

## State Governments and Privatization: Improving Infrastructure Through Incentives

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**ABSTRACT:** As the “middle” actor in the United States’ federal system, state governments are tasked with a unique mix of roles where state-level institutions serve as both an active provider of services and grantee recipient from the federal government, as well as an overseer and grantor for functions provided by lower-level governments. This chapter argues that state government functions—both as an active provider of services and as an overseer of local government functions—have improved through the utilization of private sector resources and persistent problems in many of those functions could be improved through a greater commitment to utilizing competition and the private sector for the delivery of public infrastructure and services. It also argues that typical objections to increased competition and privatization of government infrastructure services represent moral objections found lacking when approached from a Public Choice framework.

## **INTRODUCTION: State Governments, Stuck in the Middle of Two**

While both federal and local (county, municipal) governments include functions that can be identified as providing services and overseeing the delivery of services by subordinate entities, state governments, existing between federal and local governments in U.S.' governmental hierarchy, occupy a space that sees it at the heart of many of the decisions involving critical infrastructure in the country, whether as the responsible provider for the infrastructure and related services themselves, or as a regulator over infrastructure and services provided by local governments.

For every category of major infrastructure individuals would identify as "public," from criminal and civil justice to corrections facilities, to energy generation and transmission, to health care services, highways, solid waste pickup, and water and sewer systems, state governments provide critical functions as providers and overseer of local government providers.

The flow of grant funding from the federal government makes its way into both types of functions. For highways and corrections (FORMAL SOURCES), state agencies serve as a recipient and decide how best to disburse those funds to projects and functions state governments manage themselves. State governments also receive grant funds from the federal government for water and sewer systems and for solid waste services and facilities but must make decisions on how such funds get disbursed to the lower-level entities managing those functions themselves.

In addition to serving as a grant "middleman" between federal and local governments, state governments also serve as a direct grantor to lower-level governments and institutions from its revenue sources.

Grants between governments often come regulatory with hurdles designed to ensure funding gets devoted to intended uses but can also create significant uses of valuable resources in order to ensure compliance. Both receiving and disbursing grant monies come with inherent risks: Dedicating resources to receive grants come with opportunity costs, and state governments may disburse grants to lower governments based on flawed, or overburdensome considerations that lead to suboptimal outcomes.

Just as state governments encounter numerous risks in the pursuit and the disbursement of grants, they also encounter numerous risks concerning the management and oversight of infrastructure and services. For both types of cases, private entities have filled critical roles to improve managing infrastructure and services, and in a more forward-looking manner that seeks to avoid repetition of practices that have led to the issues government infrastructure faces.

This chapter attempts to show how the increased opening of the private sector to pursue opportunities in managing public services and infrastructure linked to state governments' functions have improved outcomes relative to a regime where private sector competition is prohibited (through regulatory or other means). While many categories of public infrastructure in the U.S. are far from performing optimally, a "path dependency" of poor (often unintended) government risk management practices can be seen as responsible for deferred maintenance and other issues of neglect that critical infrastructure in the U.S. faces. Highways and municipal water systems provide examples of how government contracting with private entities, through outsourcing, but especially through more comprehensive public-private partnerships, have improved both infrastructure and service delivery in a way that

ensures better performance through greater emphasis on infrastructure's whole lifecycle, rather than more reactive approaches governments commonly face, such as a "fix it when it breaks," or "worst first" approach that struggles to provide consistent quality of infrastructure or services.

The chapter also looks at corrections, where "improvement" has been more marginal, but also dictated by criminal justice concerns that concentrate power in public actors that face minimal to no residual claimancy of their decisions with respect to criminalization and punishment. Even there, a similar story develops as with highways and water: public sector path dependence leading to poor outcomes, and private actors providing potential solutions. The chapter closes by examining common objections to outsourcing, privatization, and public-private-partnerships, which suffer from applying a morality framework that fails to grasp the reality of providing public infrastructure in services, while often accusing private providers from the same type of shortsightedness that has led state agencies to seek private actors in the first place.

