Western Australian Prison Officers' Union of Workers
Submission to the

Economic Regulation Authority
Inquiry Into the Efficiency and Performance of Western Australian Prisons

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1. Purpose of the Inquiry

The Economic Regulation Authority (ERA) has been directed by the Treasurer 'to undertake an inquiry into options to improve the efficiency and performance of public and private prisons....ERA will provide advice to the Government on the efficiency and performance of prison services based upon economic, market and regulatory principles. This will include advice on the design of appropriate performance standards, incentives and performance monitoring processes for the prisons system' (ERA 2014: 3).

Three primary outcomes are required of the Inquiry. First, is 'the development and calculation of a set of benchmarks to allow comparisons of the performance of individual prisons in Western Australia. The Department of Corrective Services would use the benchmarks to identify areas in which the performance of individual prisons could be improved.' Second, 'ERA will examine service delivery options that provide incentives for service providers to improve their performance'. Finally, the inquiry 'will examine options to improve contestability in the delivery of services in the prison system' (ERA 2014: 3).

2. Scope of the Submission

The scope of this submission is narrowly focussed on the primary outcomes of the Inquiry. It addresses the theoretical and methodological issues in the construction and interpretation of performance frameworks and benchmarks for the delivery of prison services. Second it addresses the application of economic incentives to performance benchmarks both in the delivery of public and private prison services. Finally, it examines the role of privatisation and 'contestability' in the delivery of prison services.

3. Why the Inquiry?

Before commencing the primary aspects of the submission it is worth noting the absence of any substantive rationale advanced by ERA and/or the WA Treasurer for conducting the Inquiry into the performance of WA prisons.

ERA identifies two background issues to the Inquiry, but these do not, by themselves, constitute a necessary and, certainly, not a sufficient reason for such an Inquiry. The first issue is the absolute size of public outlays on the penal system in WA, as the 'Western Australian prison system cost $608 million to operate in 2013-14' (ERA 2014a:1). To put this in perspective, in 2013-14 total WA general government expenditure was estimated to be $27.6bn. (Government of Western Australia 2013a: 3). WA prisons thus represent just 2.2% of total WA general state government expenditures.[1] In the same year expenditure on health and education was estimated to be $3.9bn and $4.5bn respectively (Government of Western Australia 2013b). *Prima facie* it would be a more efficient and effective use of scarce ERA resources to seek efficiency gains in other fields of general government activity that constitute a much larger share of state expenditure. To put it simply a 10% efficiency gain in prisons would yield a saving of $60m compared to a similar percentage gain in health of $450m.

[1] Allowing for capital expenditure and other activities, such as juvenile services operated by the WA Department of Corrective Services, this brings total expenditure up to $801m. This represents just 2.9% of total general outlays.

Moreover, the WA correctional system has been subject to contestability for close to 2 decades, with private prisons accounting for 20.4% of average daily prisoner population (Productivity Commission 2014: Table 8A.1). The ERA identifies contestability as a key driver of efficiency; it is a key means to 'provide incentives for service providers to improve their performance' (ERA 2014a:18). Many other fields of state government expenditure such as education have not been subject to such a high degree of contestability as the prison system in WA. If one accepts the ERA argument regarding the positive effect of contestability, it follows logically that the scope for future efficiency gains within the WA correctional system is *prima facie*, likely to be much smaller than other areas of state government activity that have not yet been subject to such a high degree of contestability. It also follows that conducting the inquiry would seem to question the ERAs assertion regarding the efficacy of contestability if a further comprehensive and potentially expensive performance framework is required to promote efficiency in the system.

Allied to this point is that ERA notes the Department of Corrective Services already has developed and implemented 'an extensive set of compliance testing standards that are used to monitor the compliance of public prisons. These standards are service standards, setting out the requirements of prison services. Each standard highlights a key objective and prescribes a number of outcomes to be achieved to ensure compliance with that objective...In total there are 27 service standards that cover areas of care and wellbeing, custody and containment, rehabilitation and reintegration and governance....The service standards for the privately operated Acacia prison and Wandoo Reintegration Facility are specified in the respective contracts for these facilities as Operation Service Requirements' (ERA 2014a: 28). In addition, aside from the monitoring activity of the Department there is the oversighting work of the independent statutory authority the Office of the Inspector of Custodial Services (OICS). However, despite the existence of comprehensive standards and external monitoring ERA presents no evidence that the standards under which these two agencies operate are inadequate or implementation of the monitoring system requires rectification. To conduct an Inquiry into service standards, performance benchmarks and monitoring in the absence of any evidence of deficiencies in these areas raises concerns regarding potentially wasteful duplication of effort.

The only apparent justification for the Inquiry is that currently these standards apply to the prison system as a whole as they do 'not provide information from individual prisons for benchmarking purposes' (ERA 2014a: 31). ERA has been asked to develop' a set of benchmarks to allow comparisons of the performance of individual prisons in Western Australia' (ERA 2014a: 31). The obvious questions then is, in the absence of any criticisms or concern at the existing standards and monitoring system why was not Department of Corrective Services and/or OICS asked to develop such standards? Would not this have been a better use of scarce public resources?

The second background issue is ERA (2014: 1) cites Productivity Commission data suggesting that 'the Western Australian system is relatively expensive to operate. In 2012-13, the average cost per prisoner per day in Western Australia was $342, compared to $297 per prisoner per day nationally'. However, ERA also notes that there are many possible explanations for this cost difference including 'issues relating to the geographic dispersion and demographics of the population (for example, age and gender)'. In other words, neither the Treasurer nor ERA has rigorously established that the WA prison system is, in fact, relatively less efficient, having regard to all intervening variables that affect costs. Indeed, as if to emphasise this lack of knowledge regarding actual cost relativities and the variables

affecting these relativities the first question asked of participants to the Inquiry in the Consolidated List of Questions is:

'Do you agree that prisons are more expensive to run in Western Australia? If not, why not? If yes, what are the specific factors that result in Western Australian prisons being more expensive to run (in terms of cost per prisoner per day) compared to other States? Are any of these factors within the control of the Government, the prison system or individual prison operators?' (ERA 2014a: 55).

The Treasurer granted up to one year for the conduct of the Inquiry (ERA 2014a: 54). The absence of a sound rationale for commencing the Inquiry raises important issues regarding the efficient allocation of scarce public and private resources and the potentially high opportunity cost of this Inquiry.

Finally, it is also worth noting the potential for a fundamental conflict in the design of the Inquiry. On the one hand the ToR requires ERA to develop a performance framework for the WA prison system (and thereby implicitly assumes that such a framework is suitable for the WA prison system). 'A key deliverable of the inquiry will be the development and calculation of a set of benchmarks to allow comparisons of the performance of individual prisons in WA' (ERA 2014a: 54). On the other hand a key question posed by ERA of participants to the Inquiry is: 'Are the principles outlined by the ERA for designing performance frameworks and performance benchmarks appropriate? Why or why not?'

This raises the intriguing possibility that ERA fulfils its contractual obligation to the Treasurer in developing a performance framework for the prison system but concludes either such a performance framework is inappropriate or can only be used subject to severe caveats that greatly limit its ability to achieve the objectives set for it by the Treasurer. One can speculate that for ERA to find that a performance framework conforming to its definition 'of a good performance framework' is not appropriate, would be, to use a well worn phrase, 'a courageous decision'.

The various matters raised in this section beg the obvious question, why the Inquiry?

3.1 Inquiry Focus on Direct Budgetary Cost

The Terms of Reference (ToR) set for the Inquiry appear to give undue priority to the issue of cost in the administration of prisons. In conducting an 'inquiry into options to improve the efficiency and performance of public and private prisons' the first task prescribed by the Treasurer for ERA is to 'take into account different categories of prisons and any other significant operational differences and the implications these will have for the cost of service provision'. In addition, the first activity in constructing the 'key deliverable' of a performance benchmark is to 'draw upon new and existing costing models of prison services belonging to the Department of Corrective Services' (EARA 2014a: 54).

What is notably absent from the ToR is a requirement for a balanced evaluation of prison performance and a performance framework that requires, for example, ERA to have regard to 'quality', 'value for money', 'quality of working life of those employed within the prison system' and the 'interests of all stakeholders in the prison system'. It is, of course, possible for ERA to interpret its ToR to encompass a wider and more balanced meaning; nevertheless,

it needs to be acknowledged the original ToR implies a focus on narrowly defined budgetary costs.

4. Performance frameworks and benchmarks for the delivery of publicly funded prison services.

4.1 ERA Position on Performance Benchmarks

This section briefly sets out the ERA understanding of performance frameworks and benchmarks. The ERA presentation is a standard textbook model of performance frameworks and benchmarks.[2]

The purpose of a 'performance framework' is to provide 'a means by which an organisation can improve its performance. A well-designed framework has a number of components that allow an organisation to measure and evaluate performance and to provide incentives to improve performance'.

There are six components to the ERA performance framework.

The first is a clear statement of the organisation's objectives. The performance framework is used to measure how efficiently and effectively it is meeting its stated objectives.

