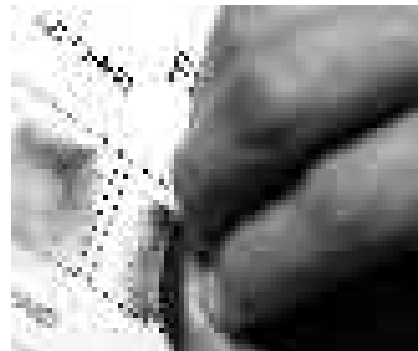


WEIGHING THE WATCHMEN: EVALUATING THE COSTS AND BENEFITS OF OUTSOURCING CORRECTIONAL SERVICES

PART I: EMPLOYING A BEST-VALUE APPROACH TO PROCUREMENT

by Geoffrey F. Segal and Adrian T. Moore
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Part I: Employing a Best-value Approach to Procurement

BY GEOFFREY F. SEGAL AND ADRIAN T. MOORE

Executive Summary

Prison populations in the United States have swelled over the last 20 years. Fiscal constraints at the federal, state, and local levels have left few funds available for the accommodation of new prisoners, and overcrowding is a serious problem at many of the nation's jails and prisons. In response, correctional authorities have turned to the private sector by contracting for the construction, financing, and operation of private prisons.

Factors Behind the Privatization Decision

Traditionally the debate over privatization has been whether or not privatization saves money. This was particularly an issue with correctional services. The concept of cost is easy to grasp and the figures are usually large, while other issues are more subtle and less sensational for either proponents or critics to use in arguments. However, research suggests that cost no longer is the dominant driver of privatization in corrections. Several other factors have become as important as cost savings in justifying privatizing, but they are harder to measure and even harder to hang an argument on in a political debate. These factors include:

- **Privatization to Achieve Improved Quality.** Quality outcomes from outsourcing arise from the appropriate safeguards that governments write into contracts. There is thus increased incentive for the contractor to produce high-quality work and to ensure proper performance. Contracts can be performance-based (focusing on outputs or outcomes) and can include quality assurances or quality-control assurances.

- **Privatization to Manage Capacity.** Prison overcrowding continues to plague many correctional facilities across the country. Because of the urgent need for new or expanded facilities, over 21 percent of state agencies say speedy project delivery is a key driver in the decision to privatize. Construction of a prison or jail takes governments an average of two and one-half years, while private firms complete the same type of project in about half the time.
- **Privatization to Improve Accountability and Better Manage Risks.** If written properly, a privatization contract gives policymakers more control and flexibility. To realize these benefits: 1) contracts have to be written with measurable criteria for success and mechanisms for termination where appropriate; 2) the government has to monitor compliance and be able to demonstrate non-compliance if it occurs; and 3) procurement laws have to allow selection criteria other than lowest bid so that a firm with a record of terminations can be excluded from bidding even if its bid is the lowest. Privatization allows governments to shift the risks to the contractors, which helps achieve both the most efficient risk allocations and allows risk to be used as a management tool. The power of the contract is often overlooked by public officials, who thus miss the opportunity to build quality assurances or quality controls into project delivery as a means of managing risk.
- **Privatization to Spur Innovation.** Competitive outsourcing can produce innovative solutions. The freedom to invent allows for new processes that integrate relevant technological advances.
- **Privatization to Gain Access to Expertise and Acquire New Services.** With the ability to draw inmates from a large population pool, private corrections companies can specialize in unique facility missions. Examples of unique private facilities include those devoted to geriatric inmates or terminal and chronically ill inmates, those devoted to teen offenders, or even regional jails that circumvent barriers to joint-operating agreements between governments. By privatizing, in effect, governments can purchase a service inherently different than what is provided by their own in-house resources. As such, policymakers can tailor their privatization initiatives to meet their specific goals and specific needs, and acquire services that are otherwise not available in-house.
- **Privatization to Improve Efficiency and Flexibility.** Private firms must compete to win the right to manage a facility or for contracts to house inmates. Thus, private corrections firms have strong incentives to run efficient operations. Some means by which they improve efficiency include controlling legal liabilities, reducing use of overtime, managing to prevent injuries and workers' compensation liabilities, and improving labor productivity. Moreover, competition and the fear of privatization drive efficiency in both the public and private corrections marketplace, because government facilities are pressured to become more efficient and to provide better services to compete with private prisons.

Cost Savings in Corrections Privatization

Even though cost savings is becoming less central to privatization decision-making, it nonetheless is important. A preponderance of evidence suggests that private prison facilities do create cost savings. We identified 28 studies that analyze cost data, and while none of these studies is without their flaws, many do a good job of achieving comparable results. Virtually all of the studies find private prison costs to be lower—on average between 5 and 15 percent.

Comparing the cost of privatized services relative to government services is a complex undertaking that requires making initial assumptions that partly shape the outcome. The simple fact is that cost comparison is

more an art than a science—a fact that pains many who would prefer cost comparisons to be simple matters of data analysis. It is a fundamental tenet of cost comparisons that the work requirements, physical plant, quality measures, etc. must be identical for a cost comparison to be accurate. This means ignoring different factors that may include inmate population characteristics, facility age, design, and layout, to name but a few. In order to eliminate the situation of “comparing apples to oranges,” specific adjustments must be made to cost comparisons that take these differences into account.

Not only is comparing identical facilities, populations, and conditions impossible, but postulating identical situations puts the cart of cost comparison before the horse of motivations for privatization in the first place. If a government prison and a private prison are identical in every detail that could affect cost, what is the point of privatizing? Many of the driving factors for privatization (such as quality, innovation, and cost savings) are necessarily lost in this postulation. Arguably, no pure “apples to apples” comparison is possible.

Other examples of cost distortions appear during the contract-award process. Contracting agencies often micromanage service delivery, dictating staffing patterns, prison design style and type, the wages employees are to be paid, and other details. This level of input may appear to give the contractor more control, but it also directly raises the costs of the outsourced services and at the same time slams the door on opportunities to do things in new ways that save money.

Quality: The Flip Side of Privatization?

