

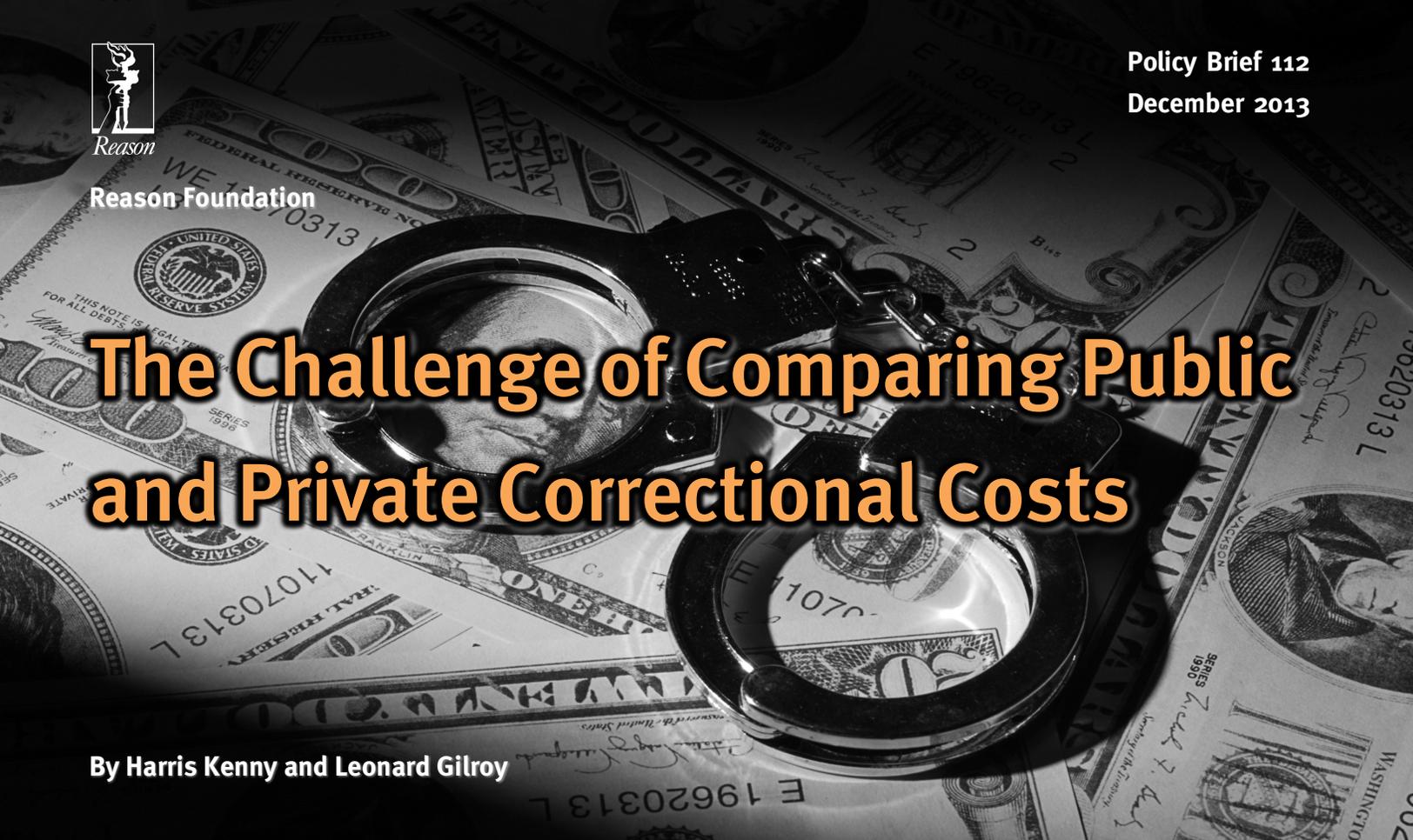


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A black and white photograph of a magnifying glass resting on a stack of US dollar bills. The magnifying glass is positioned over a \$100 bill, and its lens is focused on the portrait of Benjamin Franklin. The background is filled with various denominations of US currency, creating a textured, layered effect. The title text is overlaid on this image in a large, bold, orange font with a black outline.

# The Challenge of Comparing Public and Private Correctional Costs

By Harris Kenny and Leonard Gilroy

## Executive Summary

Eight percent of inmates in the U.S. federal and state prison system are housed in privately operated correctional facilities. Yet there remains debate over the relative cost of public and private prisons. Some research suggests that governments can save money through public-private partnerships; other research finds that the cost difference is negligible or that public sector delivery is cheaper. One of the primary reasons for this disparity is different budgeting and accounting practices in the public and private sectors, which make “apples-to-apples” comparisons difficult and often distort cost comparisons in favor of the public sector.