Second, is the setting of 'service standards...that an organisation must meet in delivering its operations. These may include minimum standards that must be met (that is, they are non-negotiable and prison operators must adhere to them in all circumstances) or performance standards that will be rewarded if achieved (for example, exceeding targets for a percentage of prisoners completing education and training programs)'.

Third, is the setting of benchmarks for these service standards. Benchmarks 'provide a specific metric against which the performance of organisations can be assessed? In conducting benchmarking across several comparable organisations the monitoring agency is able to identify poor performance to be rectified and good processes and programs that could be replicated... It is important that metrics are selected that make a meaningful contribution to maximising the achievement of the organisations' objectives. Benchmarks should be selected that stem from the objectives of prisons. Each objective will have a number of indicators that can be used to assess the achievement of that objective. These performance indicators can be used as benchmarks for assessing the performance of prisons. Selecting benchmarks in this way assures that benchmarks address an objective of the prison system'. It is also important 'that benchmarks measure outcomes not outputs'. It gives the example of a metric for the target of reducing drug use among prisoners. The metric should be the degree of reduction in drug use and 'not completing a drug reduction program', as the latter is simply an output measure (ERA 2014: ch 4).[3]

Fourth, is a system of 'performance monitoring is the means by which a governing organisation is able to determine if standards are being achieved and organisations are performing well...[it] includes the responsibilities for compiling, reviewing and auditing reports and the frequency with which performance reviews will be undertaken. This role would typically be undertaken at arms-length from the service provider'

[2] See for example *Handbook of Cost-Benefit Analysis, Department of Finance* 1994*;* Fitzpatrick, J., Sanders, J. R., & Worthen, B. R. *Program Evaluation: Alternative Approaches and Practical Guidelines* (3rd ed.). Allyn & Bacon

Five, aside from providing guidance as to whether an organisation is achieving its objectives and how well it is meeting them 'a good performance framework will give organisations the incentive to achieve the performance targets that it sets. These incentive mechanisms can come in a variety of forms and may be different across private and public sector entities. An example of an incentive mechanism often used is performance linked payments. This involves the setting of desired performance levels that attract a fee to the contractor if achieved'.

Finally, ERA note a number of pre-conditions for successful performance benchmarks. Chief among these is that accountability for performance and control of performance cannot be separated. 'The development of a performance framework for the prison system is complicated by the fact that many of the factors that affect the overall cost and performance of delivering prison services, are external to, or cannot be influenced by, the prison system. Operators and administrators of the prison system can only be held accountable for factors over which they have influence' (ERA 2014a: 44).

4.2 Criticisms of ERA Performance Framework and Benchmarks

This section is directed at addressing the question posed by ERA: 'Are the principles outlined by the ERA for designing performance frameworks and performance benchmarks appropriate? Why or why not? Are there other principles that should be considered? What are these?' (ERA 2014a: 54).

The performance framework as proposed by ERA is not appropriate to the WA prison system due to:

- the absence of a cost-benefit analysis to determine if the proposed framework will yield positive results in excess of its cost
- there is no agreement between ERA and the prison system as to what are the objectives of the prison system;
- a performance framework that is used to allocate resources to 'high performing' workplaces or individuals can result in a perverse outcome of virtuous or vicious cycles. Initial differences in the performance of prisons can result in high performing prisons gaining resources and thereby incrementally improve their already good performance while lower performing prisons may be 'starved' of resources resulting in growing relative decline in performance. (The problems of creating efficient and effective incentive systems and their perverse effects are taken up in more detail in section 5).
- the theoretical and methodological problems involved in creating benchmarks and associated performance measures present insurmountable barriers. ERA proposes the performance benchmark framework will be applied to comparing the 'performance' of individual prisons and as a basis for allocating resources within the prison system via incentive payments.

As proposed the benchmarks and performance measures are not fit for purpose.

It is concluded that given the nature of the 'service' provided by the prison and the type of production system generating these services, performance benchmarks as proposed by ERA can only serve as a general guide, a 'rough guide', to evaluating system performance and they are inappropriate to compare performance across prisons and across public and private

sectors and they are inappropriate to determine resource allocation within the system. An alternative example of a method for improving system performance is the recent research report from the OICS into recidivism (Office of the Inspector of Custodial Services 2014). It suggests the Department of Corrective Services develop the internal capacity to undertake comprehensive evaluation of recidivism programs, evaluate programs with a view to identifying 'what works'; ensure that the best practice measures are disseminated across the prison system, through staff training and capital investment and 'that adequate resourcing is prioritised for strategies aimed at reducing recidivism' (OICS 2014: 29-30). The focus is to use evaluation to identify best practice in terms of inputs and outcomes and invest resources to assist lower performing institutions to implement remedial action and in turn evaluate the outcomes of this remedial action.

In addition, those who undertake the evaluation and those who act upon its findings must recognise the limitations of the exercise when applied to a system as inherently complex as a prison system. This is a system which is subject to multiple and conflicting objectives. Performance of the system is influenced by multiple independent variables some of which can be measured, others can only be qualitatively assessed and others will simply be unknown, appearing as part of the 'residual' in a regression equation. Moreover, as ERA is at pains to emphasise, it is a system in which prisons are given responsibility for outcomes over which they exercise either no or only partial control.

4.2.1 No cost-benefit analysis

The ToR for the Inquiry has not requested a cost-benefit analysis of the proposed performance benchmark and it is uncertain whether such analysis is permitted within the ToR. It is unknown at this stage whether the development of a performance framework, including the independent monitoring system, will yield improvements in efficiencies and effectiveness that exceed what will arguably be the high cost of their development and implementation. To put it another way, constructing the performance framework without an initial cost-benefit analysis would contradict the principles underlying the construction of a 'good performance framework'

4.2.2 Lack of agreement between ERA and the prison system on system objectives

ERA (2014a: 19-20) notes that it is generally accepted that the objective of prisons include 'incapacitation, deterrence, rehabilitation and retribution'. However, 'ERA considers that prison operators can only be held accountable for influencing two of the objectives of prisons: incapacitation and rehabilitation'. The reason for this is that 'executive government and the judiciary has some influence over the deterrence and retribution objectives of prisons through its public policy settings on crimes and associated sentences. Hence, executive government and judiciary can influence the performance of the prison system as far as it relates to these objectives (ERA 2014a: 19-20).

By contrast the Department of Corrective Services identifies its 'responsibilities' as:

- 'providing offender management services that protect the community
- giving offenders the interventions they need to make a positive difference in their lives and reduce their involvement in the criminal justice system
- supporting offenders to become responsible citizens by adopting law-abiding lifestyles

- promoting crime prevention' (https://www.correctiveservices.wa.gov.au/about-us/our-responsibilities/default.aspx).

The last objective 'promoting crime prevention' certainly encompasses deterrence and rehabilitation of prisoners to reduce re-offending rates and may even connote retribution to the extent that the prospect of retribution for one's crimes also promotes deterrence.

There are a number of problems with the lack of agreement between ERA and the Department over the objectives of the system. First, ERA notes performance benchmarks and targets drive activity or should drive activity within the system. By focussing on only two of the four objectives the ERA performance framework will result in an unbalanced prison system. Second, it seems extraordinary that the task of defining the purpose of the prison system for the goal of assessing performance and allocation of funding into the future should be allocated to an unelected agency such as ERA whose primary task is the regulation of infrastructure monopolies. The task of the defining the purpose of the prison system in a democratic society, whose job it is to deprive its citizens of their liberty, should surely be the responsibility of the WA Parliament?

4.2.3 What is to be measured, inputs, outputs or outcomes?

There is some ambiguity in the ERA performance framework as to what constitutes an output or equivalently an outcome. 'A performance framework should not be so prescriptive that it discourages innovation. A framework will ideally be outcome based, allowing prisons to innovate in order to find the best way to achieve that outcome....A framework will ideally be outcome based, and allowing prisons to innovate in order to find the best way to achieve that outcome. For example, a performance framework that only rewards a prison operator for the number of prisoners completing rehabilitation programs may discourage prison operators from finding innovative ways of rehabilitating prisoners' (ERA 2014a: 27). An appropriate outcome measure for rehabilitation could be, for instance, change in the rate with which ex-prisoners achieve employment or return to gaol.

But elsewhere ERA (2014a: 3) provides as an example of 'performance standards that will be rewarded if achieved', a prison 'exceeding targets for a percentage of prisoners completing education and training programs'. Now, this may simply reflect the time pressure ERA was under in developing the Issues Paper.

A much more fundamental issue is that a sole emphasis, or even undue emphasis, on measuring and benchmarking outcomes as the chief objective of a performance framework is that a system monitor will have no information or inadequate information as to how different performance outcomes are achieved. Indifference to outputs also entails indifference to inputs; in fact ERA seems particularly averse to prescribing inputs for the prison system. An obvious implication of a performance system in which data collection and monitoring is oriented solely or largely to outcomes is that a separate programme of evaluation will be necessary to identify the causes of differing results. This by necessity involves an examination of the specific inputs and outputs that give rise to these differing outcomes. This issue can be stated as follows: the ERA performance framework permits identification of differences in the achievement of performance benchmarks and targets but appears not to have embedded within it a performance evaluation function.