The major charge against privatization is that quality and security are sacrificed by reducing costs. Yet there is clear and significant evidence that private facilities provide at least the level of service that government-run facilities do. Private correctional facilities have measured well against government-run facilities in almost all criteria of quality, including:

- **Quality-comparison Studies.** We identified 18 quality-comparison studies, and all but two found the private facilities to perform as well or better than government-run facilities. Overall, the research supports a pattern of high-quality services in private facilities.
- **American Correctional Association (ACA) Accreditation.** *Independent accreditation by the ACA designates that a facility meets nationally accepted standards for quality of operation, management, and maintenance.* There are currently 5,000 government and privately managed detention facilities located around the United States. Only 532 are accredited by the ACA—465 of 4,800 government-managed facilities (10 percent ACA accredited) and 67 of 150 privately managed facilities (44 percent ACA accredited).
- **Contract Terminations and Renewals.** As Dr. Charles Thomas wrote, *“This indicator evaluates quality by measuring the willingness of contracting agencies to renew existing contracts. The hypothesis behind this first indicator is that contracts would be terminated for cause or not renewed if the contracting agency was dissatisfied with the caliber of services they received.”* Since the first modern private prison opened in 1985, there have been only a handful of contract terminations and virtually every contract has been renewed.
- **Court Orders and Prisoner Litigation.** In 2001, of the 50 state correctional departments, 13 entire departments were under a court order to relieve unsatisfactory conditions, and 15 states had at least one facility under court order. In comparison, no privately operated prison has ever been placed under a court order for problems with conditions. In fact, several states have had tremendous

success in getting facilities out from under court orders by contracting with a private firm to run it, and incorporating the court imposed standards into the terms of the contract. At the same time, while private prison companies and correctional officers are much easier for inmates to sue than are governments and public employees, they appear to suffer fewer lawsuits.

Policy Alternatives to Cost Comparisons

Correctional services privatization needs to catch up with best practices of privatization of other services nationwide by adopting a “best-value selection” criteria. “Best-value” is rooted in the simple concept of value—selecting firms to provide services or projects based on qualifications and technical merits, not just on lowest cost—as long as the price is the true value of what is promised. Governments are becoming better shoppers, and realize that the best value is not always the cheapest. Selecting simply the cheapest alternative assumes all other things are equal, which they rarely are.

The more complex the privatization process is, the more important a best-value selection criterion is. When the goal of privatization is a mix of cost savings and other objectives, best-value procurements still allow all factors to be weighed appropriately in making the privatization decision. Policymakers now recognize that with privatization they are often buying something different from the services traditionally provided in-house. Best-value selection allows these differences to be properly weighed in context of desired outcomes.

Performance-based Contracting

Performance-based contracts are a key way to capture the broad range of privatization goals that go beyond simple cost savings. Performance-based contracts clearly spell out the desired result expected of the contractor, while the manner in which the work is to be performed is left to the contractor's discretion. These contracts allow governments to purchase results, not just process, and reward the private firm only if specified quality and performance goals are met. This makes privatization even more dramatically a case of purchasing something fundamentally different from in-house government services, which are often guided by nothing more than the goals of simply building and staffing.

To date, the most advanced use of performance-based contracting in corrections occurs in Australia. Using a set of performance measures to govern the contracts and structure payments to private firms, private operators receive three revenue streams from the government: an accommodation service fee, a corrections service fee, and a performance-linked fee.

Conclusion

Cost comparisons are only part of the data needed to evaluate the merits of privatization, and the measurable data alone cannot paint the complete picture. The full measure of worth of privatization has to be assessed in a policy context, with full due given the broader goals that can be achieved, including quality and performance. Most important is recognizing that cost savings from privatization are themselves a product of competition, and that competition has beneficial effects on the entire system.

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Part 1

Introduction

During the 1960s and 70s, violent crime increased dramatically in the United States. The 1980s saw this trend level off and the 90s have seen slight decreases in serious crimes. However, serious crime remains at levels three times those seen in the 1960s. As prison populations have swelled around the country, budget constraints at the federal, state, and local levels have left little room for the substantial growth needed to accommodate new and existing prisoners, occasionally resulting in the release of dangerous prisoners to relieve prison overcrowding.

As many recent reports have chronicled, correctional departments now face a crisis in space and cost that they often cannot resolve with current resources. In response to these mounting pressures, federal, state, and local correction authorities are turning to the private sector to relieve the stress by contracting for the construction, financing and management of private prisons.

Part 2

Why Privatize Correctional Facilities and Services?

The public debate over privatization often revolves around whether privatization saves money. This is particularly true when the topic is correctional services. Costs are easy to grasp, the figures are usually large, and other issues are more subtle and less sensational for proponents or critics to use in arguments. But a 1998 survey of state correctional departments found cost savings to be only the fourth most often cited objective for privatization, with the most states indicating they privatized in order to reduce overcrowding, acquire additional beds more quickly, or gain operational flexibility.¹ Similarly, an American Correctional Association (ACA) survey of juvenile-corrections privatization found that over the course of the 1990s cost savings fell from being the most important reason for privatization, overtaken by seeking services not available within the state agency.²

Several other factors may be as important as cost savings to justify privatizing, but they are harder to measure and even harder to qualify in a political debate. These factors include:

- Improving quality;
- Managing capacity;
- Improving accountability and managing risks;
- Spurring innovation;
- Gaining access to expertise and acquiring new services; and
- Improving efficiency and flexibility.

A. Privatization to Improve Quality

With the increased private responsibility inherent in outsourcing, there is increased incentive for the contractor to produce high-quality work, and to ensure proper performance of facilities. According to the Council of State Governments, over 18 percent of state agencies indicate that high-quality service is one reason they have outsourced.³ Other surveys, including one by the ACA, report similar findings.⁴

Quality outcomes from outsourcing arise from appropriate safeguards governments write into contracts. Contracts can be performance-based (focusing on outputs or outcomes) and can include quality assurances or

quality-control assurances.⁵ With performance-based contracts public officials can capture the broad range of privatization goals that go beyond simple cost savings, to purchase results, not just process, rewarding the private firm only if specified quality and performance goals are met.