The *Biennial Comparison of Private Versus Public Provision of Services Report*, published in 2011 by the Arizona Department of Corrections (ADOC), exemplifies this problem. It suffers from a deficient treatment of capital assets and liabilities, omits correctional healthcare costs, fails to adjust operating costs to reflect qualitative differences in programming, ignores retiree healthcare and pension costs for public employees, overlooks the private sector’s assumption of legal claims risk, and forgets that private correctional companies pay significant

taxes to state and local governments. These methodological shortcomings undermine ADOC’s conclusion that private prisons are costlier than public ones in Arizona.

By contrast, a 2013 study by Temple University economists, which analyzed data from nine different states (including Arizona) and corrected for many of the factors discussed above, found that privately operated prisons substantially cut costs overall, while generally performing equal to or better than their government-run peers. The lesson here is that rigorous cost comparison must be undertaken carefully, lest it muddy the debate at the expense of sound policymaking.

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## Table of Contents

Introduction .....	3
Why Cost Comparisons Are Difficult.....	4
Different Budgeting Systems.....	6
Transferring Risk from the Public to the Private Sector .....	7
Case Study: Arizona Department of Corrections Cost Comparison Reports ..	8
Capital Assets and Liabilities .....	11
Physical and Mental Healthcare .....	13
Qualitative Differences in Programming .....	15
Retiree Healthcare and Pensions.....	16
Legal Claims and Administration .....	16
State and Local Tax Payments .....	17
Implications .....	18
Conclusion .....	19
About the Authors .....	19
Related Reason Publications .....	19
Endnotes.....	20

## Introduction

Of the 1.6 million inmates in the U.S. federal and state prison system, an overwhelming majority (92 percent) are housed in publicly operated correctional facilities, while the remainder (8 percent) of inmates are housed in privately operated correctional facilities.<sup>1</sup> The public sector runs the system at-large—determining who is incarcerated for what, for how long, and under what conditions—but many federal, state and local correctional agencies also partner with the private sector to provide everything from inmate healthcare and educational programming, to prison facility operations, maintenance and ownership.<sup>2</sup> Like many other types of public services subject to outsourcing and competitive contracting—ranging from local services like solid waste collection, road and highway maintenance, and park landscaping up to the administration of state Medicaid programs, the operation of federal agency information technology systems and the like—one of the central reasons that governments have chosen to partner with private firms to provide correctional services is to harness the power of competition to drive down the costs of public service delivery.

Despite decades of experience with such correctional public-private partnerships (PPPs), there remains an ongoing debate about the relative cost of public and private operation of prisons, with little consensus among academics and criminal justice researchers regarding whether or not competitive contracting actually lowers the costs of correctional service delivery for governments, and, by extension, taxpayers. Some academic and government-sponsored research suggests that governments can save money through PPPs, while others suggest that either: (1) public/private cost differences are negligible, or (2) the public sector operation of prisons is cheaper.

As one illustrative example of this phenomenon, a highly publicized Arizona Department of Corrections' (ADOC) report on the comparative cost of publicly and privately operated prisons in Arizona in 2011 concluded that government prison costs were slightly less than the cost of using private sector prisons. But a more recent study by economists at Temple University in 2013 pointed out some missing or underestimated costs in the ADOC methodology

and concluded that private prisons are saving the state up to 8 percent in the short term and over 20 percent in the long term.

Such debates are not unique to corrections; in fact, the relative costs of public vs. private service delivery are a common theme in the broader debate over PPPs and privatization across a range of public services. One of the primary reasons for this is that cost comparisons between public and private sector service providers tend to be more art than science due to fundamental differences between public and private budgeting and accounting systems, making “apples-to-apples” cost comparisons difficult.

To improve understanding of public versus private cost comparisons in the area of corrections, this brief examines the challenges of comparing costs between government and private sector providers, why sometimes comparisons are inaccurate, and ways to overcome those challenges. It includes an analysis of the ADOC report on the comparative cost of publicly and privately operated prisons in Arizona, and highlights various flaws in their cost adjustment methodology.

## Why Cost Comparisons Are Difficult

Whether operated by governments or private correctional management firms, prison facilities generally face similar types of costs that include:

- the costs of correctional officers to staff facilities;
- inmate mental and physical healthcare;
- inmate food services;
- inmate education, rehabilitation and other programming;
- facility operations and maintenance,
- utilities and more.

However, while the *types* of costs may be similar, the *actual* costs of operations tend to vary significantly from one prison to another. For example, the higher the security level of the inmates in a prison, the higher that costs per

inmate tend to be, given the need for more intensive security systems and procedures when dealing with more dangerous types of inmates and greater lengths of sentence (inmates with life sentences will incur greater healthcare costs as they age, for example). Thus, prisons housing lower-risk inmates at the minimum-to-medium security levels tend to cost less per inmate to operate than prisons housing inmates at the close-custody or maximum-security level. Similarly, prisons housing inmates with low-to-moderate physical and mental health needs may cost less to operate than prisons housing inmates with a high degree of physical and mental health needs.