4.2.4 Measured and Unmeasured Outcomes

'Some outcomes that are desirable for a prison system to achieve can be measured, but other desirable outcomes cannot. A well-functioning prison system will need to achieve both the measurable and unmeasurable outcomes. However, the selection of benchmarks can influence the way in which prison operators focus their efforts. In particular, prison operators may focus greater effort on achieving the outcomes that can be measured and less effort on the outcomes that cannot be measured. Benchmarks need to be selected carefully to ensure that prison operators also put effort into achieving desirable, but unmeasurable outcomes (ERA 2014a: 34).

It is good the ERA notes that what is measured drives activity and the potentially distorting effect of this on system performance. However, if unmeasurable outcomes are in fact important to the overall performance of the system first, it does raise fundamental issues regarding the utility of a performance framework such as that proposed by ERA and second, it is difficult to conceive how a benchmark can be constructed that measures or evaluates the 'effort' put into achieving an unmeasurable outcome. The term 'effort' does also connote an input or output, something with which the proposed performance framework is not overly concerned.

4.2.5 Incentives and Vicious or Virtuous Cycles

ERA is explicit that improvement in the performance of the overall system, individual institutions and individual workers will be driven by incentives and dis-incentives linked to achievement or non-achievement of performance benchmarks. ERA identifies two types of incentive, financial and non-financial. Examples of positive financial incentives for private prisons are the 'contracts contain performance linked fees for the achievement of Key Performance Indicators' and examples of negative financial incentives are that the 'contracting process provides [a] significant performance incentive in itself, given that failing to perform to a sufficiently high level has the potential to cost a private provider renewed contracts.... Contracts also contain disincentives for poor performance. Specific events result in an abatement fee' (ERA 2014: 30). Financial incentives for improvement are thus based on reward and punish. An example of a non-financial motivation is that 'individuals have an incentive to perform purely for the personal satisfaction that they get from doing their job well (ERA 2014: 30).

ERA suggests 'that there is no reason that formal incentive mechanisms should not be applied to public prisons as they are to private prisons', though it notes the complication that incentives for public prisons cannot rely on profit motivation' (ERA 2014: 29-30). Nevertheless, such a system does not exclude making payments to public prisons contingent upon achieving performance benchmarks and/or introducing bonus payments to groups and/or individuals within a given public institution for exceeding these benchmarks. Indeed, this seems to be exactly what ERA has in mind.

A performance framework that is used to allocate resources to 'high performing' workplaces or individuals can result in a perverse outcome of virtuous or vicious cycles. Initial differences in the performance of prisons can result in high performing prisons gaining resources and thereby incrementally improving their already good performance while lower performing prisons may be 'starved' of resources resulting in growing relative decline in

performance.[4] Higher performing institutions will be rewarded with payments that may allow for higher wages to attract better quality staff, with the opposite effect occurring in poorer performing institutions. A performance framework can thus result in no change in overall system performance.

It can only be assumed that for a performance based payment system to elicit the desired behavioural response at least two conditions must be satisfied. First, a considerable proportion of total funding must be 'at risk' with failure to achieve performance targets imposing a large cost burden on organisations and individuals; that is, there is a strong disincentive for failure. Second, payments for exceeding targets must be large in proportion to total income; this is especially the case where the targets are ambitious and effort to achieve a 'hurdle' is high. In the absence of counterveiling effects, under such a payment system, growing disparity in the performance of individual units is arguably an inevitable outcome. (The notion of 'competition' used by ERA leading to overall rising standards as a justification for a performance based incentive system is discussed in section 5).

Another reason to expect that virtuous or vicious cycles are a likely outcome is that, aside from the stimulatory effect of incentives, ERA does not specify exactly how low performing institutions or individuals will be assisted to improve their performance. It notes that a performance 'framework should be able to identify and help to rectify poor performance and also identify areas of good performance within certain organisations to allow cross-fertilisation to occur' (ERA 2014a: 27). Vague and bucolic references to 'cross-fertilisation' of ideas and practices are not a satisfactory basis for addressing the problem of how to improve performance. (The adverse effect of financial incentives on knowledge sharing across competing agents in the same market is addressed in section 5. This section also deals briefly with the economics of innovation).

The above certainly does not exclude the possibility that ERA has in mind a 'counterveiling' funding system that directly assists low performing institutions and individuals to achieve higher performance. This could take the form of providing additional resources to match or partially match those that will have flowed to high performing institutions via incentive payments or to compensate for the loss of income via a financial disincentive or 'abatement fee'. However, it must be acknowledged that providing 'a helping hand' by way of additional resources to low performers must blunt the bracing effect of competition and incentives that a performance based system is intended to create. In other words, it is difficult to reconcile the principle of resources allocated mostly or partially on a performance basis and the principle of resource allocation based on need.

4.2.6 Theoretical and methodological problems in constructing, implementing and interpreting performance standards

The extensive literature on measuring prison performance points to considerable theoretical and methodological problems constructing a performance framework as proposed by ERA. For some scholars these are insurmountable. These problems are compounded when it is proposed to use this performance framework as a means of distributing financial incentives to promote efficiency and effectiveness.

[4] In the economics literature this is known as the 'principle of cumulative causation' (Toner 1999). It is a principle long acknowledged in human experience. According to Matthew 25:29 'For whoever has will be given more, and they will have an abundance. Whoever does not have, even what they have will be taken from them'.

Referring to research on performance monitoring of prisons Gaes et al (2004: x-xi) observe: 'Scholars who take this seriously are still asking the most fundamental questions. In his summary of the state of knowledge about private prisons, Richard Harding (2001) asserts that "The ultimate question is whether private prisons can and do provide good, or even superior, quality correctional services". Harding's conclusion presupposes there are definitive ways to measure prison quality. In our judgement the literature on prison performance and the research comparing public and private prisons is essentially flawed because there has been no coherent approach to the problem....In this arena there has been more rhetoric than reality, more speculation than specifics and more postulation than proof'.

As noted above, ERA considers that prison operators can only be held accountable for influencing two of the objectives of prisons: incapacitation and rehabilitation. ERA is commendably blunt in its assessment of the limited influence of prison operators on the latter objective. 'Prison operators can partially achieve the rehabilitation objective by supporting prisoners through high quality and effective rehabilitation programs and training and education programs while prisoners are incarcerated. However, prison operators cannot be held responsible for what happens to the prisoner after they are released' (ERA 2014a: 20).

On any common sense construction of this last sentence this apparently definitive statement would indicate that ERA regards recidivism rates either as an inappropriate measure of prison operator performance or only marginally so. Yet, echoing the inherent difficulties in measuring prison performance ERA seems to have not quite made up its mind on this matter: 'prisoner recidivism rates following release from prison, number of prison escapes and serious assaults occurring in prison are all commonly used to assess prison performance. This Inquiry will identify the outcomes that best reflect the objectives of the prison system (ERA 2014a: 22). And elsewhere it observes that 'greater program effectiveness would mean that prisons are, for example, lowering recidivism rates or the number of prisoner escapes for the same cost' (p.23) and 'ERA considers that the following factors are likely to affect the achievement of the rehabilitation objective....*Intent of prison* – Some prisons (such as reintegration facilities) have a greater focus on rehabilitation than other prisons reflecting their core purpose. These prisons are likely to be more successful at reducing rates of recidivism, but should also be held to a higher standard than prisons that do not have this focus' (ERA 2014a: 46).

One of the reasons given by ERA (2014a: 34) for complexity in identifying the cause of change in recidivism rates that can reasonably be attributable to individual prison operators is 'the difficulty in identifying which prisoners are to be counted in a prison's benchmarks. There is significant movement of prisoners between prisons for a variety of reasons, including, for example, the need to attend a program that may only be run at a particular prison. In addition, many prisoners are moved between prisons shortly prior to their release to be closer to their home. In this case the prison from which the prisoner is released from may have had no effect on the prisoner's rehabilitation'.

It is worthwhile reflecting on the difficulty of attributing a cause or even a correlation from prison operations to changes in recidivism. Aside from the problem of 'prisoner movement' between correctional facilities the literature identifies three other problems 'prisoner backgrounds, release neighbourhoods and decomposing criminality from jurisdiction supervision levels' (Gaes et al 2004: 22).

‘There is a great deal of data to demonstrate that post-release outcomes are dependent on a host of background characteristics of inmates. Prior criminal history, age, sex, education level and gang membership are some of the major post-release predictors...Any comparison among institutions would have to account for compositional differences among inmates. There are many reasons why these average criminal risk levels can vary among prisons...Even within an institution security level there may be variability from district to district. This is especially true when a second rule is used to assign prisoners to institutions as close as possible to their residence and family...A great deal of evidence has accumulated that demonstrates the effect of community and neighbourhood on criminality...many ex-offenders are returning to some of the most disadvantaged and crime-prime neighbourhoods or to neighbourhoods with a high number of parolees and ex-offenders. If we are to conduct recidivism studies that try to evaluate jurisdictions and institutions, then we must take into account the impact of these neighbourhood effects...This obviously introduces another layer of complexity and noise into our understanding of institutional measurement...Post-release supervision policy and requirements are implicated in the measurement of recidivism....there may be district variations in the choices made by courts, police or other supervision agents that monitor the offender’ (Gaes et al 2004: 23-24).