B. Privatization to Manage Capacity

Prison overcrowding continues to plague many corrections agencies across the country. Over 21 percent of state agencies say speedy project delivery is an important reason for privatization.⁶

Furthermore, speedy project delivery can translate into cost savings. Since the final payment does not come until project completion, private firms strive to complete construction more quickly. While construction of a prison or jail takes governments an average of two and one-half years, private firms complete the same type of project in about half the time.⁷ The United Kingdom's National Audit Office reports that the first two privately built prisons there were built 45 percent faster than usual.⁸ In the United States, one company may have set a record, constructing a new facility in less than 90 days. The firm purchased land, got zoning clearance, lined up financing, and designed, built, and opened a 100-bed maximum-security juvenile facility in just three months.⁹ A more representative example is Delaware County, Pennsylvania. A group of private firms financed and built a new prison in two years less than it took the state to build a similar prison in a neighboring county, built it for only \$55.84 million compared to the \$93 million estimated cost if built by the county, and is saving the county an additional \$1.5 million a year in lower debt costs.¹⁰ Yet another example is the 350-bed detention center in Houston, Texas, completed in 5 ½ months at a cost of \$14,000 per bed. The Immigration and Naturalization Service calculated construction to take 30 months at a cost of \$26,000 per bed.¹¹

A 1998 survey of state correctional departments found cost savings to be only the fourth most often cited objective for privatization, with the most states indicating they privatized in order to reduce overcrowding, acquire additional beds more quickly, or gain operational flexibility.

C. Privatization to Improve Accountability and Better Manage Risks

If done properly, a privatization contract gives policymakers more control and flexibility than the sometimes red-tape bound system in house. This means that: 1) contracts have to be written with measurable criteria for success and mechanisms for termination where appropriate; 2) the government has to monitor compliance and be able to demonstrate non-compliance if it occurs; and 3) procurement laws have to allow selection criteria other than low bid so that a firm with a record of terminations can be excluded from bidding.

Only a handful of private-prison contracts have been terminated,¹² but those instances demonstrate accountability not found with in-house services. For instance, in 1999, allegations of sexual misconduct by correctional staff at a private prison in Texas led to the termination of the operating firm's contract. But the same month the General Accounting Office released a study of sexual misconduct in government prisons; it found widespread allegations of sexual misconduct in Texas government prisons and no management or

supervisor firings as a result. Regardless of the truth of either allegation, which instance appears to offer more accountability?

Privatization allows governments to shift risks to contractors, which helps achieve both the most efficient risk allocations and allows risk to be used as a management tool rather than just something to fear. The power of the contract is often a power overlooked by public officials, who thus miss the opportunity to build quality assurances and/or quality controls into project delivery as a means to manage risk.¹³

D. Privatization to Spur Innovation

Competitive outsourcing can produce innovative solutions. The freedom to invent “allows for old processes to be discarded in favor of entirely new ones—processes that integrate relevant technological advances.”¹⁴ One in five state agencies says that increased innovation is an important reason for privatization.¹⁵ Privatization is widely credited with spurring innovation in correctional services.¹⁶ In Florida, private prisons brought innovation in construction and operation of prisons, such as more compact prison designs, and greater use of technology.¹⁷

When Virginia contracted for the design, construction, and operation of two new prisons, the Department of Corrections decided to leave the details to the private bidders. One result was that the winning bidders chose to not use food warehouses at the prisons nor keep 30 days food on hand, but have food delivered to the kitchen every few days.¹⁸ Virginia’s private prison administrator, Russ Boraas describes a meeting of the state’s prison wardens when they were asked *why* every state prison had an expensive warehouse and staff to store 30 days of food. The response was a long silence—it had simply never occurred to any of them that there might be another way to manage the groceries. Ultimately, Boraas and others at the Virginia DOC decided that the practice went back to the days of mule trains, when all the state’s prisons were in remote locations and resupply could be delayed for weeks. Technology had changed, but practices did not until competition brought motivations for innovation. The private corrections firms saw in the state’s prison warehouses an opportunity to cut costs and improve their bids. State prison wardens and facility designers had no incentive to buck “the way it’s always been done.” Now, thanks to the private firms’ discovery and the pressure of competition, all state prisons are eliminating their food storage warehouses, reducing overall prison costs.

A group of private firms financed and built a new prison in two years less than it took the state to build a similar prison in a neighboring county, built it for only \$55.84 million compared to the \$93 million estimated cost if built by the county, and is saving the county an additional \$1.5 million a year in lower debt costs.

E. Privatization to Gain Access to Expertise and Acquire New Services

Over 32 percent of state agencies say that lack of state personnel and expertise was an important reason for privatization.¹⁹ Private corrections companies, with the ability to draw inmates from a larger pool, can

specialize in unique facility missions.²⁰ Examples of unique private facilities include those devoted to geriatric inmates, or terminally or chronically ill inmates, or even regional jails that avoid barriers to joint-operating agreements between governments.

In 1996 a regional director of juvenile corrections in Florida was touring vacant sections of a remote military base when he realized that an empty duplex-style housing complex could be converted into a correctional facility. The state had no plans for a new facility, but he convinced them to let him request proposals for something new and innovative, rooted in the latest research on transitioning juvenile offenders back into the outside world. The result was a contract with a private firm to run a first-of-its-kind facility focused on providing older juveniles who would not be returning to their families upon release with the skills needed to live on their own.²¹ The program is unique, but in retrospect seems a logical outgrowth of the latest research on juvenile reintegration and recidivism. That Florida official was willing to work to create an opportunity for something new, though he knew not what. And a private firm, competing for the opportunity, discovered a hitherto untried program. If it succeeds, others will most likely adopt it, at least within Florida, but likely elsewhere. If it fails, it will at least be a test of current theory.

Government officials should realize that by privatizing they are, in effect, purchasing a service inherently different from what is provided by in-house resources. As such, policymakers can tailor their privatization initiatives to meet their specific goals and specific needs and actually seek services not available in house.

F. Privatization to Improve Efficiency and Flexibility

Since they must compete to win the right to manage a facility or for contracts to house inmates, private corrections firms have strong incentives to run efficient operations. Some means by which they improve efficiency include controlling legal liabilities, reduced use of overtime, managing to prevent injuries and workers' compensation liabilities, and improved labor productivity. The last is particularly important—accomplishing the job without using excess personnel. Private correctional firms are particularly adept at consolidating administrative jobs and using fewer overall non-security staff per inmate.²²

Moreover, competition and the fear of privatization drive efficiency in the entire corrections marketplace. Government facilities are pressured to become more efficient and provide better services to compete with private prisons.