### **Governments and the Grants Economy: Give-and-Take Through Love, Fear, and Ignorance**

Kenneth Boulding's work in grants economics stems from a common observable fact: A significant portion of goods and services in a nation's economic output will come not from two-way exchanges where both parties seek to improve their condition, but from one-way transfers, or "grants" where, in the purest of terms, a grantor gives something of value to a grantee, with no expectation of any reciprocating grants, in whole, or part ("benevolence"). Rather than giving such distributions separate treatment, grants should be incorporated into exchange economics. Even further, grants and exchanges are often hard to separate:

An exchange, if it is not in some sense an exchange of "equal values," contains a grant element. Just what constitutes equal values, however, is often hard to say, and is the source of much controversy. If I buy potatoes from the farmer above the market price because I am fond of him, there is clearly a grant element in this transaction.<sup>1</sup>

The reverse also holds true: Transactions deemed "grants" very well may (and often do) contain an exchange element. Many transactions in the twenty-first century operate in a similar manner. Individuals often pay more for products deemed to be produced by firms and organizations that adopt beliefs and ethics that the buyer enjoys. Conversely, individuals look to avoid patronizing goods and services from producers who fall short of the buyer's concerns outside of the price and quantity demanded. Through the lens of the grants economy, if two options for a good or service have the same utility for the buyer, but the option from a producer A meets the buyer's ethical concerns, and rival producer B's option does not meet them, then the premium may constitute a grant.<sup>2</sup>

A seemingly paradoxical revelation of the grants economy are the diversity of sources from which drive the movement of grants, which Boulding boiled down to three categories: "love, fear, and ignorance."

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<sup>1</sup> Boulding, et. al.

<sup>2</sup> The consideration of negative externalities obviously can work against the extent to which the price premium constitutes a "grant" (hence the use of "may"), but the treatment here only serves to further illustrate how individuals and organizations structure their purchases of goods and services with considerations well beyond their relative prices to competitors.

Though U.S. intergovernmental grants may seem a topic mostly devoid of much emotion or passion, the three categories can be found present in intergovernmental grants. If “rule of law” can be defined at the heart of all transfers between governments, then dedication to preserving the “rule of law” in guiding transfers can be seen as a component of “love,” the guiding principle that ensures exchanges are acceptable, and predictable. But just as parents’ feelings toward their children’s behavior can swing widely between affection and fury, and their attitudes toward giving their children autonomy and freedom can vary from fear to blind acceptance (sometimes out of ignorance), grants from higher-level governments to lower-level governments can be made out of a genuine concern to provide needed funding, withheld as punishment for bad behavior (a “negative bad,” in Boulding’s verbiage), provided under restrictive terms that reveal a lack of trust in the grantee, or under few restrictions, reflecting trust (or possibly, ignorance).

Being divorced from the exchange economy means grants will not be driven by the robust feedback loops that drive economic activity. If a grantor finds a recipient, despite following guidelines provided by originator, fails to address problems that the grantor nonetheless sees problematic, a funding relationship based largely on trust can devolve into one more based on fear, where the grantor looks to punish poor outcomes through “negative bads,” or otherwise placing additional resources on much tighter restraints that make grants more behave like conditional exchanges, or even micromanagement conditions of grantee imposed by grantor. Another issue arises with repeat “offenses” by grantees: If the federal or a state EPA keeps fining a municipality for repeated violations, the offending agency must find ways to (a) pay the fines and (b) solve the problem, as opposed to just solving the problem. Coming to such a realization requires empathy, which can be seen as a focus shift from fear to love: “I recognize the problems you have, but I also recognize that my repeated punishments hurt your ability to solve your problems, so let’s get together and find a solution that works to solve both problems.”

While the motivations for inter-governmental grant transmissions can be seen as less intense than the three broad categories of grant economics motivations exemplify in their purest form, a brief dive into state government functions, as both grantor and grantee, can reveal some of issues that prevent better outcomes for such functions. Contracting out (to the private sector mostly, but also other governments in some cases) provide ways to overcome the lack of a role price signals play in the grants economy, structuring funding to performance that often cannot be achieved by “going it alone.”

### **From Deferred Maintenance to Lifecycle Management: Highways and Water**

Highways and municipal water are two areas of critical infrastructure where state governments have significant influence, although in much different ways. While the federal government provided much of the initial funding for the Interstate Highway system and other U.S. (badge) highways, the day-to-day operation of such highways (as well as state highways) are handled by state governments, as well as the disbursement of funds from state and federal fuel taxes. In contrast, water, wastewater and stormwater, systems are operated at a local or regional level almost exclusively, and are overseen by the state government as a regulator, while also holding responsibility for disbursing the Drinking Water State Revolving Fund to local governments, a funding program provided by the federal government.

