

# **DO ECONOMIC FACTORS EXPLAIN PRISON PRIVATIZATION**

## Workshop 1: The Performance of Performance Budgeting

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## **DO ECONOMIC FACTORS EXPLAIN PRISON PRIVATIZATION**

In most cases, budget appropriations are an indicator of policies choices, economic robustness or stress, and future monetary policies. The movement to privatize prisons is explained as a response to fiscal stress as a result of increasing correctional costs, mandatory sentencing laws, and revenue shortfalls in some states. As a result of state budgets being in the red, states have no other choice but to seek an alternative such as privatization; especially those states with fiscal capacity problems and burgeoning correctional expenditures. However, the real issue is whether states save money as a result of privatization. Studies show that there are no significant savings when a prison is privatized. Thus, a question should be addressed is what is driving the decision to privatize state prisons? Considering that state correctional agencies have not incorporated performance based budgeting into their practices, privatization of prisons seems premature. Performance budgeting has not taken off in the correctional industry and that may explain why states have not been able to mitigate the influence correctional spending has had on state budgets. If states adopted performance based budgeting, would that reduce their costs to a level where they would not need to consider privatization?

This study explores the reasons why states sought prison privatization. The argument about prison privatization is an economic and ideological debate but for profit prison providers often argue the economic perspective and it appears to have the most traction. As a result, this study focuses on economic arguments surrounding why states privatized their prisons. The study also explores the impact of using performance budgeting in corrections and its ability or inability to curtail correctional expenditures.

It begins with a brief overview of privatization across the U.S. and it looks at issues that could possibly sway the states' decision to privatize its prisons such as performance-based budgeting and whether there is a regional affect to privatization. Multiple regression analysis is carried out to test these relationships.

### **THE MOVE TO PRIVATIZE PRISONS**

The privatization of prisons began to re-emerge in the mid 1980s. The “war on drugs” and “get-tough-on-crime” campaigns helped accelerate the need to privatize prisons because of the excessive amount of people incarcerated as a result of these campaigns. So many people were locked up during these campaigns that states began to run out of space to house those arrested, convicted, and sentenced. Mass incarceration reached a tipping point causing courts to find that states were so overcrowded that they violated the 8<sup>th</sup> amendment and courts mandated that states alleviate their crowding problems by passing enabling legislation to allow prisons to be privatized.

Another problem for states was the amount of money being spent on corrections. According to the Bureau of Justice Statistics Bulletin: Justice Expenditure and Employment in the United States, 1995, states spent \$35 billion on corrections (November 1999). States spent so much money on corrections that many spent at the expense of education, and transportation to name a few areas affected by excessive correctional spending.

As states faced the correctional spending crisis head-on, many opted to seek alternative solutions such as privatization to address the problems corrections presented to states. This transition from states being unwilling to privatize functions to being more amenable to privatizing the public sector functions was observed during the national

elections of 1978 and 1980, which revealed an auspicious change in public attitudes towards a greater role for the private sector in American life.

According to the National Council of State Legislatures, Corrections was the fastest growing part of the state budgets in 1995, increasing on average 13.3 percent. Based on the growth of corrections, the current sociopolitical environment across almost all segments of the political continuum now appears more willing to accept the notion that it is suitable to reduce the size and scope of government.

### **IMPACT OF ECONOMIC FACTORS ON THE DECISION TO PRIVATIZE PRISONS**

The research to date that explores the claims that for-profit prison operators can do it cheaper is still inconclusive. Some studies show that for-profit prison providers can do it cheaper (Calabrese, 1993; Gorham, 1983; Hanke, 1987; Morris, 1999; Segal & Moore, 2002). The argument that private prisons can manage prisons cheaper and better resonates with policy makers in the current fiscal climate.

Another appealing strategy to legislators and citizens is that for-profit prison corporations can finance, construct, and build a prison with private capital. They sell this as a strength of privatization although they leave out that the lease payments are paid at a higher interest rate and are more riskier. Many states are unable to meet additional prison space because of fiscal problems associated with bad budgeting practices, waste, fiscal problems, exorbitant correctional costs, and some states, especially Southern ones are extremely poor. As a result, privatization of prisons has increased and this study tests economic explanations empirically to determine the impact they have on the states decision to privatize its prisons.

# POTENTIAL DETERMINANTS OF THE STATES DECISION TO PRIVATIZE PRISONS

The literature is filled with research that identifies economic, ideological, and political variables that may influence the decision to privatize prisons. Fiscal concerns seem to be the more important variables in this debate.

## **Hypotheses Related to Fiscal Concerns**

The main reason states appear to privatize prisons is that they buy the argument that private vendors are more economically efficient, which translates into them being able to reduce costs. It is also asserted that contracting out accords public agencies an opportunity to take advantage of the efficiency and specialized skills believed to be offered by the private sector that may be unavailable with government (Morris, 1999; Shenk, 1995). Essentially, the presumption here is that privatization promotes efficiency and competition to ultimately save costs in prison management and operations (Calabrese, 1993; DiIulio, 1987; Moore, 1998; Price & Riccucci, 2005). To assess the viability of this argument that economic issues drive the states decision to privatize their correctional facilities, the fiscal health of the states and their ability to deliver services are considered. Potential factors here include corrections expenditures and fiscal capacity.