G. Conclusion

The proliferation of motivations for privatization signals a change in how public officials view privatization. It is no longer simply a means to cut the budget, but has evolved into a complex policy tool that can be wielded to achieve a wide range of objectives. The ascendance of complex goals for privatization, beyond cost savings, shows how public officials seek to harness more dynamic results from private partners.

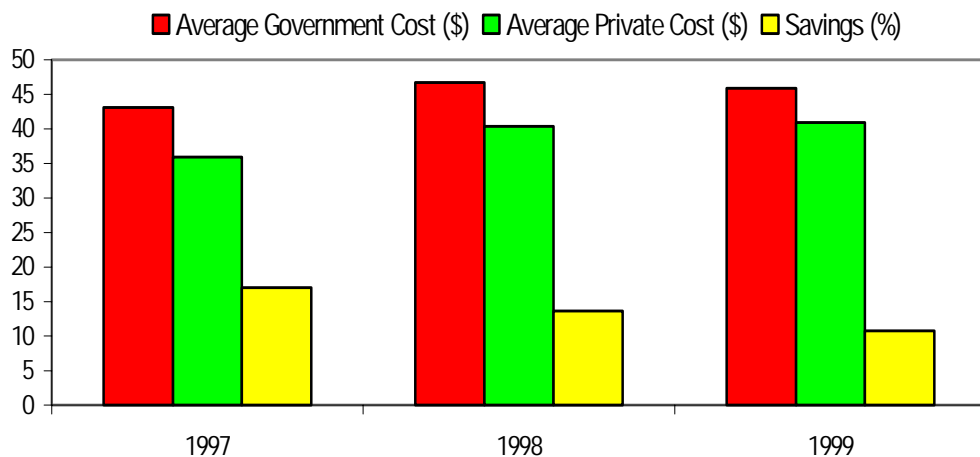
Part 3

Privatization to Achieve Cost Savings

Research shows that cost savings is not always the motivation for privatization, and is becoming less central as governments become more adept at privatization, yet cost remains very important.²³ Although cost savings virtually never stands alone in the hierarchy of factors considered in contract awards, a preponderance of evidence suggests that private facilities save money. We identified 28 studies that analyze cost data to measure if private prisons provide lower cost. Though these studies had some difficulty achieving comparable results, virtually all of them found private prisons to provide significantly lower cost—on average between 5 and 15 percent.²⁴

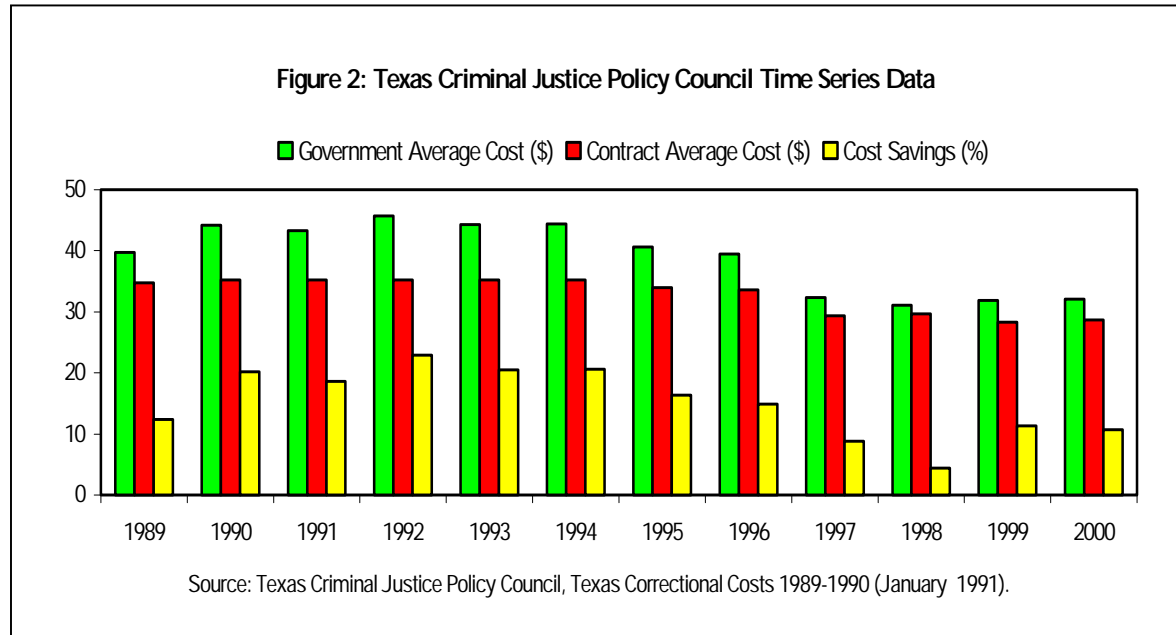
Indeed, two states (Arizona and Texas) that require cost savings provide some of the best time series data about cost savings in corrections privatization. In Arizona (Figure 1), two separate cost-comparisons have produced similar results. A 1997 report compared the cost and performance of a 444-bed private prison to 15 government-run prisons in Arizona. After controlling for indirect costs, it found average cost per inmate per day was \$43.08 in the government prisons and \$35.90 in the private prison—a 17 percent savings.²⁵ A second study in 2000 used available data to assess costs. It found average per diem costs of \$46.72 and \$45.85 for state facilities in 1998 and 1999 versus \$40.36 and \$40.88 for private facilities—savings of 13.6 percent and 10.8 percent respectively.²⁶

Figure 1: Arizona DOC Average Per Diem Costs and Savings



Source: "Public-Private Prison Comparison," Arizona Department of Corrections (Phoenix, AZ: October, 2000).