Similar problems arise in quantitatively or even qualitatively evaluating the effectiveness of particular prison interventions on, say, recidivism rates. ERA (2014: 16) notes that to reduce recidivism ‘the corrective system provides services and programs that assist prisoners to learn new skills that will help them gain employment upon release. These programs include education and vocational training through working in prison industries’.

Assume that the relevant outcome measure from participating in education and vocational training is the extent to which a released prisoner gains employment upon release. But this outcome depends very much on the state of the overall labour market, the occupational structure of the local labour market the ex-prisoner is wishing to enter, the quality of education and training received, the extent to which the education and training meets a need in the labour market and of course, the characteristics of the ex-prisoner (age, ethnic group etc) that affect the probability of gaining employment. In a performance framework all of these factors would need to be quantitatively assessed against a relevant control group (ideally a person who matched ex-offenders in all respects aside from being in prison) using say multiple regression techniques or a probit/logit model to compute the extent to which participation in education and training had altered the probability of the ex-prisoner attaining employment controlling for all relevant independent variables. It hardly needs stating that a sufficiently large sample of ex-prisoners would be required for this exercise to yield meaningful data and that as many of the economic and labour market variables in the model are themselves variable they require regular updating. Even then the problems of non-random assignment to treatment groups and ‘unobserved differences’ or 'omitted variable bias’ that influence outcomes need to be addressed (Heckman et al 1999).

Camp and Gaes (2002: 434-435) provide a further example of statistical issues the measurement of prison performance: ‘the plan was to test whether staff instability is associated with higher rates of misconduct in prisons. Although it was never expected that all types of inmate misconduct could be analysed, especially rare forms of misconduct, it seemed plausible that the data would support a regression analysis of random hit rates for drug use, using custody staff separation as an independent variable as well as prison activation status, prison size, and security level as independent variables. This analysis was not feasible, though, because of the confounding in the data among the BOP [Bureau of Prisons], the

private sector, and separation rates. Almost all of the institutions with a separation rate that was less than 10% (and corresponding low drug hit rate as well) were BOP institutions, and all of the prisons with a separation rate greater than 10% were private prisons. Given this, separation would have served as a proxy for identifying BOP and private sector prisons and not staff instability alone. Therefore, a multivariate model would have produced misleading results even if a numerical solution could be found. To put it another way, it is simply not possible to partial out the separate effects of low separation rates from BOP operations as these variables stand in for one another in this data. Given the problem with including staff instability in multivariate models, the current study reports univariate results and interprets the implications of the empirical findings'.

4.3 Other Examples of Problems with Performance Frameworks in Service Industries- the case of ERA

The ERA's own Performance Management Framework in its 2013-14 *Annual Report* provides a useful example of the limits to and difficulties of operationalising general objectives through a performance framework and 'efficiency' and 'effectiveness' measures.

The objective set for ERA, as an agency charged with regulating monopolies, is by their nature, stated in very general terms that are difficult to fit into a rigorous quantitative or even qualitative performance framework. The 'desired outcome' of ERA is 'the efficient, safe and equitable provision of utility services in Western Australia' (ERA 2014b: 26).
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Second the ERAs own effectiveness performance reporting framework is strictly circumscribed as, 'the Economic Regulation Authority is only required to report on the administrative performance of its Secretariat' (ERA 2014: 26). The *Annual Report* does not provide quantitative estimates as to the effectiveness of its regulation in improving the welfare of all Western Australians nor the efficiency in achieving these financial gains. The ERAs own performance framework is thus very limited in its usefulness. The reasons for absence of rigorous quantitative measures of its performance in attaining its 'desired outcome' is explained by ERA (2014: 84).

'The ERA cannot achieve this high level outcome directly, but instead seeks to play its part towards the achievement of this goal. The ERA's Strategic Plan includes the purpose statement: "to ensure consumers receive quality services for a reasonable price" It is recognised that decisions of the ERA in support of this outcome are very difficult to measure objectively, as the ERA must balance the interests of various parties. The requirement on the ERA to prepare performance indicators has, therefore, been modified by legislation to be limited to management functions. Section 23 of the Economic Regulation Authority Act 2003 states that: "any requirement under the Treasurer's Instructions (issued under section 78 of the financial Management Act 2006) that the Authority prepare performance indicators is to be limited to the Authority's management functions (including financial management), is not to apply to the performance of any other function of the Authority ERA and need only be complied with to the extent practicable." More objective administrative measures of performance are the quality, quantity and cost of the submissions considered by the ERA's Governing Body that facilitate its decision making' (ERA 2014b: 84).

Third, there are issues with the ERA's own effectiveness measures (Table 1).

Table 1: Key effectiveness indicators

Quantity	number of submissions made to the ERA Governing Body
Quality	rating by the ERA Governing Body as to the content, accuracy and presentation of these submissions
Timeliness	number and % of submissions provided to the ERA Governing Body within the required deadline

Source ERA 2014b: 26

It is doubtful if 'quantity' is an effectiveness indicator as defined by the ERA, rather it is a measure of output. 'Effectiveness is a measure of how well the outputs of a program or service achieve the stated objectives (desired outcomes) of that program or service' (ERAa 2014: 22). Quality is measured by the Board of Governors assigning a rating on a scale of 1 to 5 on submissions received from the ERA secretariat, with 4 rated as 'good'. Over the last 9 years to 2013-14 the average score is just over 4 (ERA 2014b: 27). The results are tightly clustered with an annual average deviation of just 0.1. However, it is not clear how this data is to be interpreted. How does it compare with similar agencies? Given that ERA has been operating for 14 years should there be a trend improvement in these scores reflecting growing internal competence and learning by doing? How does one adjust for changes in ratings over time caused by changes in membership of the Board of Governors? How does this single indicator provide any feedback on performance that can be used to improve specific areas of ERA activity? How does one adjust this quality measure for changes in the workload of the agency over time? How does one adjust for variations in the difficulty and complexity of issues to be canvassed in submissions over time? Do these effectiveness measures meet the ERAs own prescription in that such measures be capable of driving agency improvement?

Finally, the Authority's key 'efficiency indicator is cost (efficiency) - $ per submission made to the ERA Governing Body' (ERA 2014b: 27). The ERA (2014a: 21) uses the standard economic definition of 'productive efficiency...as the ratio of the value of outputs to the value of inputs'. It is thus highly questionable whether '$ per submission' is an appropriate measure of efficiency as it implies that the primary output or purpose of the ERA is the generation of submissions.

5. The Application of Economic Incentives to Performance Benchmarks

5.1 ERA Position on Economic Incentives in Performance Benchmarks

This section briefly sets out the ERA understanding of incentives in performance frameworks and benchmarks and their role in cost minimisation, innovation and redressing principal-agent problems. Implicit in the ERAs analysis of incentives and 'alternative service delivery options' or privatisation, is that private providers are subject to 'high powered incentives', whereby capital owners and their appointed managers gain a pecuniary benefit from increasing revenue and minimising costs. By contrast public sector workers have no claim to an increase in the value of assets they manage.

'Incentives are central to a well-designed prison system because, if they are harnessed appropriately, they will maximise the chance that prisons achieve the objectives set out in the performance framework. Incentives can encourage prisons to find more innovative ways to effectively rehabilitate prisoners and reduce costs, ultimately improving performance. Conversely, a prison system in which these incentives are absent is less likely to achieve the objectives of its performance framework. Prisons without good incentives are more likely to fail to achieve fundamental objectives, deliver poorer outcomes for prisoners and the community, and operate at an unnecessarily high cost' (ERA 2014a: 49).

ERA also notes the role of incentives in 'aligning' the interests of the principal (contractee) with those of the agent (contractor) in achieving the goals of the principal when they contract-out delivery of a good or service rather than produce the good or service themselves. 'Central to establishing an efficient prison system is the identification of the incentives that align the interests of the prison operator with those of the State. Consideration needs to be given to how best to maximise the benefits from alternative service delivery options, while identifying and mitigating any associated risks' (ERA 2014a: 49).

These risks arise from the fact that the economics literature suggest it can be in the interest of an agent to reduce quality of the good or service, withhold information from the principal regarding the true cost of production and their profitability and shift costs onto the principal. Indeed, there is a whole branch of economics, Transaction Costs Economics, which is concerned with the problems in contracting-out activities such as prisons (Appendix A). The magnitude of these problems with contracting-out prisons in the US is briefly mentioned in section 6.

5.2 Criticisms of Incentives in the ERA Performance Framework and Benchmarks

This section is directed at addressing the questions posed by ERA: 'Are there reasons for not applying incentives to publicly operated prisons? If yes, what are these reasons? Are the incentives for private sector providers appropriate? Are there any factors that limit their effectiveness? If there are factors that limit their effectiveness, please explain what these factors are and how they limit effectiveness".