Both highways and water systems face similar problems going forward, a situation that may be explained by the path dependence of governmental management, and oversight of those respective

systems, which, until more recently, had little incentive to consider infrastructure management in terms of its full lifecycle. Hard budget constraints further the incentive to focus on the short-term, day-to-day operation of infrastructure at the expense of keeping infrastructure assets a constant state of good repair. Contemporary discussions of the state of highways and water systems in the U.S. often include the term “deferred maintenance,” which describes a situation where a lack of care and/or routine maintenance of infrastructure assets results in asset degradation that a more dedicated approach to lifecycle management could have avoided. Both U.S. roads and water systems are rife with infrastructure problems resulting from deferred maintenance issues, but over time, agencies have come better to understand such problems, and are trying to adjust accordingly.

Private firms are often positioned to play a helpful role in not only facilitating that transfer of focus to a more forward-looking approach, but to help ensure that the focus gets maintained through the useful life of the infrastructure itself. Contracting practices over time show an increased willingness from agencies to rely on private firms not just for building infrastructure—which has been the case for decades in design-build (DB) contracts—but for outsourcing the risks that come with day-to-day operations and maintenance (OM, or O&M), as well as some or all of a project’s financing. With that willingness to transfer additional risks to the private sector has come increased attention and guidance for avoiding further deferred maintenance issues that many state agencies face, whether from managing infrastructure directly (as is the case with highways), or through the oversight of management by lower-level governments (as is the case with water-related systems).

While building and operating elements more historically have been treated separately for projects—the former usually contracted out to the private sector and the latter usually handled “inhouse” (by the government agency itself)—the combination of infrastructure delivery and operating elements have increasingly found their way into more complex contracting agreements better equipped to handle lifecycle cost considerations, and other risks that traditional public sector arrangements have had difficulty maintaining. Public-private partnerships (PPPs) can be defined as projects that include both infrastructure delivery (DB) and O&M considerations, and include risk transfers between agencies and private entities for those functions, usually over a long time period that somewhat resembles the underlying infrastructure’s useful life, or a considerable portion of it.

## Highways

The primary source for highway funding, fuel taxes, serves as a proxy for the use of road surfaces themselves: Since fuel is needed to propel a vehicle, the amount of fuel purchased, at least to some extent, provides a decent substitute for distance traveled. Over time, however, improved fuel economy and the introduction of alternative fuel vehicles (and a limited ability to raise rates and broaden applicability of charges to alternative fuel vehicles) have severely “deflated” the effectiveness of fuel taxes. From 1980-2016, the average fuel economy of a passenger vehicle in the U.S. has risen by about 50%, from 6.3 km per liter, to 9.4 km per liter.<sup>3</sup>

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<sup>3</sup> Bureau of Transportation Statistics, United States Department of Transportation. “Table 4-23M: Average Fuel Efficiency of U.S. Passenger Cars and Light Trucks.” *BTS.gov*. <https://www.bts.gov/content/average-fuel-efficiency-us-passenger-cars-and-light-trucks>

The diversion of fuel taxes to non-road maintenance and projects presents another problem confronting fuel taxes' ability to pay for roads: Eight states divert at least 20% of fuel taxes to non-road uses, while five states (NY, RI, NJ, MI, MD) divert over 30% of fuel tax revenues.<sup>4</sup> Arguments can be made (especially in densely-populated locales like New York City) that the transit that gets funded by some of those diverted revenues reduces reliance on roads, but unlike roads (tolling excepted) transit operates with direct user fees for use, while fuel taxes only provide a rough proxy, and one of diminishing effectiveness. But not all diversions go to transit: Alaska places its fuel tax revenues in its General Fund, which all but ensures that the revenues will be used for whatever lawmakers want. While Kentucky has a lower diversion rate than many states (10.9%), the top recipients for diverted funds are the state police and Secretary of States' operating budgets (93% of total diversions, combined).<sup>5</sup>

The increasing ineffectiveness of fuel taxes can be seen on many of the highways throughout the U.S. Assessments of American roads and bridges from professional organizations typically receive poor grades. The American Road & Transportation Builders Association (ARTBA) identifies roughly 20% of all highway miles in the U.S. are structurally deficient.<sup>6</sup> The American Society of Civil Engineers' (ASCE's) "Infrastructure Report Card" for roads from 2017 identifies a combined highway backlog total of \$836 billion, stating, "(t)he U.S. has been underfunding its highway system for years.<sup>7</sup> Highways and roads are often closed for repairs or are damaged to the point of needing to be closed. Alternatives to fuel taxes for funding roads and highways are developing, but making such a switch without providing a lifecycle management focus to roads and highways means the current problems now are likely to be revisited in the future.<sup>8</sup>

The U.S. Department of Transportation has provided guidance for agencies to incorporate lifecycle management considerations into highway construction, maintenance, and repair for over 20 years, and states have been shifting to a longer-term focus.<sup>9</sup> But state DOT resources are limited, and can only be stretched so far, leaving agencies to make tough decisions on which projects get those resources, resulting in the backlogs.