The Texas Criminal Justice Policy Council conducts a biannual review of the average cost per day of government facilities and the average contract price at private facilities to measure compliance with the privatization cost-savings requirement. The first comparison was published in 1991 with the latest published in 2001 (Figure 2).²⁷ These data represent the best longitudinal evidence of cost savings. The average contract price has consistently been between 4.4 percent (1998) and 22.9 percent (1992) lower than the average cost of government facilities.



The importance of cost savings, and the widespread belief that it can be found through privatizing correctional facilities, has spurred several states to mandate in statute that privatization deliver cost savings (see Table 1).

Table 1: Prison Privatization Statutory Cost Savings (by State) ¹	
State	Requirement
Arizona	Operate at lower cost or provide superior quality services at the same cost as the state.
Florida	Correctional Privatization Commission's contracted facilities required to demonstrate at least a 7 percent cost savings. Private facilities funded to be more program-intensive than Department of Corrections facilities.
Louisiana	Cost cited in statute. Must adhere to all federal, state laws, ACA standards.
Massachusetts	Less costly than government provision. Services must be equal to or exceed state quality.
Minnesota	Cost cannot exceed \$55 per day per inmate.
Mississippi	Ten percent cost savings required.
Ohio	Five percent cost savings required. RFP will define state cost.
South Dakota	May not exceed the daily cost of keeping an inmate in the state prison system.
Tennessee	Five percent cost savings required.
Texas	Cost savings of not less than 10 percent.

The problem with such laws is that they choke off the opportunity for beneficial privatizations and further suggest that a mathematical process can determine policy choices. If that were true, a computer could decide whether or not to privatize, and we would not need elected officials. But the decision is not a mathematical

one—it is deliberative, and requires weighing a number of factors, of which some general knowledge of costs is but one.

Comparing the cost of privatized services to government services is a complex undertaking that requires making initial assumptions that partly shape the outcome, and for which there is no one generally accepted process and set of assumptions. A survey of the contracting practices of 120 cities, counties, and district governments nationwide found that half the respondents had no formal method for analyzing and comparing costs.²⁸ And it is widely recognized that government cost accounting does not provide adequate data to allow accurate comparison with private-sector costs. Hence, cost comparisons can *always* be legitimately critiqued on their technical merits. “Analysts must apply professional judgment. Because of the subjective nature of these decisions, it is inevitable that these conclusions will be challenged.”²⁹

The simple fact is that cost comparison is more an art than a science³⁰—a fact that pains many who would like cost comparisons to be simple matters of data analysis. In short, cost comparisons are not a mathematical exercise. Government’s own inability to properly estimate its own true, fully allocated costs makes meaningful comparisons rarely available.

Indeed, studies of privatization cost comparisons almost always discuss the lack of agreement on a single acceptable way to measure and compare costs.³¹ All too often legislation or policy directives that direct cost comparisons require “appropriate adjustments” be made to the data. But such adjustments are necessarily matters of judgment based on assumptions—in effect, policy decisions—and thereby the results of cost comparisons are often muddled.

Comparing the cost of privatized services to government services is a complex undertaking that requires making initial assumptions that partly shape the outcome.

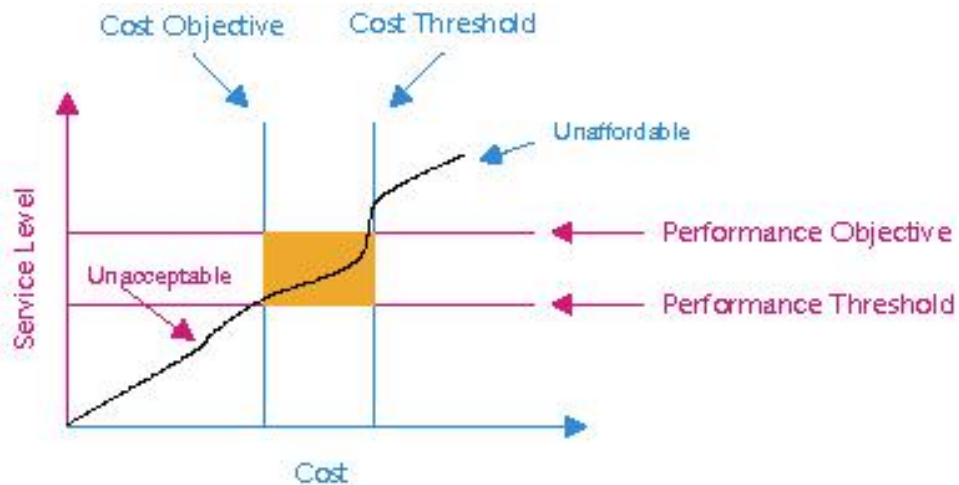
Adjustments are made to cost data to attempt to get rid of problems of comparing apples to oranges. It is a fundamental tenant of cost comparisons that the work requirements, physical plant, quality measures, etc. must be identical for a cost comparison to be accurate.³² In comparing costs of privatized correctional services, this means assuming away different factors that may include inmate population characteristics, facility age, design, and layout, differences in accounting for indirect and even some direct costs, and regional wage and materiel cost differences, to name but a few. Indeed, those who dismiss the existing corrections privatization cost-comparison literature base their position on the accusation that the comparisons were apples to oranges—that there were too many differences between the facilities compared.³³ “Researchers who compare institutions must realize that facilities vary widely on a great number of factors that affect costs; so much so that simple comparisons are not very meaningful.”³⁴ Indeed, the Florida Office of Program Policy Analysis and Government Accountability has gone so far as to modify some government prisons to make them more comparable to private prisons.³⁵

But achieving identical facilities, populations, and conditions is perhaps impossible. More important, creating identical situations puts the cart of cost comparison before the horse of motivations for privatization in the first place. If a government and private prison are identical in every detail that could affect cost, what is the point of privatizing, since many of the driving factors for privatization (quality, innovation, etc.) are necessarily lost? The fact remains that many of the differences found in private prisons are a result of their

ability and freedom to use different facilities and to run them differently.³⁶ Arguably, no meaningful pure “apples to apples” comparison is possible.

Figure 3: Cost vs. Service

Understanding that cost is only one variable, but an important one, contracting agencies need to identify a range of acceptable costs and a desired service level.