Costs can even vary significantly among facilities of the same security level. For example, a medium-security prison housing specialized populations—like DUI convicts or sexually violent predators—may cost more than an otherwise similar medium-security prison housing a general population, given the often higher costs associated with the rehabilitation and treatment needs associated with the specialized population.

With such inherently high variability in costs among individual prison facilities—both public and private—accurately comparing the cost of correctional services provided by the public and private sectors is widely considered difficult at best. As ADOC Director Charles L. Ryan put it, “... (I)t is important to recognize that exact private prison unit versus state prison unit comparisons are not possible due to inherent complexities resulting from the many differences in operating structure and requirements. This is equally true when comparing facilities and when comparing cost.”<sup>3</sup>

Why is this the case? Why do correctional cost comparisons tend to break down into “apples to oranges,” rather than “apples to apples”? In general terms, there are two important factors: the first is the fact that correctional agency budgets do not include all applicable costs to the public sector; the second is that cost comparisons rarely account for the financial benefits that occur when PPPs transfer risk away from taxpayers and onto private companies. Each of these factors will be dealt with in turn below.

## Different Budgeting Systems

The most notable difference between the public and private sectors is that they have fundamentally different budgeting systems. Public correctional agency budgets typically cover major operating costs (e.g., staffing, supplies, programming, etc.) but do not reflect the full range of costs paid by the government. Some costs—including risk management, pensions and other post-employment benefits, information technology, payroll, accounting and human resources—may be paid for out of other agency budgets. Hence, any analysis of public sector corrections spending that relies only on correctional agency budgets—common in public versus private prison operating cost comparisons—is likely to underestimate the true cost to taxpayers of public sector prison operation.

By contrast, when the private sector contractors bid for prison contracts they include all the relevant costs up front in their bids. Private operators know that they will only receive the per diem rate set in the contract (i.e. the rate charged per inmate, per day) and that they run the risk of punitive fines or contract cancellation if contract terms aren't met.

In other words, public sector costs are less transparent, more incomplete, and spread out across multiple agencies while many aspects of risk go overlooked. By contrast, the private sector costs are complete and bundled into the bid.

Well-written contracts keep the private sector on the hook for unexpected cost overruns, mitigating fiscal risk for the public sector and providing increased budget certainty. Privatization does require the public sector to factor in resources for contract monitoring and oversight of privately operated prisons, though it is common practice to require the private operator to cover these costs. It is important to note that while private prison monitoring and oversight costs are typically seen as “new” or “additional” costs incurred by governments as a consequence of the decision to contract out prison operations, a strong argument can be made that in an ideal scenario, corrections agencies should dedicate similar resources toward the monitoring and oversight of government operated prisons as well to ensure performance and accountability throughout the *entire system*.

## Transferring Risk from the Public to the Private Sector

Risk is understood as the possibility that a bad outcome will occur. Correctional risk is substantial, both for public and private operators. Risk can come in the form of conditions in prisons, such as poor mental or physical healthcare provision, the risks associated with overcrowding in prisons, and incidents like riots and escapes. Risks associated with substandard prison conditions can lead to legal and administrative risk via lawsuits filed to rectify what went wrong, which can include the costs of attorneys, the costs of abiding by court rulings, and restitution for aggrieved parties. Risk can also come in the form of events that are more difficult to control, such as natural disasters that would impact prison infrastructure or returns on investments for public employee pension funds. The public sector self-insures for most of the risk it faces, and this is fine most of the time, but when risk does arise it can be extremely costly. By partnering with the private sector, the public sector can transfer or offload a significant amount of risk in exchange for the largely predictable risk that comes with overseeing private operators.

California offers an instructive example here. The state suffered a years-long and very costly legal battle, which ultimately led to the U.S. Supreme Court ruling in *Brown v. Plata* that the state provided constitutionally inadequate mental and physical health conditions for inmates in its public facilities, which were operating 75 percent above their maximum capacity.<sup>4</sup> According to the Associated Press, the costs from a dozen associated lawsuits exceed \$200 million when considering the state's legal fees, inmates' attorney fees and the costs of court-appointed oversight authorities (charged with overseeing court-mandated requirements imposed on the state in various legal rulings) over the past 15 years.<sup>5</sup>

PPPs can help prevent such crises from emerging in the first place by specifying that private operators will bear some or all of the operational, legal and other risks inherent in operating prisons—shifting a potentially significant burden away from taxpayers. Well-structured contracts allow governments to hold private operators to strictly defined standards and apply punitive measures

and/or legal action if private operators fail to meet their contractual obligations. Such strong accountability frameworks are difficult to come by in the public sector.

Indeed, improved risk management is one of the key benefits of pursuing PPPs in general, whether dealing with prisons or more traditional infrastructure projects, like building and operating transportation infrastructure. That such risk transfers are not typically built into public vs. private prison cost comparisons is a serious shortcoming.

