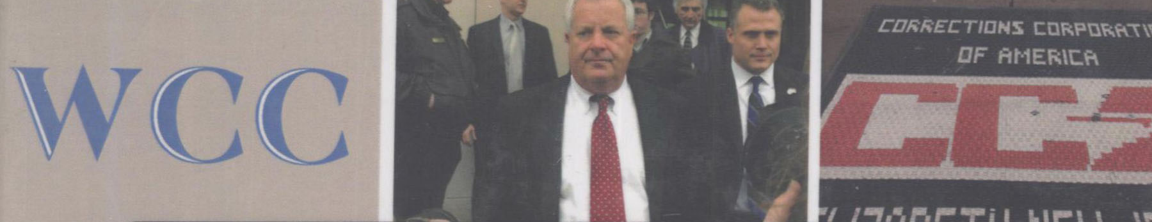

Byron Eugene Price and John Charles Morris, Editors

PRI$ON PRIVATIZATION

The Many Facets of a Controversial Industry

VOLUME II: Private Prisons and Private Profit

Prison Privatization

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Prison Privatization

Volume I
The Environment of Private Prisons

Volume II
Private Prisons and Private Profit

Volume III
The Political Climate of Prison Privatization

This book is dedicated to my mother, Mabel E. Price, for being my inspiration.

—Byron E. Price

This book is dedicated to my wife, Elizabeth Dashiell Morris, for her love and support.

—John C. Morris

Acknowledgments

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—Byron E. Price and John C. Morris

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Introduction

A Market Primer

Byron E. Price and John C. Morris

Prison privatization is a viable policy alternative to traditional government provision models because there is sufficient incentive in the arena to attract private companies to vie for the right to provide these services to government. While this may seem like a very basic observation, it is critical to understand the implications of this point in order to better understand the private sector's incentives to seek these arrangements.

Capitalist theory posits that companies that compete for customers will seek to provide the highest-quality service at the lowest cost. Through these competitive forces, and the efficiencies that arise from them, potential buyers will reap the benefits of getting more for less. Thus, governments wishing to purchase prison services would benefit from the market forces generated by multiple companies competing for government business.

However, just as government is prone to failures that limit its effectiveness as an allocator of goods and services (see Weimer and Vining 1999), a capitalist market is also subject to potential failures that limit its effectiveness as an allocation mechanism. First, markets are not always as perfect as they are assumed to be. For example, market competition exists only when there are sufficient companies offering undifferentiated products (that is, products that are directly comparable). Furthermore, functioning markets require enough sellers to create a demand for those undifferentiated products.

Market failure can also be understood through the lens of a principal–agent relationship. Developed as a means to understand the ways in which buyers and sellers interact, principal–agent theory begins with an assumption that there is a principal (buyer) who desires some good or service but who is unable or unwilling to provide for himself or herself. The agent (seller) is retained to provide that good or service to the principal. In a transaction such as a simple purchasing decision (for example, the decision to buy a bottle of water), the transaction is done at arm's length and is often accomplished through an intermediary (a retail seller of the product). Such transactions are also generally one-time affairs. On the other hand, a 20-year contract to provide prison services is a long-term, ongoing arrangement between a principal (government) and an agent (the private prison company).

In our bottled water example, the relationship is limited and secondhand, and each party clearly understands the motives and goals of the other: the company wants to sell bottled water, and the buyer wants to quench a thirst. If the buyer believes the price is fair, then the transaction is completed, and each goes away having accomplished his or her goal. If government buyers of prison services are not "smart buyers" (Kettl 1993) and fail to understand the incentives and values of the private market, a transaction may still occur, but the relationship likely will be fraught with conflict. The same is true if the private sector partner (the agent) fails to respect the goals and values of government (the principal).

Consider the market for bottled water. There are numerous companies that bottle and sell drinking water. Although we might argue that one brand of water is better than another, for many consumers, there are multiple brands of bottled water that are acceptable choices, and there are millions of consumers willing to purchase bottled water. In this case, we have large, undifferentiated markets with lots of buyers. On the other hand, consider the market for buying nuclear-powered aircraft carriers. There is currently one company in the United States with the capability to build these huge ships; moreover, there is only one buyer (the United States government) with the funds (or the need) to buy such a ship.[1] There are shipyards in other countries that can build aircraft carriers, but they are not nuclear powered. Therefore, though the market for bottled water is both large and undifferentiated, the market for aircraft carriers is neither large nor undifferentiated.

When we examine the market for prison services, we see something of a mixed picture. On the one hand, we know that the demand for private prison space is increasing, and that many states and local governments have contracted with private companies for these services. On the other hand, mergers and acquisitions have led to a significant decrease in the number of companies offering prison services, meaning that there is not a large number of undifferentiated products available to buyers. In 1995, when the State of Mississippi sought private sector companies to build and operate prisons, only two firms submitted bids, and the bids were nearly identical. The state ended up entering into (nearly identical) contracts with each of the two companies (Morris 2007).