The shaded area is where both service performance level and acceptable costs can be achieved. The areas in which the line extends outside the box are considered unacceptable because they represent ranges that do not fall within the desired service level or within the cost threshold.

Source: Lt. Col. Casey Blake, “Cost-effective PBSA,” *Contract Management*, May 2001, pp 28-32.

Many of the differences found in private prisons are a result of their ability and freedom to use different facilities and to run them differently.

A good example of the kind of policy decisions that drive cost differences is inmate treatment programs. Contracts typically do not set up separate requirements and a separate payment stream for programs to differentiate effort there from effort on security. There are far fewer opportunities to create cost efficiencies in programs than there are in facility and security management. Lumping tasks together in a single payment stream muffles the incentive to cut overall costs and makes it harder to measure savings.

Other examples of cost distortions appear in the contract award process. Contracting agencies are often tempted to micromanage the way services will be delivered, dictating staffing patterns, prison-design style and type, the wages employees are to be paid, etc. These types of demands may appear to give the contractor more control, but they also directly raise the costs of the outsourced services and at the same time slam the door on innovative ways to save money.

The most important cost-comparison information for policymaking is between competitive and non-competitive regimes. Privatization brings competition into a correctional system and naturally affects the

behavior of individuals throughout the system.³⁷ Whether from fear of being privatized themselves, or through pride in showing they can compete, or through being held to comparison by higher authorities, workers and management throughout the system respond to privatization.³⁸ In Florida, auditors suggest that prison costs statewide have been reduced by the introduction of privatization.³⁹ And in Arizona, a report examining costs in the state-run prisons to Arizona's one private prison found the cost difference converged over 1998 and 1999, mostly due to falling costs in state-run prisons.⁴⁰

This has implications for when cost comparisons use data from facilities that know they are competing against each other. You would expect government facilities that know they are being used for a cost comparison against a privatized facility to manage costs better than they would without competition. This was the case in the early 1990s when Tennessee compared costs at government and private prisons.⁴¹ During the comparison period costs at the government facilities fell roughly 4 percent.⁴² Officials looking at cost savings from privatization should be trying to assess such system-wide effects—not just the effects at one facility.

You would expect government facilities that know they are being used for a cost comparison against a privatized facility to manage costs better than they would without competition.

Rather than trying to achieve a desirable but unrealistic goal of perfect comparability, cost comparisons should strive to account for as many differences between compared facilities as possible, making certain that when explaining results, the possible effect of alternative assumptions is explained as well. The key is to provide baseline figures that involve minimal assumptions and cover comparable features, and then discuss how differences between facilities might affect costs. The policymaker, not the cost analyst, should decide how differences in programming requirements, facility design, health services, etc. (all differences created by *policy* decisions) weigh in the cost analysis.

Despite the difficulty in comparing facilities and costs, many governments are using privatization as a means to reduce correctional costs and to finance additional services. The many existing cost-comparison studies⁴³ support a conservative estimate that private facilities operate at about 5 to 15 percent lower cost than do government facilities.

Part 4

Is Quality the Flip-side of Privatization?

The major charge against privatization is that by reducing costs, quality and security are sacrificed. Yet, there is clear and significant evidence, including a wide range of quality comparison studies, that private facilities provide at least the level of service that government run facilities do. Private correctional facilities have fared well against government-run facilities in almost all measures of quality, for example, in achieving independent accreditation, in contract terminations and renewals, and in the extent of court orders and litigation by prisoners.

A. Quality Comparison Studies

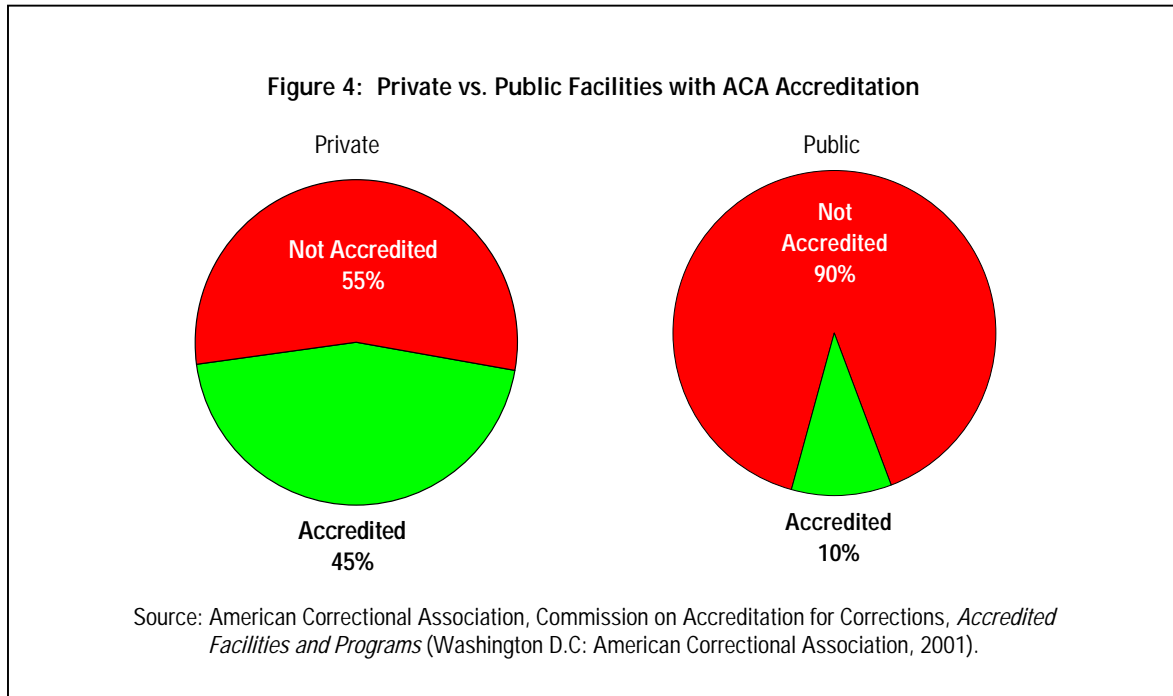
Measuring quality can be as difficult as comparing costs, because so many dimensions and variables can be included, from recidivism to access to phones, from health care to the variety of vegetables with meals. A sensible approach to comparing private and government prisons considers the various factors that typical taxpayers might consider in judging what kinds of prisons their tax dollars are buying.