## Case Study: Arizona Department of Corrections Cost Comparison Reports

Cost comparisons between publicly and privately operated prisons are difficult to get right because of the opacity of public sector accounting and its tendency to ignore or fail to quantify risks that the private sector must account for when preparing and submitting bids. In recent years, the respective costs of public and private prisons have been under the spotlight in Arizona. The Arizona Department of Corrections (ADOC) has published a series of reports on the subject that have been covered in the *New York Times*, *The Economist* and elsewhere, with some commentators suggesting that the reports demonstrate that privately operated prisons are more expensive than publicly operated prisons in Arizona. Yet, a closer look at ADOC's reports shows that conclusion is suspect.

The latest report published by the ADOC is the *Biennial Comparison of Private Versus Public Provision of Services Report*, published in 2011, which includes the *FY 2010 Operating Per Capita Cost Report*. Before examining the numbers in detail, it is important to reiterate that the corrections agency has costs that are not included in its normal budget, whereas the private sector includes all costs in its per diem rates.<sup>6</sup> Some of the most significant costs either underestimated or omitted in the ADOC report include some capital costs (such as one-time capital equipment costs, lease purchase payments and depreciation costs), inmate healthcare costs, retiree healthcare and pensions, and legal claims administration. When such figures are underestimated or omitted from

comparisons, it can paint an inaccurate and misleading picture of the true costs of prison operations.

According to the ADOC report's cost comparison methodology, the public sector appears on the surface to be more cost-competitive at housing medium security inmates than the private sector: in FY 2010, the average per diem cost was \$48.42 in public prisons vs. \$53.02 per day in privately operated facilities. The report also finds that average per diem costs were almost indistinguishable for minimum security inmates (\$46.59 for the public sector versus \$46.56 for the private sector). It is these top-line numbers that have been widely reported in the media and cited by opponents of private prisons as evidence that the state is spending more on private prisons than state-run facilities on a per-inmate basis.

But digging further into the report, two important—and underreported—factors become evident that undermine claims that private prisons are costlier in Arizona.

First, distilling a wide range of prison costs into one *average* cost number ignores a high degree of variability among prison units and obscures an enormous difference between the public and private sectors in terms of the numbers of units and inmates covered. For example, the average per diem related to minimum-security inmates held in public prisons (\$46.59) is the average of the costs for 21 different state prison units covering over 10,000 inmates, and the per diem costs of those 21 public prison units span a broad range from a low of \$39.18 up to a high of \$73.90. Meanwhile, the average per diem reported for minimum-security inmates held in private prisons (\$46.56) is the average of the costs for just *three* prison units covering just over 1,700 inmates, and the per diem costs of those three units spanned a narrow range from \$40.64 to \$48.13. Hence, the most definitive statement that the ADOC report could make was that, “[t]he minimum custody private prison contract beds per diem costs are within the range of state-run minimum custody prison unit bed per diem costs.”<sup>7</sup>

Similarly, the average per diem related to medium-security inmates held in public prisons (\$48.42) is the average of the costs for 16 different state prison units covering nearly 12,900 inmates, and the per diem costs of those 16 public prison units span a broad range from a low of \$39.29 up to a high of \$66.57.

Meanwhile, the average per diem reported for medium-security inmates held in private prisons (\$53.02) is the average of the costs for just *two* prison units covering just under 2,700 inmates, and the per diem costs of those two units spanned an extremely narrow range from \$52.09 to \$54.59. Just as with the minimum-security units, the most definitive statement on costs that the ADOC report was able to make was that, “[t]he medium custody private prison contract beds per diem costs are within the range of state-run medium custody prison unit bed per diem costs.”<sup>8</sup>

Given the above, for journalists and private prison opponents to make bold, definitive (and ultimately simplistic) claims regarding the supposedly higher costs of private prison provision based on reported averages—while ignoring the high variability of the underlying numbers, particularly in the public sector—was unwarranted and offered a highly misleading and inaccurate portrayal of the real cost situation.

Another factor critical to understanding why the ADOC report doesn’t make the case that the private sector is costlier is that the figures reported by ADOC are *adjusted* costs: the unadjusted costs are significantly higher. ADOC makes several accounting adjustments to the costs of both public and private facilities to account for differences in the way the two sectors handle depreciation, inmate healthcare service provision, and certain inmate management functions. Prior to adjustment, ADOC estimates that medium security inmates cost \$57.97 per day in the public sector and \$60.66 per day in the private sector, while minimum-security inmates cost \$55.59 per day in the public sector and \$54.20 per day in the private sector.<sup>9</sup> The unadjusted figures paint a rather different picture from the adjusted figures reported above.

And while some accounting adjustments may indeed be warranted to approximate an “apples to apples” cost analysis, the cost adjustments applied by ADOC in this case serve to either skew the analysis or wash a range of very real costs off the table as if they did not really exist.

When combined, the omission of certain costs not directly borne by ADOC and the adjustments made in the ADOC report tend to flatter the public sector’s management costs relative to the private sector. For policymakers, media and other stakeholders, it is critical to understand the nature of these omissions and

adjustments in order to get a more accurate understanding of the relative costs of public vs. private prison operation, lest they arrive at hasty or inaccurate conclusions.