*Hypothesis 1.* It is anticipated that states with higher corrections expenditures are more likely to privatize prisons than states with lower correction expenditures.<sup>1</sup>

Greenwood (1998), for example, argues that states have become increasingly aware of and disturbed by the ever-growing proportion of their budgets that is being dedicated to corrections. He points out that 20 years ago, prison costs represented only 1% or 2% of state budgets but more recently they range from 8% to 10%. Others have also suggested

that rising costs to run prisons may motivate government officials to privatize, based on their belief that the private sector can do more for less (see, e.g., Moore, 1998; Stovall & Latimer, 1994; Price & Riccucci 2005).

*Hypothesis 2.* States with lower fiscal capacity are more likely to privatize prisons than states with higher fiscal capacity.<sup>3</sup> Fiscal or tax capacity refers to the capability of governments to finance their public services (Advisory Commission on Intergovernmental Relations [ACIR], 1982a, 1982b).<sup>2</sup> It has often been relied upon to gauge the health or wealth of a state (Brace, 1993; Fetto, 2000; Gray, 1996).

The ACIR, as updated by Tannenwald and Cowan (1997), developed an instrument to measure fiscal capacity, which is the per capita tax capacity divided by the average value of this variable across the states, multiplied by 100. Based on this composite measure, anything below 100 is considered low capacity, whereas 101 and above is high fiscal capacity. As Tannenwald and Cowan point out, states with extraordinarily high tax capacity include those with large potential income/and or property-tax bases (e.g., Connecticut, Delaware, Hawaii, and New Jersey), those with a wealth of extractable minerals (e.g., Alaska and Wyoming), and those with an uncommonly high sales tax capacity by virtue of their large tourist industry (e.g., Hawaii and Nevada). In addition, the South is overrepresented by states with the lowest tax capacity (see Tannenwald and Cowan, 1997).

### **Hypotheses related to Politics and Budget Practices**

Although the argument to support prison privatization is mostly an economic one, others have argued that decisions to privatize relate more to political and budgeting practices. As Henry (1999) contends, “the decision by policymakers to contract out the

implementation of their policies to private entrepreneurs is, in short, at least as much a political decision as it is a managerial and financial one” (p. 44).

*Hypothesis 3.* It is expected that states in the Southern region are more likely to have prisons than states outside the Southern region. As Tannenwald and Cowan (1997) point out, Southern States are more likely to have lower tax capacity and to be poorer. According to the report by the Carl Vinson Institute of Government (2002) poverty in the Southeast Region has persisted over three census periods—and it is the poorest of all regions of the country.

*Hypothesis 4.* It is expected that states that adopted performance-based budgeting are more likely to not have private prisons. Melkers and Willoughby (1998) contend that “the current wave of budgeting reform focuses on the performance of government agencies and programs is reflected in state efforts to introduce performance-based budgeting (PBB)” (p. 66). Performance-based budgeting is seen as a way to demonstrate results which could translate in reducing correctional expenditures.

## **STUDY DESIGN AND DATA**

This study relies on prison and related data from the calendar year 1995. This base year was selected because it represented a leveling-off of prison privatization and it serves as an opportunity to assess whether performance-based budgeting played a role in leveling-off privatization of prisons. The data was collected from a variety of sources, including the Bureau of Justice Statistics, the US Department of Commerce, BEA and MBG Information Services, Tannenwald and Cowan’s article on fiscal capacity, and Melkers and Willoughby’s article on performance-based budgeting.

The dependent variable for the study is the number of private prisons within each of the 50 states. These data were collected from the Bureau of Justice Statistics of the U.S. Department of Justice. This offers greater precision than, for example, a dichotomous variable of whether a state has privatized prisons, because the former captures the degree or extent of prison privatization within a state.

The independent variables were explained fully in the previous section and, along with the dependent variable, are summarized in Table 1. It should be noted that no multicollinearity was found between the independent variables.

To test the relationship between state-level decisions to privatize prisons and fiscal, politics, and budgeting practices, ordinary least squares (OLS) regression analysis is relied upon.

Table 2 presents summary descriptive statistics on the continuous variables included in the model. As the data shows, there was an average of 1.9 privatized prisons in the states, with a range from 0 in states that do not have private prisons to 30 privatized within a state. The data also shows that states spent an average \$711,518 on corrections expenditures, the minimum spent on corrections was \$24,582 and the maximum amount spent on corrections within states was \$5,781, 687 million.