5.2.1 Competition and Innovation

A key claim is that 'the introduction of private providers stimulates competition and innovation, resulting in broad improvements to, and modernisation of, the prison system' (ERA 2014a: 51). ERA makes the additional assumption that 'good performance within

certain organisations' will be transmitted to other organisations via a process of 'cross-fertilisation' (ERA 2014a: 27).

It cannot be assumed that competition creates an unambiguous incentive for private firms to innovate.[5] It has long been established in economic theory, and in practice, that under competitive market conditions investment in innovation will be lower than is socially optimal. This is due to uncertainty regarding the success or pay-off to an investment in innovation and the public good aspect of innovation. The latter relates to the fact that new productive knowledge is 'non-rival' in that, unlike conventional economic goods or services, it is not 'used up' in consumption or production so that one person can use a non-rivalrous good without reducing its availability to another. New productive knowledge is also non-excludable such that an innovator cannot prevent another person from using the innovation. The non-rivalrous and non-excludable character of innovation reduces the incentive for the private sector to invest in innovation as the investor cannot appropriate the full benefit of the innovation (Arrow 1962).[6]

Focussing on non-excludability, it is also clear that competition creates a positive dis-incentive to a firm sharing its innovation with others operating in the same market. It is exactly under conditions of strong competition that knowledge sharing is most inhibited. This disincentive to knowledge sharing extends not only to competing firms/organisations; there is also a positive disincentive for a firm to share its improvements with its funding organisation (principal). In the absence of either a financial incentive from the principal for the agent to disclose this information, or a credible threat of detection and financial loss for not disclosing this information to the principal, it is in the interest of the agent to deceive the principal or avoid disclosing to the principal the scale and source of its efficiency gains. This deception or avoidance is necessary to solve two problems. First, there is a positive incentive for the principal to 'leak' the innovation to the firm's competitors and thereby lower the principal's future cost in contracting out the service. Second, the principal may seek to use knowledge of the scale and source of efficiency gains to lower the price for the service when the prison contract is re-tendered. It is in the interest of the principal to capture the monetary value of the efficiency gains made by the private operator.[7] It hardly needs reiterating that these incentives facing the principal lower the incentive of the agent to innovate.

In theory there are many ways by which a private prison operator can deceive or avoid disclosing to a principal its true cost of production and profit rate. This is not to suggest that any firm actually uses these practices; it is simply a 'thought experiment' on the theoretical impact of incentives on behaviour. First, is the use of 'related party transactions' whereby a private prison operator sets up a separate entity to supply goods and services to its prison operation and does not inform the principal of this potential conflict of interest. For example,

[5] The construction industry comes close to the economists' ideal of perfect competition with multiple competing firms producing relatively homogeneous commodities (in sectors such as residential and earthmoving etc) with low profit margins. It also has one of the lowest rates of investment in innovation, capital equipment per worker and productivity growth (Manseau and Seaden 2001). The atomistic industrial structure means that productivity gains by producers are competed away (increasing consumer surplus) which, in turn, restricts funds for further productivity enhancing investments.

[6] These market failures form the basis of government establishing property rights to productive knowledge through patents, copyright and trade marks and support for the direct generation of productive knowledge by R&D tax incentives, technology diffusion programmes and public science programmes (like CSIRO).

[7] Aside from these market based impediments to knowledge dissemination there are also secrecy provisions in private prison contracts. ERA (2014a: 29) notes 'the service requirements of the Wandoo Reintegration Facility contract are suppressed for confidentiality reasons'.

a prison operator can set up a private Registered Training Organisation to supply education and training services to the prison. Second, in the absence of a fixed price contract for operation of a prison the returns can be elevated when the hidden related entity charges above market rates for the good or service.[8] Third, even when use of a third party entity is declared and transparent the entity can still be used to hide their true costs. A common method is for the multinational headquarters, say in London, to charge a fee to the subsidiary for management training or technology transfer to its subsidiary in Australia. These fees may bear no relation to their actual costs of production. A subsidiary in Australia can also borrow capital from its overseas headquarters at a somewhat higher interest rate than commercially available. These methods is commonly used to shift profits from a subsidiary in a high tax location to a tax haven, but they also serve to hide the subsidiary's true cost of production. Finally, regardless of whether the contract price is fixed or variable a private prison may emulate the large supermarket chains and seek payments from suppliers to capture some of the suppliers' profit. [9] These payments can be hidden by being directed to corporate entities unrelated to the prison. As noted above, Transaction Cost Economics would suggest that the propensity for a profit maximising firm to engage in deception is a function of the probability of detection and the magnitude of the penalty (if any) in relation to the potential gains arising from deceiving the principal.

It is possible to conceive of a system which seeks to overcome these problems, say if the government 'splits' the gains from innovation with the private prisons operator. Such gain-sharing could take the form of the government lowering its payments to the provider to reflect its share of the efficiency gains and the prison operator retaining its share of efficiency gains in the form of higher profits. However, this confronts the practical problems of knowing the agent's true production costs and profitability and the positive disincentive on the part of the agent to disclose the scale and source of these efficiency gains, as outlined above. There is an additional confounding issue: on what economic or legal basis can a Department of Corrective Services lay claim to innovations developed by the private prison operator? Despite being funded by the public sector the innovations are the result of investment by the private operator and the private operator has legitimate claim to ownership of these. Of course, the contract for purchase of prison service from the private sector may require transfer of intellectual property to the public sector. However, this practice raises the issue of abuse of market power and unconscionable conduct by the Department of Corrective Services as it is, in effect, a monopsonist. It is the sole purchaser of prison services in the state and as such exercises undue market power over private tenderers seeking to enter the market for provision of prison services. Finally, in either of these two cases the private provider is likely to include in the price of its current and future contracts loss of intellectual property and consequent loss of competitiveness.[10]

Disincentives to investment in innovation and knowledge sharing under conditions of market competition apply with particular force to private prison operators. Exacerbating the risk to private investment in innovation for a private prison operator is uncertainty over success in

[8] With a fixed price contract above market rates charged by a related entity to the private prison operator simply causes a shift of a fixed quantum of profit from the prison operator to the related entity without an increase in the overall profit level. But even with a fixed price contract there can still be an incentive to use a hidden related party entity as it deceives the principal as to the actual profit level the agent is achieving.

[9] https://au.news.yahoo.com/thewest/business/a/25773044/coles-apologies-for-treatment-of-suppliers/

[10] Gain sharing within firms as a means of distributing profit increases is relatively common. But the practical and theoretical problems of gain sharing (such as abuse of market power by the stronger party) across unrelated entities are considerable and therefore the practice is, to the author's knowledge, very uncommon.

re-tendering and the relatively short term of the contract as this lowers the time frame to recoup gains (if they arise) from the investment.

A publicly funded and operated prison system does not have these economic impediments to investment in innovation and information disclosure as there are multiple methods to encourage public sector innovation aside from the relatively crude instruments of monetary incentives to public sector managers and privatisation.

There are multiple solutions to stimulate innovation in publicly owned and operated prison services that are more direct and arguably more cost effective than that proposed by ERA. First, is to make support for innovation a key performance indicator for senior prison managers. Promotion, recognition and esteem of one's fellow workers can be powerful extrinsic and intrinsic incentives within the public sector. Experimentation, especially within a prison setting, can be a 'risky business' and there would need to be an acknowledgment that some elements and objectives may be impacted, when implementing innovations. This caveat applies especially to radical innovations which, by definition are more risky than incremental innovations. Second, to stimulate innovation and experimentation the government could establish an 'innovation fund' similar to that operating in technology intensive sectors such as medical research (http://www.mrcf.com.au/). As with other existing funds, public prisons would compete for funding with ideas assessed by a panel of experts (comprising prison operation, technology, finance and innovation evaluation skills) on criteria such a feasibility, scope for improvement and value for money. To ensure the prison promoting the innovation has 'some skin in the game' innovation costs could be split between the fund and the prison. Third, the government could conduct regular evidence-based studies of best practice in local and global prison services and not only disseminate the knowledge but also fund training and infrastructure, to diffuse the innovation directly to public prison operators. This dissemination programme would also include the diffusion of any improvements made by local prisons arising from the 'innovation fund'. Finally, when designing new prisons maximum regard should be given to the inclusion of flexibility in use and incorporate new technologies that foster innovation and experimentation consistent with achieving the four broad objectives that are generally accepted as constituting the rationale for prison.

Jane Andrew (2011: 197-198) makes a similar point using the example of Acacia prison, often held up by advocates of prison privatisation as a success story. Andrew makes the point that such advocates do not adequately consider the scope for public sector delivery of a similar model given appropriate funding and Ministerial encouragement. 'There have been a number of innovations at Acacia Prison. These include the use of a 'smart card' to move around the prison and access bank accounts for the purchase of goods within the prison; a kitchen that allows some prisoners to cook and clean for themselves (also a cost saving measure); the use of first names for interactions between prisoners and guards; and prisoners are given greater choice of over their diet (through a pre-ordered menu plan), exercise (with a selection of equipment and activities) and work and education (through an individually tailored work plan). There is no doubt that prisons need innovative management to overcome many of the intractable problems within the system, but it is questionable whether there is anything about these management techniques that is unique to the private sector. It is feasible that they could be achieved in the public sector with appropriate directives and support from the department'.