Some of the most conspicuous omissions and accounting adjustments are in the following areas:

- Capital assets and liabilities;
- Physical and mental healthcare;
- Qualitative differences in programming;
- Retiree healthcare and pensions, and
- Legal claims and administration.

The following analysis will examine each of these issues.

## Capital Assets and Liabilities

The ADOC reports are deficient in their treatment of capital assets and liabilities. ADOC adjusts the cost comparison to include depreciation—adding \$1.41 to the average per diem cost of public facilities—since contractors already include costs of financing and depreciation in their per diem rates. The private sector incorporates these costs up front and recovers them over the life of the contract. For the public sector, ADOC argues “... (D)epreciation factor is not an actual expense incurred by [ADOC] but it is included for a more accurate comparison.”<sup>10</sup>

ADOC derives its adjustment from a 40-year straight cost depreciation factor, which causes several problems. First, many ADOC facilities are over 40 years old so their depreciation factor is \$0. Second, private facilities are newer so they have higher capital costs because they feature new technology and materials. This distorts the comparison by skewing public capital costs far lower, down to \$1.41 per diem, while private capital costs are estimated by ADOC at \$12.00 per diem.<sup>11</sup>

In the abstract, when comparing the capital costs for decades-old prisons with brand new ones, it may seem reasonable to estimate a far lower cost figure for the older facilities relative to the newer ones, regardless of whether they’re public or private. However, in the context of this ADOC analysis—and the

larger reasons *why* the state has turned to the private sector in the first place—such estimates fall short. When the state makes the decision to contract with the private sector to address overcrowding issues in state-run facilities, one cannot then simply compare a situation where a private company is building a brand new prison unit to that of an older state-run facility at- or near-capacity, since not building the new capacity is not an option. A more accurate comparison is to ask the state what it would cost government to do what they've asked the private sector to do—build new prison facilities, not simply maintain the aging facilities already built.

Further, it is misleading to simply average the depreciation costs of facilities of many different ages (some many decades old) and compare that to the depreciation costs of a much younger (or brand new) facilities. While the significant capital investment in the older facilities may already be paid for, there are still ongoing capital investment needs and a significant amount of deferred and preventative maintenance to address.

Recognizing this, a 2012 analysis by Arizona's Joint Legislative Budget Committee found that the ADOC's method of calculating depreciation underestimated the true costs of public prison ownership. The JLBC analysis found that a 20-year depreciation factor was more appropriate, which yielded a per diem depreciation cost of \$10.71, nearly seven times ADOC's original estimate of \$1.41.<sup>12</sup> Obviously, if the JLBC number was used in the ADOC report, the overall per diem costs of public sector prison operation would have been significantly higher than the private sector's per diem costs.

A better way to handle this would be a “value for money” analysis, which is a form of cost-benefit analysis that in this case would compare traditional public service delivery with one or more public-private partnership alternatives. The analysis should specifically consider what it would cost the state to build and operate a comparable facility itself, under current market conditions, relative to the alternatives. In other words, the apples-to-apples comparison would recognize that a new prison is being built, then compare the various options to accomplish the task.

For example, ADOC plans to build a 500-bed maximum-security facility in Buckeye, Arizona, that's scheduled to open on July 1, 2015. The Buckeye

facility is projected to cost \$50 million, \$20 million of which was allocated by the legislature in FY 2013.<sup>13</sup> These figures, along with other recent facility expansions, could be used to benchmark against traditional public service delivery.

The ADOC analysis also excludes expenditures from allocation to public and private facilities on lease purchase payments and one-time costs for capital equipment without explaining why. This is a considerable sum; these two factors added up to almost \$25 million in 2010.<sup>14</sup> Meanwhile, ADOC bore \$530,000 in capital costs for ADOC in the form of “pay-as-you-go” capital costs in 2010.<sup>15</sup> Accurate value for money analyses would be more sensitive to the treatment of capital assets and liabilities in the prison system.

Beyond these calculation issues, the ADOC analysis fails to recognize an important fact: that it is essentially “leasing to own” these privately operated prisons. Arizona’s private prison contracts are structured such that after 20 years, the state takes ownership of the prisons that private operators finance, build and operate on its behalf. In other words, the state is taking advantage of the amount listed as the capital component of private per-diem fee schedules—which essentially covers land acquisition and building costs—because it is gradually purchasing prisons through the per diem payments the state makes to its private partners. Further, the contracts provide an amortization schedule, and the state can opt to purchase prison facilities at a pre-defined amount before the expiration of the contracts if it so chooses. Per diem rates go down once the state assumes full ownership if the state chooses to retain a private operator. In fact, in 2014 ADOC plans to purchase the Marana Community Correctional Treatment Facility—the first of its private prisons built in 1994—for \$150,000, as set out in the original contract, and it issued a request for proposals in April 2013 seeking potential operators for the facility once ownership transfers back to the state.<sup>16</sup>

## Physical and Mental Healthcare

The ADOC report’s treatment of costs related to physical and mental healthcare for inmates is also questionable, specifically because ADOC removes these figures from the cost comparison to only focus on operational costs. Yet,

correctional healthcare costs represent a significant cost in both the public and private sectors and should be accounted for in a fair and transparent manner when comparing the full costs of public and private sector prison operations.