Private sector firms have long been used by state DOTs to undertake projects. The initial construction for the Eisenhower Interstate Highway system itself was provided through DB contracts between state agencies and private companies, financed through federal funding disbursed to states.<sup>10</sup> Maintenance and resurfacing projects are often handled through contracts with the private sector, too. But while contracting for construction and/or maintenance alone, and in separate arrangements may save some

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<sup>4</sup> Feigenbaum, Baruch and Joe Hillman. "Revealing State Gas Tax Diversions." *Reason Foundation*. June 2020. <https://reason.org/wp-content/uploads/revealing-state-gas-tax-diversions.pdf> (7/14/20)

<sup>5</sup> Ibid. 15.

<sup>6</sup> American Road & Transportation Builders Association. "Frequently Asked Questions." <https://www.artba.org/about/faq/> (7/14/2020)

<sup>7</sup> American Society of Civil Engineers. "2017 Infrastructure Scorecard: Roads." <https://www.infrastructurereportcard.org/cat-item/roads/>

<sup>8</sup> "OReGO: Oregon's Road Usage Charge Program." *Oregon Department of Transportation*. <https://www.oregon.gov/ODOT/Programs/Pages/OReGO.aspx> (7/14/2020).

<sup>9</sup> U.S Department of Transportation. "Life-Cycle Cost Analysis Primer." August 2002.

<sup>10</sup> Weingroff, Richard F. "The Greatest Decade 1956-1966." *U.S. Department of Transportation*. <https://www.fhwa.dot.gov/infrastructure/50interstate.cfm>

resources, as with private production, scale can bring even greater benefits, from a cost and risk-management standpoint.

As mentioned the previous section, PPPs allow multiple infrastructure project components (designing, building, financing, operating, and maintaining) to be worked into a single project with a private entity (a consortium of companies, also called a special purpose vehicle) made of firms dedicated to fulfilling those project components.

The expanded scope of P3 contracts (in duration, as well as in services provided) allows for a more focused approach to lifecycle-cost management than more traditional DB and service contracting. Entering a DB contract gives the private partner a strong incentive to stay within the asking agency's project guidelines at as low of a cost as possible, as does contracting for individual services. A private company entering a contract with a DOT usually has little incentive to look beyond the time period of the contract. For service contracting, the desire to get contracts renewed does provide some incentive for added forward-thinking, but the term and scope of such projects give private firms little incentive to care about the underlying infrastructure's lifecycle.

But when the private partner is called to do more than just build or maintain infrastructure, incentives change dramatically. Since the consortium will be constructing and operating (and possibly, financing) the infrastructure, it has to think about cost minimization over the PPP contract's term, usually 30 years or more.

For highways, a decades-long PPP is likely to include one or more rehabilitative projects for the infrastructure. Spending too little on initial construction may mean more rehabilitative costs over time. Not completing enough routine maintenance and resurfacing can also lead to higher costs down the road, as well as more frequent closings of lanes for repairs. The time value of money also plays an important role in such commitments. The Federal Highway Administration's National Highway Construction Costs Index (NHCCI), which tracks inflation in road construction costs, nearly doubled from Q12003 to Q42019, from a baseline of 1 to 1.92.<sup>11</sup>

## **Water Systems**

While water and wastewater (sewer) systems are under the purview of local governments, state governments play several key oversight roles: They share regulatory enforcement with federal agencies, as well as disburse federal money to systems through the U.S. EPA's Drinking Water State Revolving Fund, which distributed \$22.7 billion to over five thousand unique public water systems between 2008-2017. Those functions mean that states an important role in decisions that affect the construction and operation of water infrastructure, even if local governments are the ones doing the heavy lifting.