In 1995 there were 98 state privatized prison facilities (Bureau of Justice Statistics, 1995). Close to 36% of the privatized prisons were located in the South,<sup>4</sup> with the remainder of the prisons located outside the South.<sup>5</sup>

## **RESULTS**

The OLS results on the contribution of fiscal concerns and politics and budgeting practices to privatization are presented in Table 3. The data shows that performance-

based budgeting and fiscal capacity are not determinants of prison privatization. That is to say, contrary to my hypotheses, fiscal capacity and budgeting practices or performance-based budgeting do not explain why states may choose to privatize. As noted, governments tend to publicly justify their decisions to privatize on the basis that it is cost efficient.

On the other hand, corrections expenditures and the region where the private prisons are located seem to better explain why states may choose to privatize. As seen in Table 3, corrections expenditures and regional breakdown of private prisons variables are statistically significant. This confirms the advocates of prison privatization assertions that states decide to support privatization because of the exorbitant amounts spent on corrections. However, the confirming of the hypothesis that privatization of prisons is a Southern phenomenon is confirmed and supports other studies that found that the South is more likely to use imprisonment as a form of social control.

Finally, as can be see in Table 3, the model explains about 47% of the variation in decisions to privatize state correctional facilities.

**TABLE 1: Summary of Dependent and Independent Variables**

Variable Name	Coding of Variables
Dependent variables	
Number of private prisons	Number
Independent variables	
Corrections expenditures	Dollars (spent on corrections)
Fiscal capacity	Number
Performance-based budgeting	0=no performance-based practices 1=yes performance-based practices
Regional breakdown of prisons	1= CT, ME, MA, NH, NJ, NY, PA, RI, VT 2= IL, IN, IA, KS, MI, MN, MO, NE, ND, OH, SD, WI 3= AL, AR, DE, FL, GA, KY, LA, MD, MS, NC, OK, SC, TN, TX, VA, WV 4= AK, AZ, CA, CO, HA, ID, MT, NV, NM, OR, UT, WA, WY

**TABLE 2: Summary of Descriptive Statistics**

	Mean	Minimum	Maximum	Standard Deviation
Privatized Prisons	1.900	0	30.00	.501
Corrections expenditures	711,518	24,582	5,781,687	1,066,427.342
Performance-based budgeting	.4400	0	1	.50143
Regional breakdown prisons	2.66	1	4	1.05620

**TABLE 3: The Privatization of State Prisons, 1995 (ordinary least squares, standardized coefficients)**

	$\beta$	Standard Error	t
Corrections Expenditures	.635*	.000	6.014
Fiscal capacity	.036	-.036	-.347
Performance-based budgeting	-.025	1.081	-.226
Regional breakdown of prisons	.360*	.505	3.346
R <sup>2</sup>	.513		
Adjusted R <sup>2</sup>	.47		

\*p<.05.

### SUMMARY AND DISCUSSIONS

The privatization of prisons continues to be hotly debated and a major source of controversy in this country. How does the state manage its resources in a climate of resources scarcity? These are questions that must be addressed. Do private prisons actually alleviate fiscal stress for the states or do they create fiscal stress by lobbying for laws such as mandatory sentencing and truth-in-sentencing through the American Legislative Exchange Council (ALEC). Clearly in order for for-profit prisons to make money they need laws favorable to their industry.

This study looked at only the determinants for prison privatization and not the advantages and disadvantages of privatization. Nor did it seek to assess whether prison privatization is more efficient and effective. The study also looked at whether

performance-based budgeting practices affected the states decision to privatize. The idea here is that if states incorporated performance-based budgeting into their correctional departments can they control costs. Surprisingly, performance-based budgeting made no difference concerning the states privatization decisions; suggesting that other issues may be driving the states decision to privatize. The research presented here suggests that costs may be a driving factor regarding the states decision to privatize its prisons.

This research adds to the literature that examines the privatization of prisons. It is intended to generate further interest and research in studying not only why states privatize, but the ultimate effects of prison privatization on the inmates, correctional staff, and the general citizenry. Further research is certainly called for, and more-in-depth case studies may shed additional light on the question of why states privatize their prisons.

## NOTES

1. Price and Riccucci (March 2005) test the relationship between corrections expenditures and prison privatization in 1990 while the current study looks at the same relationship in 1995.
2. More precisely, tax or fiscal capacity is an estimate of the amount of revenue a state would collect if it utilized a “representative” tax system comprising national average tax rates applied to commonly used tax bases.
3. Price and Riccucci (March 2005) test the relationship between corrections expenditures and prison privatization in 1990 while the current study looks at the same relationship in 1995.
4. The states in the South, as defined by the Bureau of Justice Statistics include Alabama, Arkansas, Delaware, District of Columbia (not included in this data set), Florida, Georgia, Kentucky, Louisiana, Maryland, Mississippi, North Carolina, Oklahoma, South Carolina, Tennessee, Texas, Virginia, and West Virginia.
5. The Northeast accounted for 0% of state privatized prisons, Midwestern states account for about 2%, western states account for 52%. California has 30 privatized prisons which overstates the level of privatization in the West.

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