Other categories of market failure can also exist. A common issue is that of asymmetric information, in which the seller of a good or service always has more information about that good or service than the buyer does. In the United States, we use a variety of laws to protect consumers against problems of asymmetric information. Many states, for example, have lemon laws on the books. No reasonable consumers would buy an automobile if they knew that particular auto would suffer significant mechanical failure. However, car companies have been found to sell autos they knew to be defective to unsuspecting consumers.

Problems of adverse selection and moral hazard are also common forms of market failure that stem from problems of information asymmetry (Kettl 1993). Adverse selection occurs when a principal chooses an agent who may not be capable of performing the tasks required by the principal or may not be capable of performing them at a level concomitant with the expectations of the principal. No matter how much due diligence and investigation a principal may undertake, the agent will always know more about his or her own qualifications than the principal. Likewise, claims of ability by an agent cannot always be verified by the principal. An agent may claim specific abilities or advantages over its competitors, but to divulge details of process may well jeopardize the agent's competitive advantage in the market. This may not be a significant problem in short-term interactions, but it can become a significant issue when long-term contracts are part of the equation.

Moral hazard is a problem of a difference in interests, and it occurs when agents seek to place their interests ahead of those of the principal. This swap of interests is what theorists refer to as "shirking" behavior—agents shirk responsibility of the principal by meeting their own interests before meeting those of the principal. The incidence of moral hazard can be reduced by monitoring the actions of the agent, but monitoring is not free. Every dollar spent on monitoring is a dollar not spent on service delivery. As an example, suppose a homeowner hires a contractor to paint a house. The homeowner (principal) wants a house that has been nicely painted using quality materials. The homeowner might therefore specify a certain brand or quality of paint and require the contractor (agent) to carefully remove the old paint before applying new paint. If the homeowner then goes to work while the contractor paints, the homeowner has no way to know whether the contractor removed all the old paint, or whether the contractor bought the expensive paint specified by the homeowner or a discount paint at half the price (and, perhaps, half the quality). Indeed, the contractor's incentives act exactly in this manner: the difference in the cost of the paint and the reduced labor spent removing the old paint translates into significant extra cost savings (profit) for the contractor. On the other hand, the homeowner could stay home and watch the work being performed. The principal thus assumes the additional cost of a day of missed work (or a day's vacation used).[2]

Prison privatization can create some difficult principal–agent problems; chief among these problems is the issue of goal co-alignment. Public prisons are generally considered to have three goals of varying importance: punishment, rehabilitation, and the protection of society. On the other hand, the chief goal of a company offering prison services is profit. Indeed, if the chief goal of the private company were any different, capitalist theory tells us the company would not be competitive and would not remain a viable economic entity. Moreover, rehabilitation services are often among the more costly of prison services, and they represent one of the least easily measured outcomes of the corrections system. Private companies can increase their profits significantly by cutting corners on rehabilitation services. An additional benefit to the company is that a poorly rehabilitated inmate may be more likely to recidivate, which in turns creates more future demand for the prison company.

The themes and issues discussed in this introduction are reflected in the chapters in this volume, which collectively raise issues about the incongruence of incentives that arise when the coercive power of the state is privatized. The actions of private companies are governed largely by the incentives of the market, and to expect private companies to act differently is to remove any perceived benefit expected by involving the private sector in the delivery of public services. Ultimately, the question at hand becomes not whether private companies will change to meet public sector expectations,[3] but how much goal incongruence can be tolerated by the public sector.

In the first chapter, Brandi Blessett offers an overview of the nature of the private prison industry. She examines the industry through different lenses—a critical theory lens, an economic lens, and a political lens. In each case, she finds that the private prison market acts much as capitalist theory tells us it should: it focuses on profits and efficiency but at the cost of fairness, social equity, and transparency.

Chapter 2 more fully develops the market perspective and discusses the incentives created when private prison companies are publicly traded on a stock exchange. Eric Horent and Leslie Taylor-Grover examine the prison industry using incentive-based regulation approaches (price cap regulation and performance-based regulation) and new institutional economics. They conclude that performance-based regulation offers the potential to better monitor the activities of the industry.

Paul Leighton investigates the various models used to finance private prisons in chapter 3. By examining the costs associated with the construction and operation of a prison, Leighton provides insight into the ways in which firms raise funds to capitalize the business and details the additional pressures for profitability and return on investment such techniques generate.

Chapter 4, written by Leslie Taylor-Grover and Robert Carey, provides an overview of the economics of prison labor. As one of the major areas of potential cost savings is the reduction of labor costs, a more complete understanding of labor economics at both the individual and aggregate levels helps us better understand the cost structure of private prisons. In addition, their discussion of the use of inmate labor and its costs and benefits unveils an issue often overlooked in discussions of prison privatization.