While the state's role in water systems differs from the more direct handling of highways by state DOTs, the two classes of infrastructure share some common ground with respect to practices that historically have favored the short-term over the longer-term considerations of the infrastructure's lifecycle. Many water systems contain "mains" (distribution pipes), pumps, and other components near or past their

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<sup>11</sup> Federal Highway Administration, U.S. Department of Transportation. "National Highway Construction Cost Index."

useful life, sometimes even a century old, especially in older cities in the eastern and midwestern U.S. Many lead service pipes connecting mains to end users installed in the early 20<sup>th</sup> century —6.1 million according to the AWWA—are made predominantly with lead.<sup>12</sup>

One key area of difference between highways and water systems (other than the level of government managing them) lies in visibility: Poor road surfaces are easy to identify, but poor water mains and sewer lines, buried underground, typically are not. Therefore, repair and placement of water system components often comes reactively: fixing things as they break, as opposed to preventing their breakage in the first place (which is difficult without replacement of old components). The ASCE's 2017 scorecard for water infrastructure estimates 240,000 breaks in the U.S. every year.<sup>13</sup> The impact of main breaks often has spillover (sorry) effects into other types of infrastructure: The breakage can also work to damage roads, requiring additional repairs and closures.

But a lack of water main breakage does not mean all is well: Building off estimates from the U.S. EPA and the AWWA, the Chicago-based Center for Neighborhood Technology estimates 2.1 trillion gallons are lost every year from leaking water mains, which comes to about 15 percent of all drinking water consumed in the U.S.<sup>14</sup> Monitoring the underground activity of water systems has improved with innovative technologies, but fixing leaks can be costly, so many municipalities elect to replace what's broken and gushing, not what's damaged and dripping.

In addition to aging infrastructure, water systems face other issues. Expansion of the system to newly constructed housing adds budgetary pressures to day-to-day operations. Sourcing of water is also an issue, especially more in the western U.S. Some of the nation's western largest cities (Los Angeles, San Antonio) are not located near enough sources of potentially potable water to meet their citizens' demands. Contamination of drinking water is another issue. While water treatment facilities have become much better at identifying when problems may occur before they happen through assessing the water's "turbidity" (cloudiness), the solution often requires end users to boil their water before consuming it. Even still, outbreaks of parasites and bacteria have been better contained in the past couple of decades. In 1993, Milwaukee, Wisconsin underwent the largest waterborne outbreak in U.S. history, where roughly one fourth of area residents (403,000 out of 1.6 million) were contaminated by the *Cryptosporidium* parasite, with 69 deaths attributed to it.<sup>15</sup>

Wastewater systems also face considerable issues presently. Since many systems are built so that stormwater enters wastewater systems, sharing the same pipes, wastewater treatment facilities can get inundated with inflows. When stormwater input is especially heavy, that can lead to "overflows" where mixed sewage and stormwater get discharged into waterways. Although likely one of the worst cases, Harrisburg, Pennsylvania, which has a combined wastewater/stormwater system, was responsible for

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<sup>12</sup> Cornwell, David A. et al. "National Survey of Lead Service Line Occurrence." *American Water Works Association*. April 2016. <https://awwa.onlinelibrary.wiley.com/doi/abs/10.5942/jawwa.2016.108.0086>

<sup>13</sup> American Society of Civil Engineers. "2017 Infrastructure Scorecard: Drinking Water." <https://www.infrastructurereportcard.org/wp-content/uploads/2017/01/Drinking-Water-Final.pdf>

<sup>14</sup> Center for Neighborhood Technology. "The Case for Fixing the Leaks." 2013.

<sup>15</sup> Corso, Phaedra S. et al. "Costs of Illness in the 1993 Waterborne *Cryptosporidium* Outbreak, Milwaukee, Wisconsin." *Emerging Infectious Diseases*. v9 n4 (April 2003): 426-431. <https://www.ncbi.nlm.nih.gov/pmc/articles/PMC2957981/>

over one billion gallons of such contaminated discharges into the Susquehanna River, *in 2018 alone*.<sup>16</sup> The city is hoping to negotiate with the U.S. EPA to avoid further sanctions, already under notice from state and federal regulators to clean up their mess.

Baltimore maintains separate systems for stormwater and wastewater, but still discharged an estimated 260 million gallons of raw sewage in the same year.<sup>17</sup> Florida systems have seen their share of sewage spillage problems, too, with an estimated 1.6 billion gallons of wastewater (including over 370 million gallons of raw sewage) flowing into waterways, from over 20,000 reports of spills over a roughly a decade (2009-2019).<sup>18</sup>

## Corrections

Unlike with highways and water systems, the institutions that determine the nature of corrections in the U.S. exist largely outside of corrections itself. Police make arrests, and criminal courts (prosecutors and judges, along with lawmakers) make sentencing guidelines that largely determine how many people get incarcerated, as well as the length of incarceration. While it is true that corrections agencies are able to have a say in many decisions about their operations (procedures and guidelines on using force, punishment for acts while incarcerated), the populations for which corrections agencies are responsible, for the most part, is not one of them.