5.2.2 Performance based incentives

‘Most merit or performance-based pay plans share two attributes: they absorb vast amounts of management time and resources, and they make everybody unhappy’ (Pfeffer 1998).

The danger of monetary incentives is not that they are ineffective, but they are, or can be, too effective, especially their power to induce unforseen and perverse outcomes that undermine the original intention of the incentive scheme. ERAs treatment of performance based incentives is very abstract and does not confront the complexity of designing incentives that are efficient, achieve their goals and do not create perverse outcomes. The difficulties in achieving these outcomes are possibly best illuminated by way of the following real-world example.

It is generally accepted that the joint-stock company, that is a company with liability to capital owners strictly limited to the value of their respective shareholdings, dates from the 1500s and some trace it back to mid-medieval times. Despite having been in global existence for over 600 years there is still no satisfactory resolution of the problem of how to align the interests of principals (shareholder) and agents (managers). Due to perverse incentives confronting remuneration consultants, company remuneration committees and company executives one major study of companies listed on the Australian stock exchange found ‘the often-stated link between high executive pay and company performance does not exist. Indeed, the evidence is that as an executive’s pay increases, the performance of the company deteriorates. Against three criteria: return on equity, share price change and change in earnings per share, statistical analysis shows that high excessive pay levels actually coincide with a lower bottom line’ (Shields et al 2002: iii). It concluded in even stronger terms that ‘current high levels of executive remuneration reflect systematic rent-extraction rather than optimal principal-agent bargains’ (Shields et al 2002: 29).

Another review of performance pay schemes concluded that ‘Generally speaking, many incentive schemes are more appropriate to measurable repetitive tasks. They are not suitable for high technology and service activities requiring information-sharing, problem-solving and team work’ (International Labour Organisation 1998: 9). Prison operation is exactly the type of service activity that has these attributes. This is compounded by the fact that the objectives set for prison are diffuse and possibly contradictory. This review also found that globally an important means to link pay to performance in an efficient and equitable way is through collective bargaining whereby workers and management consult on ways to improve efficiency and effectiveness in return for annual wage increases.

The US legal scholar Hadar Aviram provides an excellent example of perverse incentives arising from a payment system for prisons ironically, derived from the very success of such incentives in reducing an institution’s recidivism rates. Aviram also notes the point made previously of the need to resource prisons to lift the performance of all prisons, not just successful ones, though he fails to observe that this goal contradicts the logic of payment for results.

With a performance pay linked to reducing recidivism rates ‘care must be taken to avoid a situation in which unsuccessful prisons simply close and all inmates are shuttled to successful prisons, making the latter, over time, overcrowded and unsuccessful. This incentive structure must be accompanied by a plan to heal troubled prisons, which should include resources for implementing proven vocational and educational training programs. Everyone should be offered an opportunity to succeed in recidivism reduction. Care must also be taken to foresee

efforts to “game” the new system by admitting solely inmates who have better rehabilitative chances, by requiring that facilities accept inmates in their relevant security level on a random allocation basis (Aviram 2014: 44).

6. Privatisation of Prison Services

6.1 ERA Position on Prison Privatisation

ERA suggest that privatisation is an 'option for service delivery' due to the greater scope for financial incentives driving achievement of performance frameworks within the private sector. Nevertheless, the ERA adopts a mostly agnostic view as to its merits and suitability in the Issues Paper.

The next section deals with the adverse consequences of 'high powered incentives' in private prisons in the US. It also considers the Australian experience of privatisation focussing on the validity and reliability of cost comparisons and the sources of potential cost reduction. It concludes with a reflection on how robust are the arguments that have been put forward to explain why the Australian experience of 'privatisation' is different to that in the US.

6.2 US experience with prison privatisation

For a number of reasons it is instructive to reflect on the US experience with prison privatisation. First, it vividly demonstrates the scale and scope of problems that can occur. Second, for advocates of prison privatisation it serves as a counter-point to the manner in which the policy has been implemented in Australia.

6.2.1 Drivers of prison privatisation in the US

The strong and persistent advocate for prison privatisation, Professor Malcolm Feeley, provides a remarkably frank assessment of the main drivers of prison privatisation in the US but also some of the factors behind its failure to realise expectations. 'In the United States the contemporary move to privatize adult facilities has been driven in large part by the dramatic growth in prison populations, rising costs, and problems with overcrowding. Problems are most acute in the southern states- those with the fastest growing prison populations, the worst histories of prison abuse, the smallest tax bases, and in most instances the most backward public services' (Feeley 2014: 1421).

6.2.2 Expectations not achieved

Feeley (2009: 1421-1422) also provides a remarkably frank assessment of the scale and scope of failure of prison privatisation to achieve its objectives in the US. 'They promised cheaper financing, faster and cheaper construction, cheaper provision of auxiliary services, and cheaper operating expenses. And of course, all of this was promised with better results. Private contractors made offers (often accompanied by substantial political donations to the right people) that were not refused. Privatization was seized upon by desperate politicians and harried corrections officials. They could give off some of their problems to private contractors. Hardly a recipe for responsible administration of prisons, public or private. There is no question that privatization has been fraught with problems—back room deals, corruption, incompetence, careless planning, and the like...Discussion about prison privatization in the United States is polarized. Private contractors and a handful of researchers they have engaged make claims of both efficiency (less costly) and effectiveness (lower recidivism rates, fewer suicides, less institutional violence, and the like)... critics can easily challenge such claims and are correct often enough to call privatization into serious question. Opponents can point to scandals: suicides, escapes, inmate violence, understaffing, high staff

turnover, and the like'. It is to document some of these scandals we now turn. (Including these examples is certainly not to infer that similar practices occur outside the US).

6.2.2.1Corruption of public officials and the judicial system

'Prisons are big operations, and private contractors operate in a competitive atmosphere, so it is not surprising that there are frequent stories of questionable lobbying practices, conflicts of interest, bribery, and the like. So, with good reason, privatization in the United States has come to smell of dirty politics and lax administration. This impression is reinforced by the fact that the states that rely most heavily on privatization are in the South, a region with a long history of plantation model prisons, chain gangs, prisoner lease systems, and forced work, as well as weak traditions in public administration and social welfare' (Feeley 2014: 1424).

'In 2008, many conscientious Americans were shocked to discover that two Philadelphia judges- Mark Ciavarella, the former President Judge of the Luzerne County Court...and Michael Conahan, a Senior Judge in the same county- were indicted and convicting for accepting money from a private juvenile facility provider, Robert Mericle, in return for sentencing thousands of juvenile defendants harshly so they would be sent to the detention centers. Mericle, a real-estate developer, was a staunch supporter of Ciavarella's election campaign' (Aviram 2014: 31).

6.2.2.2 Declining health standards in prisons

Aviram (2014) places prison privatisation within the wider context of the rise of neoliberal social and economic polices so that the 'retreat from welfare responsibility on the outside is clear on the inside as well. This has included a transformation in the perception of the inmate, from ward of the state to a consumer of services. As an outcome, public and private prisons have narrowed their healthcare offerings to "bare life" sustenance. One effect of the privatization of prison health care has been muddled accountability for medical negligence...many practitioners working for private companies reportedly have had their licenses revoked in other states...Private health care providers fiercely fight journalists who expose instances of medical neglect in prisons...journalistic investigations into Prison Health Services, a private prison provider, exposes the problematic nature of private health care in local jails... horrifying examples of neglectful healthcare, which show that the hope of efficient care is shattered by scant and unqualified medical staff and unpunished employee misconduct, prompting scathing reports by the New York State Commission of Correction' (Aviram 2014: 30-31).

6.2.2.3 Declining security standards

'Privately operated prisons appear to have systemic problems in maintaining secure facilities. The data on inmate escapes and random urinalysis are important indicators that signal a host of issues... an escape usually signals failures in multiple levels of security procedures such as a failure by the perimeter patrol, a failure to discover escape contraband, a failure to gather intelligence, and a failure to monitor and secure potential escape routes. Contraband drugs also probably signal the occurrence of many failures, including an inability to monitor the visiting room, inmates on gate passes, and inmate mail, or the inability to gather intelligence information. The failures that produce escapes or illegal drug use can result from problems in policy and procedures, in technology, and in staff capabilities. We have focused on staff

capabilities, and we suggest that the "greener" the workforce, the more likely there will be lapses in fundamental security procedures. The "greenness" of the workforce may pertain not only to line staff, but to midlevel supervisory staff as well (Camp and Gaes 2002: 444-445). In turn this "greenness" was attributed to 'a high separation rate. Separation rates at private prisons were typically much higher than were those of the BOP (Bureau of Prisons) and state public-sector prisons well' (Camp and Gaes 2002: 445).