A number of independent studies, using a variety of approaches compare the quality of government-run and private correctional facilities. We identified 18 such studies, and all but two found the private facilities perform as well or better than government-run facilities.⁴⁴ Overall, the research supports a pattern of high-quality services in private facilities.

B. American Correctional Association (ACA) Accreditation

Independent accreditation by the ACA is designed to show a facility meets nationally accepted standards for quality of operation, management, and maintenance. ACA accreditation is frequently used by the courts as proof of improvement toward the lifting of court orders. In Louisiana state prisons were under court order for overcrowding and poor conditions for decades. A crucial step to getting the order lifted was achieving ACA accreditation for each facility. For years, little effort was expended to meet that goal and none of the facilities, including new ones, succeeded. But in 1990, when writing its first contract with a private firm to operate a prison, the state required the firm to achieve accreditation. It did. Encouraged, the new head of state corrections ordered the rest of the state system to seek accreditation. Serious improvements had to be made, but by 1996 every prison in the state save the one maximum-security facility had achieved the goal, and the court order was lifted.⁴⁵

There are currently 5,000 government and privately managed detention facilities located around the United States, with only 532 accredited by the American Corrections Association (ACA)—465 are public and 67 are private.⁴⁶ Thus, no more than 10 percent of government correction facilities have been accredited, whereas 45 percent of private facilities have been accredited (see Figure 4).



C. Contract Terminations and Renewals

“This indicator evaluates quality by measuring the willingness of contracting agencies to renew existing contracts. The hypothesis behind this first indicator is that contracts would be terminated for cause or not renewed if the contracting agency was dissatisfied with the caliber of services they received.”⁴⁷ Since the first modern private prison opened in 1985 there have been only a handful of contract terminations.⁴⁸ Virtually every contract up for renewal has been renewed. In the few cases of contract termination that have occurred, competition in the industry has assured that public officials were quickly able to hire a new firm to replace the old.

D. Court Orders and Prisoner Litigation

In 2001, of the 50 state correctional departments, 13 entire departments were under a court order to relieve unsatisfactory conditions, and 15 states had at least one facility under court order.⁴⁹

In comparison, no privately operated prison has ever been placed under a court order for problems with conditions. In fact, several states have had tremendous success in getting facilities *out from under* court orders by contracting with a private firm to run it, and making meeting the court-imposed standards a term of the contract.⁵⁰ At the same time, though private-prison companies and correctional officers are much easier for inmates to sue than are governments and public employees, they appear to suffer fewer lawsuits.

Part 5

Policy Alternatives to Cost Comparisons

Can cost savings become somewhat less important than quality? Are quality improvements possible? On what basis should privatization decisions be made? Simple cost comparisons are often plagued by criticism. What alternatives to simple cost comparisons are available when making privatization decisions? We suggest that correctional services privatization catch up with the best practices of privatization of other services nationwide and adopt a best-value selection criteria. Best-value is rooted in the simple concept of value—selecting firms to provide complex services or projects based on qualifications and technical merits, as long as the price is a value for what is promised. Governments are beginning to recognize what every consumer already knows—sometimes if you pay more, you get more; that is, the cheapest is not always the most desirable. Requiring the government to always buy the cheapest assumes all other things are equal, which they rarely are.

The more complex the privatization is, the more important issues other than lowest absolute cost will be. When the goal of privatization is a mix of cost savings and other objectives, best-value procurements allow all factors to be weighed appropriately in making the privatization decision (see Table 5). Policymakers recognize that with privatization they are often *buying something different* from the services traditionally provided in house. Best-value selection allows these differences to be properly weighed in context of goals or desired outcomes.

Table 5: Determining Priorities and Trade-offs

When contracting agencies are considering privatization they must identify the goals they want to achieve and the cost implications of those goals. Begin by identifying where current operations are on the sliding scale for each “cost-impact area” shown along the bottom of the figure (project delivery, flexibility, etc). Innovation and flexibility should ultimately result in cost savings, but for this exercise are used to show the importance of value. If long-run flexibility and innovation are a privatization motivation, contracting agencies should expect an initial cost impact. Next, determine the desired direction of change (up or down) as an organization within each area (i.e., develop outcomes), taking into account how it affects costs as shown on the left of the figure. The idea is to illustrate how an agency might want to use changes in one set of goals to free up resources to make changes in others without necessarily increasing total costs. This exercise will help agencies better define their priorities by illustrating cost impact and trade-offs that are made to achieve long-term goals.

Table 5: Determining Priorities and Trade-offs (con't)

	Faster	Improved	More Hiring	Non-specialization	Higher	Improved	More
High	↑	↑	↑	↑	↑	↑	↑
Cost Impact	↓	↓	↓	↓	↓	↓	↓
Low	↓	↓	↓	↓	↓	↓	↓
	Longer	Existing	Outsourcing	Specialization	Lower	Existing	Less
	Project Delivery	Quality	Demand	Expertise	Accountability	Innovation	Flexibility

Requiring the government to always buy the cheapest assumes all other things are equal, which they rarely are.

A. How-to Tips for Using Best-value Contracting⁵¹

Successful best-value contracting requires three things:

- First, an early determination of key parameters, i.e. completion date, security requirements, mobilization, etc;
- Second, development of key project criteria translated into performance measures; and,
- Finally, and the most essential, the development of evaluation criteria. Evaluation criteria can be either quantifiable (dollars) or nonquantifiable. Common criteria include: technical excellence, management capability, financial capability, prior experience, past performance, optional features offered, completion date, and risk to government.

Once selection criteria have been established and bids have been received, successful selection depends on evaluation. The following five steps help ensure a successful selection:

- First, identify technical differences between proposals, comparing their strengths, weaknesses, and risks against evaluation criteria;

- Second, identify the potential impact of each difference, assigning a positive or negative impact to each strength or weakness;
- Third, consolidate similar technical differences and eliminate differences that will likely have a small impact on selection. Remaining proposal discriminators should be developed, ensuring that the team understands what is offered and why it adds and doesn't add value to the proposal;
- Fourth, rank the discriminators on a relative scale. This is very important. Nonquantified criteria should be ranked as favorable, neutral, or unfavorable. Once nonquantifiable criteria are ranked, quantified discriminators are evaluated; and,
- Finally, document the analytical processes and the cost/technical tradeoff process used in selection.