Therefore, prison populations get determined largely by groups that have little-to-no residual claimancy for bad decisions.<sup>19</sup> Prosecutors don't get fined when they wrongfully convict someone, just as police often get away using unjustifiable violent, and even, deadly, force with little-to-no punishment. If a judge "throws the book" and repeatedly gives out long sentences, it is up to the corrections agencies to find space for those incarcerated. On the one hand, it does make some sense that the entities in charge of sentencing not be overly concerned with capacity restraints when doling out punishment: If the individual is guilty for crimes that laws deem punishable with incarceration, then the punishment should happen as the laws deem, and equality under the law provides that similar infractions be treated similarly until laws change. However, a push toward harsh sentencing can severely hamper corrections systems, which do have capacity constraints.

While prison populations were low in earlier parts of the 20<sup>th</sup> century, a growing total population, a greater number of acts defined as criminal, and a "tough on crime" mentality that saw its heyday in the 1980s-2000s, have grown the incarceration ranks drastically (see Figure 1, below). Incarceration really took off in the mid-late 1970s, reached a peak about the middle of last decade, and has dropped a little since. Since prison capacity is mostly fixed in the short term, overcrowding in the face of such fast inmate growth would seem a threat without additional checks on incarceration, which the status quo

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<sup>16</sup> Dance, Scott. "It's not just Baltimore: Another city is sending much more sewage into the Chesapeake Bay, report says." *Baltimore Sun*. 22 August 2019. <https://www.baltimoresun.com/news/environment/bs-md-harrisburg-sewage-20190822-ayxnvjvegbglhojgcrtoyxcmq-story.html>

<sup>17</sup> Ibid.

<sup>18</sup> Salman, Joh, et al. "Sewer Crisis in The State of Florida: Aging infrastructure and storms contribute to massive spills." *Gatehouse Media*.

<sup>19</sup> <https://www.bjs.gov/content/pub/pdf/hspsfy25-86.pdf>

makes difficult. While funding did increase significantly during those decades, capacity did not keep up with populations.<sup>20</sup>

And indeed, overcrowding has been a problem in many state corrections systems. About a decade ago (2011), the U.S. Supreme Court, in *Brown v. Plata*, ruled that overcrowding conditions in California's corrections facilities had become so dire (over 180% capacity at peak), that they constituted a violation of the U.S. Constitution's 8<sup>th</sup> Amendment protections against "cruel and unusual punishment."<sup>21</sup> The U.S. Department of Justice ruled similarly with respect to Alabama's state prisons in 2019.<sup>22</sup> As of the end of 2017, the federal Bureau of Prisons identified 24 states exceeding their minimum capacity, even as total populations dropped slightly.<sup>23</sup> Sending inmates to other states with open capacity has been a common practice for some time, which can make visits more difficult to coordinate for inmates' friends and loved ones, and place the incarcerated in a worse position with respect to their mental health, unable to connect with some of the few contacts they have with the outside world.

But ensuring space for inmates is merely one issue in corrections. Many state correctional facilities are in poor shape, too, even if operating at acceptable capacity rates. The largest corrections facility in Kansas' state prison system, Lansing Correctional Facility, completed construction in 1868, with construction authorization coming in the first year of the Civil War (1861). The Oklahoma State Penitentiary (the largest in the state's corrections system) opened in 1908, only a year after Oklahoma became a state. Louisiana's Angola Penitentiary has been a state prison since 1901, but the facility itself dates back into the late 1800s.

As with highways and water, a lack of long-term focus has hurt outcomes in corrections. Since most inmates will re-enter society at some point, making sure they do not come back remains a big issue. A report released in 2019 by the United States Sentencing Commission studied recidivism rates among over 25,431 prisoners who were released in 2005, of which 10,004 were violent offenders. The violent offenders recidivated at a rate of 63.8%, compared to 39.8% for non-violent offenders, with rearrest occurring at median times of 18 months, and 25 months, respectively.<sup>24</sup> A 2014 report from the Bureau of Justice Statistics tracked recidivism in 30 states among 404,638 inmates finding 67.8% were rearrested with three years of release, and 76.6% rearrested within five years.<sup>25</sup>

Given the eventual release of inmates, the incarceration experience, in addition to atone for harmful behavior, is to prepare inmates for release. Offering therapy for mental health and substance abuse issues, as well as educational and job training provide some broad examples of ways to help ease inmates' transitions back into society. With the rise of the punishment-first, "tough-on-crime" mentality, the rehabilitative purpose of incarceration has been given short-shrift, which can have a de-humanizing