ADOC's rationale for excluding correctional healthcare costs from its analysis is that some prison contracts cap the amount of physical and mental health risk the private operators will assume for their assigned inmate population. However, such caps are not a "limitation imposed by the private contractor," as ADOC suggests.<sup>17</sup> They are either a term imposed by ADOC directly—or one negotiated by the private operator and accepted by ADOC—during the contracting process.

Nor are these caps universal: some private prison operators assume full responsibility for inmate healthcare costs. The ADOC's cost comparison adjustments do not make sense in instances where this is the case. It is also important to note that a review of the data for the period in question (October 2011) finds only nine out of 4,657 inmates who were categorized as having serious physical illnesses in the ADOC comparison facilities.<sup>18</sup> In other words, ADOC excluded medical costs from cost comparison based on a very slim percentage of cases within the public prison population.

The result of this cost adjustment is that for medium security inmates the public sector's costs are adjusted from \$57.97 per diem by an average cost of \$10.08 down to \$47.89 (ultimately \$48.42, once all adjustments were made). For minimum security inmates the public sector's costs are adjusted from \$55.59 per diem by an average of \$9.43 down to \$46.16 (ultimately \$46.59, factoring in all other adjustments).<sup>19</sup> (Other adjustments leading to the aforementioned figures are inmate management functions and depreciation of state beds.)

By contrast, medium security in-state private prison beds are adjusted from \$60.66 per diem by \$7.64 down to \$53.02. Minimum security in-state private prison beds are adjusted from \$54.20 per diem by \$7.64 down to \$46.56. Overall, the public sector adjustment for healthcare delivery ranges from \$9.43 to \$10.08, whereas the private sector adjustment is \$7.64 in both cases.<sup>20</sup>

ADOC's medical expense adjustment for in-state contract prisons is a weighted average developed using the individual contract fee schedules. However this does not distinguish between minimum and medium security prisons, which

differ.<sup>21</sup> Out-of-state contracted beds were excluded because ADOC does not ask contractors to identify the medical component of their per diem rate for inmates.

The point of this discussion is not to argue that the state has skewed the analysis one way or the other, but rather that given the use of averages applied to broad categories of facilities, it becomes impossible to tell whether or not the healthcare adjustments are truly representative of actual facility-level healthcare delivery costs—and thus, whether any of the healthcare adjustments are accurate or not. Given the wide range in operating costs across facilities (as discussed in the previous section), it is reasonable to assume that there will be a similar degree of variability in healthcare costs on a prison-by-prison basis, which would effectively be washed away when reducing such figures down to averages.

## Qualitative Differences in Programming

One of the most important aspects of public sector versus private sector comparisons is evaluating performance, especially of educational and vocational programming. ADOC cost comparison numbers do not account for differences in the types and quality of programming between the public and private sector. Private operators are often required to provide *more* programming than public operators, due to contract language that makes this a critical point.

For example, the ADOC analysis compares Marana Arizona State Prison with the Graham Unit of the Arizona State Prison Safford Complex. A private operator runs the Marana prison and provides substance abuse treatment for inmates that are generally categorized as low-risk drug and driving under the influence (DUI) offenders.<sup>22</sup> No adjustment is made for this program. While this skews cost comparisons, the far worse consequence is that failing to quantify and incorporate program cost effectiveness—and include long-term outcomes—introduces a serious deficiency in any analysis that may be used by policymakers to guide corrections policy.

## Retiree Healthcare and Pensions

Retiree healthcare contributions and liabilities are inherently different between the public and private sector. Retiree healthcare and pension costs for public employees are diffused over long time horizons, and exist outside ADOC's budget. These costs are also highly opaque: recent analysis of retiree healthcare conducted by the Vera Institute of Justice Center on Sentencing and Corrections "could not obtain the necessary financial data to determine these costs."<sup>23</sup> Moreover, a new report by The Pew Center on the States and the Laura and John Arnold Foundation finds that the Arizona Corrections Officer Retirement Plan (again, handled outside ADOC's budget) is underfunded by \$448 million—this represents a small share of the state's substantial \$13 billion underfunded pension system.<sup>24</sup>

By contrast, privately operated prison contracts include all salaries and benefits in the per diem rates, so there is no outstanding obligation for taxpayers to cover benefits once the contract is over. Instead, private operators typically provide 401K accounts, or some other type of defined contribution plan, for their employees. The result of these divergent approaches to retiree benefits is that the private sector offers significant cost savings over the public sector—yet this is not taken into account by the ADOC's cost adjustment methodology. In fact, a 2012 Arizona Joint Legislative Budget Committee report estimated that the state's unfunded pension and retiree healthcare liabilities in the correctional system would translate into a per-diem cost to the state of \$2.67 per inmate. Despite being a very real obligation for taxpayers, this is a cost not factored into the ADOC cost comparison report.<sup>25</sup>