Forcing contractors to emulate in-house procedures eliminates many of the reasons to privatize.

B. Performance-based Contracting

Expanded use of privatization brings more pressure to ensure results, control outcomes, and avoid problems. Performance-based contracts have emerged as a state-of-the-art contracting tool to give government managers better control over contractors and greater assurances of accountability.

Typical contracts for correctional services tend to emphasize inputs: procedures, processes, the wages to be paid, amount or type of equipment, or time and labor used. But forcing contractors to emulate in-house procedures eliminates many of the reasons to privatize. Such micromanaging removes the ability of the contractor to innovate, be flexible, or offer enhanced or different types of service. More and more, governments are using performance-based contracts—an output- and outcome-based approach to contracting.⁵²

*A performance contract is one that focuses on the outputs, quality and outcomes of service provision and may tie at least a portion of a contractor's payment as well as any contract extension or renewal to their achievement.*⁵³

Performance contracts clearly spell out the desired result expected of the contractor, but the manner in which the work is to be performed is left to the contractor's discretion. Contractors are given as much freedom as possible in finding ways to best meet the government's performance objective.

What this means for corrections privatization is that performance-based contracts are a key way to capture the broad range of privatization goals that go beyond simple cost savings. They allow governments to purchase results, not just process, rewarding the private firm only if specified quality and performance goals are met. This makes privatization even more dramatically a case of purchasing something fundamentally different from in-house services.

Contracts for correctional services have been among the slowest to adopt performance approaches, but there is some progress in agreeing on how to define performance.⁵⁴ But there is some progress. The American Correctional Association is in the process of changing its accreditation standards, which are the standards

used in most correctional privatization contracts, to go beyond simple process measures and include a broad range of performance measures.⁵⁵ And the Office of Juvenile Justice and Delinquency Prevention is six years into a program to develop performance-based outcome standards for juvenile correctional facilities.⁵⁶ Both efforts will help make outcome measures more accepted and systematically used in corrections and will make performance-based privatization contracts easier to develop and monitor.

Today, the fullest use of performance-based contracts in corrections is in Australia. The State of Victoria uses private prisons to house nearly half of its inmates, using a set of performance measures to govern the contracts and structure payments to private firms.⁵⁷ Private operators receive three revenue streams from the government:

- An *accommodation-service fee* pays for housing the prisoners; this essentially offsets the private debt incurred in constructing the facility;
- A *correction-service fee* covers specific services, such as correctional officers, health care, food, education, and rehabilitation programs;
- A *performance-linked fee* aligns the company's long-term interests with the government's goal of quality services. The fee is tied to a set of performance indicators, including escapes, deaths in custody, assaults on inmates, and assaults on staff. As long as the company meets standards in these areas, based on averages from government prisons, it receives the full fee.

This last fee is what makes the Australian model innovative. It ties the private companies' return on equity to a set of performance goals, thus aligning their long-term interests in running profitable facilities with the government's interest in quality services. Recently an audit suggested that the performance goals be ratcheted up to continue to push outcomes above average for government facilities.⁵⁸

Part 6

Conclusion

“The contracting out decision is not a simple matter of pure economic efficiency.”⁵⁹
“[L]ooking only at numbers to assess a government service can be a big mistake.”⁶⁰

Cost comparisons are only part of the data needed to evaluate the merits of privatization, and the measurable data alone cannot paint a full picture. The full measure of worth of privatization has to be assessed in a policy context with full due given the broader goals that can be achieved. Most important is recognizing that cost savings from privatization is itself a product of competition, and that competition has beneficial effects on the entire system.

Policymakers should be wary of over-reliance on cost-comparison data in making privatization decisions, and be certain that cost analyses do not take upon themselves to make policy assumptions in determining cost figures. Factors such as quality and innovation are often key reasons for privatizing, even if the cost is higher. Cost savings can be important, if weighed in the context of system-wide dynamic change that competition, through privatization, brings. Performance-based contracts allow governments to capture the broad range of goals of privatization, while rewarding good performance and penalizing poor performance.

When goals are properly identified and established, privatization often leads to success. Numerous independent studies show that the quality of private prisons is at least the same level as government prisons, and in most cases improved through privatization. Best practices suggest that cost savings is rarely used as a stand-alone merit for privatization, but when savings is a motivation it can be achieved. Time-series data from Arizona and Texas coupled with several other studies, support conservative estimates of savings between 5 and 15 percent.

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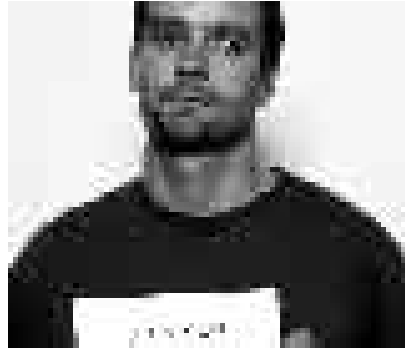
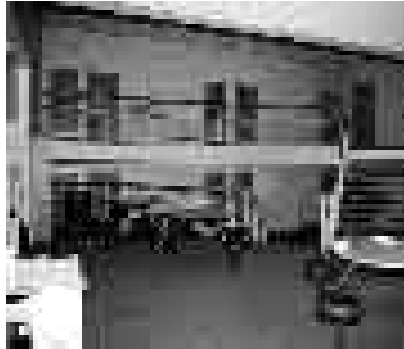
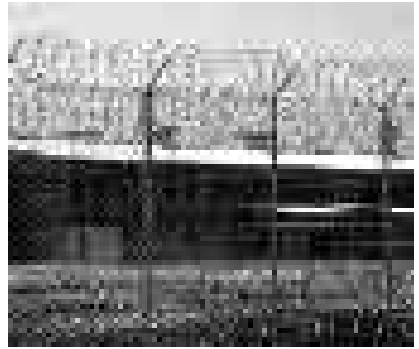
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