In chapter 5, Katharine Neill and Matthew Gable detail the development and growth of the "prison-industrial complex." Using a group-theory heuristic as a framework, Neill and Gable explain how a combination of self-interest and aggregated (industry-wide) interest has created a politically and economically powerful industry that seeks to enhance its profitability by marginalizing opposing interests and influencing the policy discussions to create expanding markets for future growth.

The delivery of health care in private prisons is the subject of chapter 6, written by Melanie Wilson-Lawson. Health care costs are significant for the corrections sector, and many inmates face both physical and mental health challenges. Wilson-Lawson offers a framework for a national approach to health care in prisons and concludes that such a framework must be a public function if public health outcomes are to be meaningful.

Chapter 7 offers an analysis of prison privatization from a political economy perspective, using public choice theory, neoliberalism, and governance theory as lenses to examine these questions. Maurice Vann and Samuel Brown find that the debate over private prisons has been largely dominated by public choice terminology, and they suggest that viable public debate must include a broader vocabulary of concepts to be meaningful in political terms.

The engagement of private prisons as a means to economic development is explored in chapter 8 by Leslie Taylor-Grover, Eric Horent, and Tiffany Wilkerson-Franklin. As poor, often rural, communities struggle to create employment opportunities for their citizens, many are turning to the prison industry as an option for economic development. They conclude that the evidence about the viability of this approach to economic development is, at best, mixed, and that the best outcomes are generally found when a coordinated effort is made to integrate the facility into the existing community through ties to other local institutions—schools, local businesses, and civic organizations.

Chapter 9 offers a comparison of the operation of public and private prisons, specifically along the lines of personnel issues, facility quality and cost, and safety and security of both inmates and corrections officials. By focusing on the trade-offs between government provision and outsourcing, Benjamin Inman directs our attention to the issues of cost savings, quality, efficiency, effectiveness, flexibility, and responsibility—all standard arguments in favor of prison privatization. Inman concludes that evidence in favor of privatization is, at best, mixed, and a careful process to develop the specific values important to policy makers in a jurisdiction will help determine the most appropriate recommendation as to who should provide these services.

In chapter 10, Leslie Taylor-Grover details the practice of building private prisons on speculation. By placing the question in a policy context, Taylor-Grover leads the reader through a series of policy implications raised by the construction of private prisons not linked to expressed demand. Although such practices necessarily involve risk on the part of the private firms, those firms often seek to mitigate their risk by influencing the policy environment in their favor.

The links between the private prison industry and the telephone industry are the subject of chapter 11. Stephen Raher develops the parallels between the deregulation of the telephone industry and the growth of the private prison industry, as both sectors took advantage of a political environment that treated industry regulation as a toxic process. Deregulation of the telephone industry has also resulted in significant profits to be made by both prison operators and telephone service providers by creating unregulated monopolies for inmate telephone access in private prisons. Telephone companies receive exclusive rights to offer phone service in a private prison, and they then charge exorbitant rates to inmates and their families. In return, the private prison company receives a share of the profits from the arrangement, which in turn enhances the profitability of the prison company.

Finally, chapter 12 illustrates the issues surrounding the importation and exportation of inmates across state lines to maintain profitable prison capacities. Tiffiney Barfield-Cottledge illustrates the international nature of many of the service providers and details the diversification practiced by many of these companies to ensure market penetration in a range of corrections services. She concludes by raising several important policy questions surrounding the practice of transporting prisoners across state lines.

We conclude this volume with a discussion of the summary themes developed in the chapters and some observations on the state of the knowledge of the private prison market. By summarizing the knowledge in this area, we are able to identify those areas in which our collective knowledge is adequate, as well as those areas in which research is lacking. As prison privatization is necessarily a relationship between two very different sectors of society, understanding what happens at the interface of these sectors is critical to understanding the nature of the services and the challenges that arise from the relationship.

Notes

1. Even if other countries or individual citizens wished to purchase such a product, nation security concerns would prohibit such a sale.
2. Note that additional monitoring costs could also exist. The contractor might save an empty bucket of expensive paint from a previous job and refill the container with an inferior paint. The homeowners could

prevent this kind of behavior, but it might involve accompanying the contractor to the store to buy the paint or buying the paint themselves (or, more absurdly, having samples of the paint tested—clearly a monitoring cost few would be willing to bear).

3. Note that this argument is somewhat different than Heilman and Johnson's (1992) "paradox of privatization," in which privatization has the effect of making the private sector more like the public sector than the reverse. Their argument is that the paradox occurs because of the monitoring and accountability requirements placed on private firms engaged in public–private partnerships. Though this is no doubt the case, the question is one of degrees—we cannot expect the private sector to look completely like the public sector, and to do so would invalidate the justification for privatization in the first place.

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