6.2.2.4 Prisoner abuse

'A less visible private function is that of transportation companies, which are a private business that serves public and private prisons...These transportation services have yielded several serious problems, including dangerous driving, improper security leading to escapes, and even inmates being burned alive in a defective bus. Also notable are more than a few instances of sexual and physical assault of inmates in the hands of private transportation employees' (Aviram 2014: 30-31).

6.2.2.5 Prisoner work in private prisons

There is a history of publicly operated prisons having prisoners engage in work from which the prison or the state can directly profit, for example, car licence plates produced in prison and sold to persons registering their car. As long as this work is balanced against other objectives of the prison and conforms to ILO conventions on forced labour and OH&S requirements, such work is unproblematic and probably beneficial for the prisoner. Profits flowing to the state can benefit the wider community in terms of lower taxes or higher services and can be thought of as part of the reparation by the prisoner for offending.

But this unproblematic situation does not hold when a private prison operator makes private profits from the labour of its inmates. Professor Richard Harding (1999: 117) noted many years ago that 'privatisation seems to have thrown into sharp relief the whole question of what we expect from prisoner work. A whole raft of questions that were left fuzzy when the public sector managed all prison operations now require answers: type of work, wage rates, rostering arrangements, contract structures, informal or formal rewards for participation, and so on. These are important issues, and it may be a good thing that they are now pressing against us in a way that demands discussion and resolution'.

One recent report on prison labour in private prisons in the US found that 'sweatshop labor is back with a vengeance. It can be found across broad stretches of the American economy and around the world. Penitentiaries have become a niche market for such work. The privatization of prisons in recent years has meant the creation of a small army of workers too coerced and right-less to complain. Prisoners, whose ranks increasingly consist of those for whom the legitimate economy has found no use, now make up a virtual brigade within the reserve army of the unemployed whose ranks have ballooned along with the U.S. incarceration rate... two prison privatizers, sell inmate labor at subminimum wages to Fortune 500 corporations like Chevron, Bank of America, AT&T, and IBM. These companies can, in most states, lease factories in prisons or prisoners to work on the outside. All told, nearly a million prisoners are now making office furniture, working in call centers, fabricating body armor, taking hotel reservations, working in slaughterhouses, or manufacturing textiles, shoes, and clothing, while getting paid somewhere between 93 cents and $4.73 per day. Rarely can you find workers so pliable, easy to control, stripped of political rights, and subject to martial discipline at the first sign of recalcitrance, unless, that is, you traveled back

to the nineteenth century when convict labor was commonplace nationwide' (Fraser and Freeman 2014).

6.3 What are the cost savings in privatisation of Australian prisons and how are they achieved?

Advocates of prison privatisation point to lower costs as a factor in their favour. "In 2003, the average total cost in the public sector was around $255 per prisoner per day (or around $95,000 per year). That figure now exceeds $100,000 per year. Our best estimate, therefore, is that Acacia's total costs - for both Serco and the Department - are probably no more than 55 percent of the public sector average" (Office of the Inspector of Custodial Services, 2008a: 1.37 cited in English et al 2010).

Jane Andrew (2011) and English et al (2010) examined these matters using reports by the OICS into the Acacia Prison. In summary, they found that quantifying the effect of prison privatisation on costs is exceedingly difficult. First, allocating head office and monitoring costs across individual prison relies on arbitrary judgements. Second, the studies did not control for the multitude of intervening variables within and across individual prisons that influence cost differences. It is a complex and expensive task to identify the sources of these cost differences, their value for each prison and to update and regularly monitor these differences. Finally, even accepting the proposition that privatisation is a source of both cost reduction *and* quality improvement, the cause of this change cannot be attributed to privatisation *per se*.

6.3.1. Allocating head office and monitoring costs

English et al (2010) cite the Third Report of the Office of the Inspector of Custodial Services (OICS) into Acacia Prison as to problems in accurately measuring and comparing the costs of individual prisons. "It is surprisingly difficult to make precise calculations about the true costs of imprisonment. The easiest part of the equation is the private provider's costs, because these can be determined by reference to the fees that were paid under the contract. However, this is not the total cost. The Department of Corrective Services also incurs costs at Acacia, primarily through its monitoring and contract management services" (OICS, 2008a: 1.32).

"When calculating the costs of public sector prisons, it is possible to get a rough overall costing by reference to the Department's annual funding requests that are made to the Public Expenditure Committee of the State Parliament. However, it is very difficult to calculate the precise costs of any particular prison and to untangle the extent to which costs are incurred 'onsite' or by way of general services (such as corporate services and prisoner programs) that emanate from 'head office'" (OICS, 2008a: 1.33).

6.3.2 Controlling for intervening variables

There are many intervening variables that influence cost differences across prisons that need to be controlled for if such comparisons are to be at all meaningful. A short list of some include:

- how are capital assets measured, at historical cost or current replacement cost? If current replacement cost does it take into account capital gains in the value of the prison land; an important consideration for metropolitan facilities. Or is the

replacement cost assessed on replacing just the physical facility but on a site with cheaper land cost? It may not be possible to literally replace an older facility as it may no longer conform to current building codes or correctional standards. How does this influence capital values? Do public and private prisons use the same accounting standards; say for depreciation rates which can greatly affect the value of assets and cost of capital?

- differences in physical layout. 'In making comparisons between Acacia and the public sector, it is important to recognise that Acacia does enjoy some advantages. These include economies of scale due to its size, its modern buildings and security arrangements, and its location. By comparison, some of the public sector's most expensive prisons are the smaller and older regional prisons. As previously noted, there is also room for debate about the most accurate way to calculate total costs' (OICS, 2008a: 1.38 cited English 2010). Andrews (2011: 201) makes a related point, that newer buildings can incorporate efficiencies through new technology, 'there are other areas of controversy that distort the cost comparisons outlined in the [OICS] report. Acacia is a new prison, designed to facilitate a different style of prison management that relied more heavily on surveillance technology, thereby doing away with the need for the same level of staffing'.
- newer prisons have lower maintenance costs. Typically construction contracts have allowance of 7 years for the builder to rectify faults in construction and materials. Older prisons have to meet costs that emerge as a result of defective building practices and materials aside from the obvious higher maintenance cost in older structures.
- the security rating of prisons affects costs, as typically maximum security structures and staffing are more expensive than medium or low security
- newer prisons, which do tend to be private facilities, may also benefit from lower labour costs as newly recruited staff, by definition, do not have extensive experience and tenure which typically translates into higher average pay. Compounding this, it has been found in the US that 'correctional officers in their first year of employment are far more likely to resign or be dismissed than are more experienced officers. Given the fact that newly activating prisons almost always have a higher percentage of new staff than do more established prisons, it follows that newly activating prisons have higher separation rates, all other things being equal' (Camp and Gas 2002: 437). The same factor may apply in Australian prisons
- private operators of 'greenfield', non-unionised sites can use their monopsony power to bargain down labour costs. Andrews (2011: 201) reports that 'Acacia's staff were initially recruited on workplace agreements, and it appears that remuneration levels were well below those in the public sector' (OICS 2003:63). In the presence of labour market distortions like monopsony, lower wages and increased worker effort, say through longer shifts, represent an income transfer from workers to the private prison operator and to some extent the government. These cost reductions do not represent the exploitation of new technology or some other 'free good' and should not be confounded with the notion that they necessarily reflect efficiency gains; rather they reflect differences in bargaining power. As Professor John Quiggin (1994, 2002) has argued, under such conditions there is no necessary overall increase in net social welfare
- allied to this last point studies in the US have suggested that private prison seek to reduce labour costs by reducing the skill content of prison employees using approaches to the design of job content associated with Frederic Winslow Taylor's 'Scientific Management'. This involves decomposing complex tasks into simpler tasks that require less experience, training and responsibility and, therefore, can use

less skilled and cheaper labour. Gaes et al (2004: xiii) call this "the McDonaldization argument for efficiency. If the private sector is to cut costs it will probably come from reduction in expenditure for prison labor....advocates of prison privatization have implied that the routine of prison guards can be broken down and simplified so that prison labor becomes fungible- the economic term for easily replaceable'. These management strategies potentially reduce job satisfaction and skill acquisition. In turn, lower skill acquisition may affect future earnings of employees within and outside the prison system and needs to be factored into any cost accounting

- as noted above in public and private institutions prison labour can be used to offset the costs of imprisonment for example, by engaging inmates in prison maintenance work and sale of goods and services. In private prisons there may be greater use of prison inmates for this purpose and/or greater incentive to search out higher priced alternative uses for prison labour. When prison labour is used by entities related to the prison operator the task of identifying the true returns to the corporate entity as a whole is made even more difficult
- private prisons may lower costs by lowering the quality below that specified in their contract. The incomplete nature of contracts may create the space for opportunism through quality reduction, which is either difficult to detect without the principal incurring large monitoring costs or lies in a 'grey area' that may take expensive litigation for the principal to seek a court ruling to clarify. (See the appendix for discussion of these terms). Andrews (2011: 200) notes that in one prison staffing 'levels fell consistently below that of the public sector and also the level expected within the contract'. '(T)he expectation was that...total staffing establishment would be in the region of 250 FTEs. That level of staffing would enable about 100 persons to be on the ground during the day shift on a normal weekday. Yet current staffing levels on the ground appear to fall far below this level. As noted earlier, our count on one weekday during the Inspection indicated that only around 61 operational staff were on-site, compared with Hakea's 140 staff for around 550 prisoners on the same day' (OICS 2003:61). This issue could have been rectified in the intervening period via contract re-negotiations or increased monitoring. On this issue Andrews (2011: 202) quotes the OICS report that '(t)he new contract must – whoever is the successful bidder – be more prescriptive about the extent and range of human inputs, and if this drives the costs up to a point nearer to public sector costs, so be it' (OICS, 2006:iv)
- where private prisons have some control over selection of prisoners there is a clear incentive to reduce entry of high cost prisoners. Moyle (1999) provides the example of a private gaol apparently gaming the system by using its delegated powers of punishment to 'breach' a inmate for violation of prison rules, whom the prison regarded as being potentially a higher cost prisoner. This rendered him ineligible for re-admission to the private prison as the breach meant he no longer met the conditions for entry. Moyle suggests this was a case where punishment served an economic purpose, to reduce supervision costs for the private prison by transferring the prisoner to the state system.