## Legal Claims and Administration

One of the most substantial areas of risk in corrections comes in the form of judgments and legal claims, which are rarely included in ADOC's budget. For example, the Arizona Department of Administration's Risk Management Division paid \$2.2 million in costs stemming from corrections-related judgments and legal claims in 2010 alone.<sup>26</sup>

These issues can be and are effectively pre-empted through well-structured public private partnerships. For starters, private operators are liable to pay fines to ADOC or have their contract revoked if their facilities are overcrowded or fail to meet other requirements. In most instances, this should eliminate the possibility of costly lawsuits occurring. Furthermore, Arizona includes indemnification and insurance clauses in its requests for proposals from private operators (a standard operating procedure in the corrections industry), which basically means private operators would face any lawsuits on their own. The language below is typical of such clauses:

*Contractor shall indemnify, defend, save and hold harmless the State of Arizona, its departments, agencies, boards, commissions, universities and its officers, officials, agents, and employees (hereinafter referred to as “Indemnitee”) from and against any and all claims, actions, liabilities, damages, losses, or expenses (including court costs, attorneys’ fees, and costs of claim processing, investigation and litigation) (hereinafter referred to as “Claims”) for bodily injury or personal injury (including death), or loss or damage to tangible or intangible property caused, or alleged to be caused, in whole or in part, by the negligent or willful acts or omissions of Contractor or any of its owners, officers, directors, agents, employees or subcontractors.”<sup>27</sup>*

The ADOC’s cost comparison methodology makes no adjustment for the fact that private prison operators take legal claims risk away from the public sector—and, by extension, taxpayers.

## State and Local Tax Payments

Additionally, there are unavoidable structural differences between public and private prison operators that ADOC does not account for. Contractors are operating as for-profit commercial entities, so they pay a variety of corporate, income, and property taxes and fees to their jurisdictional governments. By contrast, state agencies are tax-exempt so taxes are an excluded cost for the private sector. Hence, a proper comparison of costs would credit the private sector for taxes paid back to the state.

In Arizona’s case, a 2010 report prepared by an economic consulting firm estimated that one private correctional management company alone paid over \$26 million in taxes to the state and local governments the previous year.<sup>28</sup> These and tax payments by other private prison operators were not accounted for in the ADOC analysis, but they should be if the goal is to present a fair and accurate analysis of the full range of benefits and costs to the state and its taxpayers through the use of correctional contracting.

## Implications

Arizona’s imperfect approach to prison cost comparisons leads to misunderstanding among policymakers, journalists and taxpayers. If the costs outlined throughout this study were factored differently then the state would have a far more accurate understanding of its correctional system, and would be able to make better corrections policy choices based on more comprehensive data and information.

In fact, a 2013 study by Temple University economists that attempted the most robust academic analysis of the comparative costs of public and private prisons to date—and which analyzed public sector data from nine different states (including Arizona) and corrected for many of the factors discussed above—found that privately operated prisons substantially cut costs overall (by between 12 percent and 58 percent over the long-term), while also generally performing equal to or better than their government-run peers.<sup>29</sup>

In Arizona’s case, the Temple study estimated that the state saw savings through privatization in the range of -1.0 percent and 8.0 percent in the short-term and between 14.3 and 22.3 percent over the long-term. The authors suggest that the ADOC report discussed above “reached a surprising, and, we believe, incorrect conclusion,” in part because the agency inadequately addressed depreciation and correctional officer retirement issues.”<sup>30</sup>

Overall, the Temple University study strongly suggests that state correctional agency estimates of the comparative costs of government and private sector prison can often be misleading, and when costs are not allocated appropriately or fully captured, they will tend to understate the potential benefits of privatization. This certainly appears to be the case with the ADOC report.

## Conclusion

It is important for policymakers and the public to have accurate and transparent comparisons of the costs of public and private prisons, both so that tax dollars are spent wisely and to ensure that high quality correctional services are delivered. Arizona shows this can be problematic because of the way cost comparisons may treat physical and mental healthcare, capital assets and liabilities, qualitative differences in programming, retiree healthcare and pensions, and legal claims and administration.

Rigorous cost comparison is more art than science and should be undertaken carefully, lest taxpayers get a skewed view of the relative costs of the public and private sectors in corrections. Ultimately, misuse or abuse of cost comparison muddies the conversation at the expense of sound policymaking.