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<sup>20</sup> Citation needed <https://www.census.gov/programs-surveys/gov-finances.html> (Pfaff's chart cites as source)

<sup>21</sup> *Brown v. Plata* <https://www.supremecourt.gov/opinions/10pdf/09-1233.pdf>

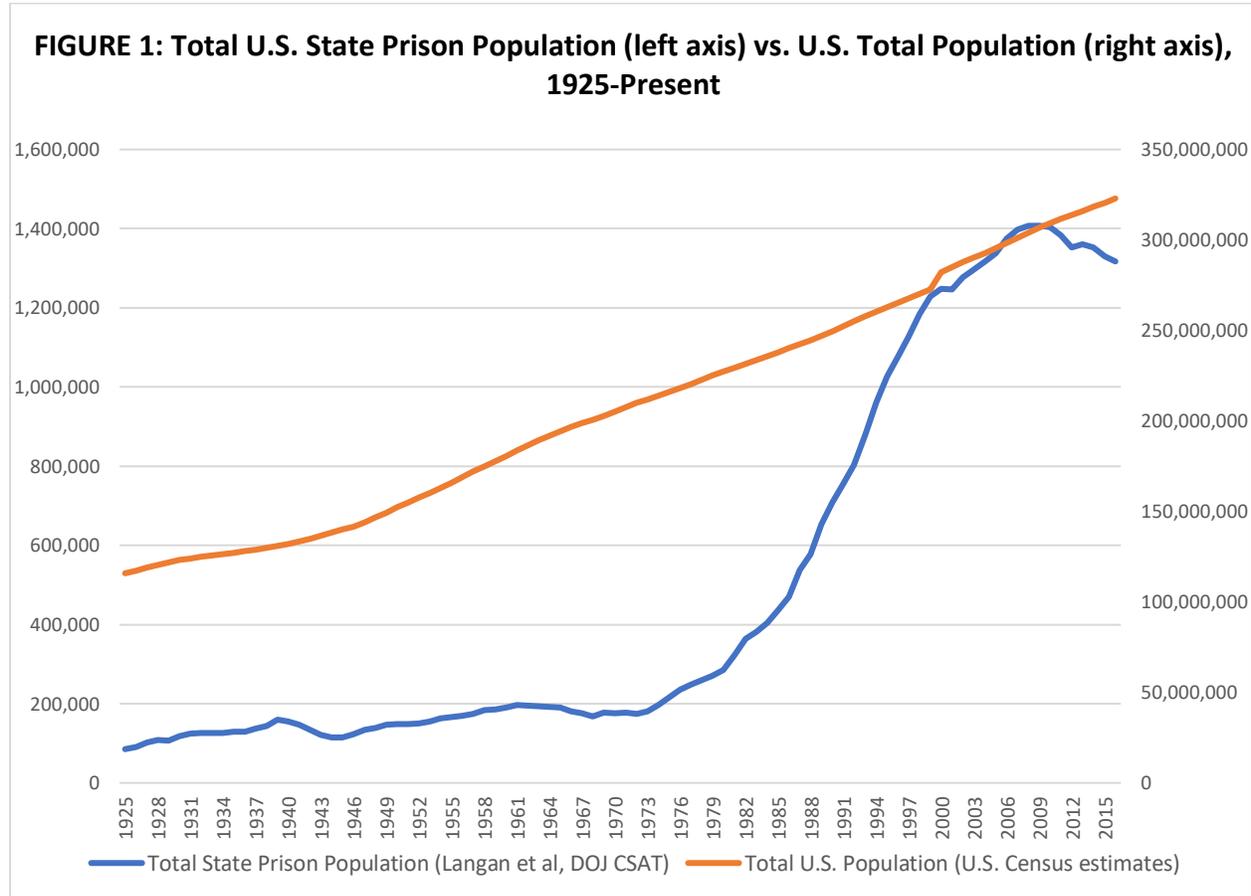
<sup>22</sup> U.S. Department of Justice. "Justice Department Alleges Conditions in Alabama Men's Prisons Violate the Constitution." *justice.gov*. 3 April 2019. <https://www.justice.gov/opa/pr/justice-department-alleges-conditions-alabama-mens-prisons-violate-constitution>

<sup>23</sup> Bronson, Jennifer and E. Ann Carson. "Prisoners in 2017." *U.S. Department of Justice*. April 2019. <https://www.bjs.gov/content/pub/pdf/p17.pdf>