6.3.3 The problem of attribution

In Australia, even for advocates of prison privatisation private ownership is not a necessary and sufficient condition for improving performance and efficiency. Two other factors are critical. These are the tight specification of what prisons do and how they are expected to do it and the role of an external, independent authority creating and monitoring these performance standards.

English et al (2010: 9-10) provide the following description of role of the Office of the Inspector of Custodial Services and the creation of performance standards. 'Established on 1 June 2000, pursuant to Section 35(a) of the Public Sector Management Act 1994(WA), the OICS is the only Australian inspectorate to possess statutory autonomy. It has direct access to parliament, makes its reports publicly available, and, like auditors-general, has unfettered authority to conduct inspections. The WA model is designed to ensure that the Inspector's activities remain independent of government interference and that the conduct of custodial operations in all WA prisons is transparent and fully accountable (OICS, 2000).The mission of the OICS is:

''To provide the people of Western Australia with an independent and effective prison inspection and review service which is fair and just and evaluates the extent to which objectives of imprisonment are being achieved'' (OICS, 2001: 20).

The OCIS has responsibility for the accountability of prison management in both public and privately managed prisons in WA. The jurisdiction of the OICS includes prisons, as well as court security and custodial services (including prisoner transport services). The purpose is to provide independent external scrutiny of the standards and operational practices of all WA prisons (OICS, 2001). OICS strives to provide a mechanism for "promoting consistent qualitative evaluations against broad and transparent principles and benchmarks to ensure that prisons understand the main parameters of our inspections" (OICS 2008a: 8). The OICS evaluation methodology is based on legislative requirements, the DCS cornerstones, the United Nations (UN) Charter of Human Rights and international custodial best practices.

The OICS has published two codes of inspection standards. The first outlines the thrust of the OICS approach and mandates inspection standards for adult custodial services (OICS 2007). The second provides insights into unique circumstances relating to indigenous prisoners (OICS, 2008b) and elucidates the relationship between the 2007 and 2008 codes. The primary role of the OICS is to promote continuous improvement of custodial services. According to the Preface, the primary purpose of the Code is to inform those responsible for the custodial management of prisoners about the standards, and to prompt timely response to potential breaches of standards. According to OICS, the achievement of these objectives rests on four core principles: an independent OICS and independent inspection services; rehabilitative imprisonment that helps prisoners to lead a law-abiding and self-supporting life on release; the protection of prisoners' human rights; and the prevention of abuse' (English et al 2010: 9-10).

According to Professor Richard Harding (2000: 240) the OICS provides 'an extremely strong regulatory and accountability structure'. Similarly, Professor Malcolm Feeley (2014: 1422) praises the OICS as a model of 'independent state inspectors of prisons whose integrity is unimpeachable, whose reports are thorough, and whose recommendations command attention'. Again, 'private prisons are held to high standards and are closely monitored...In their tenders, corrections officials have developed increasingly long lists of expectations so that in many instances the hoped-for cost-savings of privatization have evaporated even before contracts were let' (Feeley 2014: 1424-1425).

Two key points emerge from this analysis. First, given the critical role attributed to standard setting and independent external monitoring of these standards in raising the performance of all prisons it is impossible to isolate the effect of privatisation as an independent factor in this change. From a logical point of view, standard setting and external, independent monitoring

do not entail, nor do they require, a transfer of ownership from public to private sector. The case for a strong independent effect of privatisation *per s*e in influencing prison performance has yet to be demonstrated.

Second, it is arguable that the conditions giving rise to these improved outcomes, that is, standard setting and independent external monitoring are fragile. Professor Feeley (2014: 1422-1425) identifies a range of underlying factors giving rise to these conditions such as state governments prepared to adequately resource prisons to set and effect higher standards; governments prepared expose itself to the risk of independent scrutiny in the administration of prisons; the absence of an excessive rise in prison population that can overwhelm the system and undermine standards and finally, a highly professional state public bureaucracy that can design and implement the requisite changes. The risks to these underlying conditions include an extended period of severe state budget constraint which can undermine adequate resourcing of standards and their enforcement; a 'tough on crime' policy that results in a large and sustained rise in the rate of imprisonment and prison population; continued cuts in the state prison bureaucracy resulting in a loss of core capacity and/or politicisation of the state bureaucracy that is more compliant with a government intent on reducing prison standards.

Appendix A. *Determinants of risk in contracting-out*

This section briefly sets out key principles of TCE analysis, drawn from the work of Nobel Prize winner in Economics, Oliver Williamson, focussing on the determinants of risk in market transactions.

Williamson analyses risks arising in market transactions by relaxing a number of the key assumptions required for perfect competition. The foremost of these is recognition of 'bounded rationality' on the part of consumers and producers, characterised by limited information and processing capacity and systematic biases in agents' assessments of risk and reward. Compounding this risk is that typically a contractor (agent) knows more than a contractee (principal) about the characteristics of a good or service she or he is offering and about the conditions under which it is produced. This leads to 'information asymmetry' between the principal and agent, which can result in inefficient contracting even if all parties act in good faith. 'Opportunism' also occurs in market transactions as some principals or agents cheat by failing to honour contracts, shirk effort or otherwise do their best to ensure they get the best out of any bargain. TCE argues that a key, if not sole, factor determining the extent to which an agent actually engages in opportunism is economic incentives confronting the agent. Ethical considerations may also be a factor.

For both principals and agents, the extent of risk attached to contracting under conditions of bounded rationality, information asymmetry and opportunism depends on a range of factors governing the nature of the commodity to be contracted-out and the conditions under which it is produced and consumed. The factors include first, the importance of the contracted activity to the performance of a principal's organisation. The more important an activity to the survival, profitability or quality of an organisation's output, the higher the risk in contracting an activity out. It is not just direct costs and rewards that enter into agents' decision-making regarding 'important' market transactions; TCE argues that externalities also need to enter into a principal's calculation. The risk of acquiring an 'important' good or service in the external market is increased when such transactions are undertaken only once or very infrequently. This limits the principal's scope for learning from market transactions and for improving outcomes from such exchanges.

Second, some goods or services are complex in that it is difficult and/or impossible to specify precisely in a contract the balance or weights to achieve conflicting or vaguely stated objectives and/or the performance characteristics or attributes of inputs required for their production. Contracts subject to such ambiguity are described as 'incomplete'. The scope for opportunism on the part of agents is increased when contracts are incomplete.

Finally, differing risks to principals and agents emerge when the production of a good or service is marked by either high or low barriers to entry. Low barriers to entry occur when a producer, to successfully operate in a market, requires minimal investment in human and physical capital and has low sunk costs. For an agent, low barriers to entry minimise the risk of adverse action by a principal if the agent is detected acting opportunistically and the principal seeks to either penalise the agent or cancel the contract. Conversely, high barriers to entry impose risks for the agent and typically require the principal to offer the agent a long-term contract to offset the agent's investment risk. However, this poses a risk to the principal in effectively locking-in a principal to a long-term supply contract and negates the potential benefit in subjecting supply of the out-sourced commodity to regular competition.

TCE reveals that attempting to shift risk between contracting parties arising from these multiple sources itself generates costs and risks. A principal can seek to insulate itself from such risks by the use of short-term contracts. This allows the principal to avoid long-term exposure to opportunistic agents and litigation and other transaction costs in terminating a contract. But short-term contracts will likely raise the hurdle rate of return sought by the agent investing in high-cost assets, especially in the case of assets designed to meet specialised needs of a principal. Risks to both principal and agent in this situation of 'bilateral dependence' can be addressed by the use of longer term supply contracts, but these may reduce competitive pressure and the incentive for an agent to lower costs and innovate. In a long term supply contract agents may also retain rents arising from efficiency gains that lower production costs. In subjecting an activity that was produced in-house to a long term supply contract, a principal also risks losing knowledge about the commodity and associated production processes. This may disadvantage the principal in future contract negotiations. (adapted from Toner 2014).

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