## About the Authors

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## Related Reason Publications

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## Endnotes

- <sup>1</sup> Source: U.S. Department of Justice, Bureau of Justice Statistics, *Prisoners in 2010*, December 2011, pp. 14, 30.
- <sup>2</sup> These prisons hold varying levels of inmates; serve various gender, race, and ethnicity demographics; and offer different programming and healthcare service, etc.
- <sup>3</sup> Arizona Department of Corrections, *Biennial Comparison of 'Private Versus Public Provision of Services*, December 2011, p. 5. [http://www.azcorrections.gov/ARS41\\_1609\\_01\\_Biennial\\_Comparison\\_Report122111\\_e\\_v.pdf](http://www.azcorrections.gov/ARS41_1609_01_Biennial_Comparison_Report122111_e_v.pdf)
- <sup>4</sup> The Supreme Court ruled on this case, *Brown v. Plata*, in May 2011.
- <sup>5</sup> Don Thompson, "AP Exclusive: Inmate Lawsuits Cost Calif. \$200M," Associated Press, February 11, 2013. <http://bigstory.ap.org/article/ap-exclusive-inmate-lawsuits-cost-calif-200m>

- <sup>6</sup> See discussion in previous section.
- <sup>7</sup> Arizona Department of Corrections, *Biennial Comparison of 'Private Versus Public Provision of Services*, December 2011, p. 62.
- <sup>8</sup> Ibid, p. 63
- <sup>9</sup> *FY 2010 Operating Per Capita Cost Report*, Arizona Department of Corrections, April 13, 2011, p. 3.  
[http://www.azcorrections.gov/adcreports/ADC\\_FY2010\\_PerCapitaRep.pdf](http://www.azcorrections.gov/adcreports/ADC_FY2010_PerCapitaRep.pdf)
- <sup>10</sup> Ibid., p. 17.
- <sup>11</sup> Ibid., p. 22.
- <sup>12</sup> Arizona Joint Legislative Budget Committee, *State-Private Prison Cost Comparison*, staff memorandum, September 2012, cited in Simon Hakim and Erwin Blackstone, *Cost Analysis of Public and Contractor-Operated Prisons*, Temple University working paper, April 2013, <http://goo.gl/1A9QB> (accessed May 22, 2013).
- <sup>13</sup> Craig Harris, "Arizona prison contract will go to private firm," *The Arizona Republic*, August 26, 2012.  
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- <sup>14</sup> *FY 2010 Operating Per Capita Cost Report*, p. 20.
- <sup>15</sup> *The Price of Prisons: Arizona Fact Sheet* (New York: Vera Institute of Justice, January 2012).
- <sup>16</sup> Gary Grado, "State to buy Arizona's first private prison," *Arizona Capitol Times*, April 29, 2013.
- <sup>17</sup> *FY 2010 Operating Per Capita Cost Report*, p. 2.
- <sup>18</sup> *Biennial Comparison of Private Versus Public Provision of Services Report*, p. 51.
- <sup>19</sup> *FY 2010 Operating Per Capita Cost Report*, p. 3.
- <sup>20</sup> Ibid.
- <sup>21</sup> Ibid., p. 2.
- <sup>22</sup> *Biennial Comparison of Private Versus Public Provision of Services Report*, p. 31.

- <sup>23</sup> *The Price of Prisons: Arizona Fact Sheet.*
- <sup>24</sup> *Arizona's Pension Challenges: The Need for an Affordable, Secure and Sustainable Retirement Plan* (Washington, D.C.: The Pew Center on the States; Houston: The Laura and John Arnold Foundation, November 2012), p. 1. <http://www.aztreasury.gov/wp-content/uploads/2012/02/AZ-Pension-Challenges-Report1.pdf>
- <sup>25</sup> Arizona Joint Legislative Budget Committee, "State-Private Prison Cost Comparison" (staff memorandum), September 2012. Cited in Simon Hakim and Erwin Blackstone, *Cost Analysis of Public and Contractor-Operated Prisons*, Temple University working paper, April 2013, <http://goo.gl/1A9QB> (accessed May 22, 2013), p. 36.
- <sup>26</sup> *The Price of Prisons: Arizona Fact Sheet.*
- <sup>27</sup> *Notice of Request for Proposal (Number ADOC12-00001388 / 120088DC)*, State of Arizona, December 21, 2011, p. 103. [http://www.azcorrections.gov/adcd/divisions/adminservices/notice\\_rfp\\_1200001388.pdf](http://www.azcorrections.gov/adcd/divisions/adminservices/notice_rfp_1200001388.pdf)
- <sup>28</sup> Elliott Pollack and Company, *CCA Arizona Correctional Facilities Economic and Fiscal Impact Report*, January 2010, [http://www.cca.com/static/assets/CCA\\_Arizona\\_Impact\\_Report\\_2009\\_FIN\\_AL\\_011810.pdf](http://www.cca.com/static/assets/CCA_Arizona_Impact_Report_2009_FIN_AL_011810.pdf) (accessed May 23, 2013).
- <sup>29</sup> Simon Hakim and Erwin Blackstone, *Cost Analysis of Public and Contractor-Operated Prisons*, Temple University working paper, April 2013, <http://goo.gl/1A9QB> (accessed May 22, 2013).
- <sup>30</sup> *Ibid*, p. 13.