition because of lower salaries (Logan 1990, p. 47) leading to deteriorating levels of quality.

Concerning liability issues, advocates of privatization state that it may decrease the risks for government through higher quality performance and through indemnification and insurance. However, as Shichor (1998, p. 90) points out, “the state can delegate authority to private parties to administer the punishment of offenders, but it cannot shed its legal liability for what is happening in a privately operated prison. Consequently, government agencies that contract with private corporations have to ensure that private contractors will be accountable for their actions.”

3.4 Accountability and Moral Issues

Concerning accountability and moral issues, there are very few arguments that support prison privatization. Advocates claim that accountability may even increase because it is easier for the government to monitor a contractor than to control itself because privatization promotes the development and use of objective performance measures (Logan 1990, p. 44). However, as mentioned before, monitoring is a crucial area in the correctional sector.

On the other hand, the setting and enforcing of the laws of society are inherently and essentially functions of the state, and incarceration of offenders is an integral part of the legal process (Brown 1994, p. 105). Therefore, privatization of imprisonment may involve an improper delegation to private hands of coercive power and authority. The government has to ensure that the contractor’s role is limited to administering punishment, not allocating it (Harding 1994, p. 65). As Morris (2007, p. 323) states, “prisons serve as a symbol of the coercive power of the state”.

Prisons for Profit and Modern Bounty Hunters
Another issue about privatization is that it may put profit motives ahead of the public interest, inmate interests and the purposes of imprisonment (Logan 1990, p. 45).

“While government agencies, at least formally, are mandated to serve the public good and are responsible to the citizenry, private businesses, as noted, are established principally to pursue profits for their owners and investors.” (Shichor 1998, p. 88)

Furthermore, contracting on a per prisoner, per diem basis gives private companies an incentive to hold prisoners as long as possible. It creates incentives to lobby for laws and public policies that serve special interests rather than the public interest; in particular, private prison companies may lobby for more imprisonment (Logan 1990, p. 46). The existence of a well-funded and motivated force behind a push for tougher policies will pose additional problems in any effort to arrive at more rational and humane penal policies (Chan 1994, p. 55). Basically there is a conflict between the interests of society in ultimately minimising the number of people confined in prisons, and the financial interests of private prison operators in maximising the number of prisons and prisoners, and the length of sentences (Brown 1994, p. 105). It is likely that the private prison industry will be able to influence government policies for its own benefit without regard to the public interest (Shichor 1998, p. 84). This fact may expand the use of imprisonment and weaken the search for alternatives. From a moral perspective, it is questionable whether it is proper that a private corporation profits from punishment which causes deliberate suffering for members of society who were caught breaking the law (Shichor 1998, p. 84).

![Figure 2: Total inmate population growth in the US (Merryman 2001, p. 6)](image)

Considering the increasing number of inmates (see Figure 2 as an example for the US), it is necessary to think about alternatives to imprisonment. Although the crime rates in the US have started to decrease since the early 1990s (Merryman 2001, p. 15), the inmate population continues to increase.
The demand for politicians to be tough on crime has led to such measures as mandatory sentencing and “three strikes” laws that send criminals to life in prison following their third felony conviction. Along with the measures against drug abuse, these policies have increased the demand for prison space (Merryman 2001, p. 8). This led to the search for better and cheaper possibilities, including the privatization of corrections. This raises the question about other possibilities of punishment in areas where the prisoners do not jeopardize society, e.g. through therapy or higher monetary penalties. Although these are very important considerations in this area, a more detailed analysis of these aspects would go beyond the scope of this paper.

4 Conclusions

To conclude this paper, we have to summarize our essential findings once again. First of all, security – including the provision of prisons – is a public good. Therefore, prisons have to be financed publicly. Second, government failure is one of the most popular justifications for privatization. In the case of prisons, however, it seems that privatization can easily lead to market failure, including natural monopolies and principal-agent relationships. Third, empirical data about the cost of public and private prisons show that privately run prisons are cheaper to run. However, measurement of output and quality in prisons is very difficult. Fourth, following the preceding argument, the incompleteness of contracts and the asymmetry of information may lead to deterioration in quality. Finally, setting and enforcing laws of society are inherently and essentially functions of the state.

Considering all these arguments, a privatization of prisons could make sense from a purely economic perspective due to possible cost reductions. However, the conflict between profit motives and the public interest seems especially crucial. This may weaken the search for alternative punishments. The fact that the number of inmates has been increasing although the crime rates have started to decrease should make us sceptical. Probably the question about privatization of prisons is more an issue of doing things right, rather than doing the right things. Doing the right things could mean to think about measures to reduce the inmate population and to give innocuous prisoners a new chance to organize their lives.
References