<sup>24</sup> [https://www.ussc.gov/sites/default/files/pdf/research-and-publications/research-publications/2019/20190124\\_Recidivism\\_Violence.pdf](https://www.ussc.gov/sites/default/files/pdf/research-and-publications/research-publications/2019/20190124_Recidivism_Violence.pdf)

<sup>25</sup> Durose, Matthew R., et al. "Recidivism of Prisoners Released in 30 States in 2005: Patterns from 2005 to 2010." *U.S. Department of Justice, Bureau of Justice Statistics*. April 2014.

effect on individuals who have already lost many of their liberties. “When the only tool you have is a hammer, everything looks like a nail,” as opposed to an individual that needs help overcoming problems before re-entering society. While greater focus on education, rehabilitation, and therapy have come in more recent years, and while almost all prisons systems do provide some of these services to inmates, the extent of their offering and effectiveness remains mixed.



While many prisons prior to the 20<sup>th</sup> century were privately-owned and/or managed, present-day private prisons have mostly been a recent occurrence, picking up at about the same time as incarceration took its big jump in the 1980s-1900s.<sup>26</sup> While such findings often make private prisons a target for blame as a *cause* of mass incarceration, a closer examination finds the accusation wanting. John Pfaff’s work in this area has been especially revealing, pointing out that blaming private prison companies for mass incarceration as part of a “Standard Story” that misattributes mass incarceration’s causes. As private prisons handle roughly seven percent of state prison populations, incarceration

<sup>26</sup> The relationships between state and prison operators in this period created some terrible incentives and even worse outcomes, especially in the Jim Crow south: Operators would often “lease” inmates as workers compensated only for food, shelter, and clothing. The practice was undoubtedly lucrative for states: 73% Alabama’s state government revenues in 1898 came from the leasing of inmates, up from 10% merely 15 years earlier. As one would expect, death rates for inmates in states that allowed such leasing arrangements were much higher (10x) than non-lease states See: Mancini, Matthew J. *One Dies, Get Another: Convict Leasing in the American South, 1866-1928*. University of South Carolina Press. 1996.

growth in the 1980s and 1990s is better attributed to policing, prosecutorial, and sentencing procedures, where private prisons have little influence.<sup>27</sup>

The use of the private sector in corrections is seen more in providing various support services to inmates than the operation of prisons themselves. Re-entry and educational programs at the state level are often handled by private prisons companies, as are medical services. CoreCivic and GEO Group, two of the largest private prison companies operating in the U.S., both have extensive health care and re-entry service operations.<sup>28</sup>

### **The Ignorance of Moral Objections to Privatization**

Many of the most effective objections to privatization and outsourcing (in terms of preventing it) adopt a similar mindset as the Pacheco Law's reasoning (and sheer ignorance of Public Choice). Some work to deify public sector workers but more emphasis is placed on being on the offensive against privatization. Private providers are dismissed as inferior, and even immoral, based on the fact that they profit. Cries are often made that outsourcing prevents transparency: The American Federation of State, County and Municipal Employees (AFSCME) drafted a resolution against privatization in 2014, stating "Privatization does not allow transparency of the inner workings of contractors" and "The government's responsibility for the welfare of all is being eroded by replacing public functions with private, for-profit, unregulated enterprises."

These sorts of objections can be found extensively in discussions of private corrections and of water systems especially. Profits in prison operation are told to provide too strong of an incentive to cut costs.<sup>29</sup> But the incentive to cut costs exists for any operator, as does the incentive to have prisons operating at as full of a capacity as possible. Critics often point to arrangements where private prisons contract on the basis of guaranteeing funding for a minimum specified number of inmates, but public sector operators also have the same incentive to get funding for as many inmates as possible: All the better if none ever show up!

In one recent example of a state corrections system contracting with facilities out-of-state, Vermont chose to move inmates from a publicly run prison in Pennsylvania to a privately-run one in Mississippi. Among the reasons: Even though Pennsylvania was willing to charge Vermont less than the private prison company on a per inmate basis, Pennsylvania, unlike the private company, required payment for a minimum of 250 inmates, regardless of whether beds are empty or not. But the funding arrangement was not the only problem. Officials at the Vermont Department of Corrections has trouble finding details about several inmate deaths that occurred at the Pennsylvania facility. The state's Defender General, said of the move from Pennsylvania that to the best of his observations the inmates were "happy to get out of there."

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<sup>27</sup> Pfaff, John F. *Locked In*. Basic Books. 2017. 79-104.

<sup>28</sup> CoreCivic health care (nursing and mental health professionals):

<https://jobs.corecivic.com/page/show/healthcare>

CoreCivic Reentry: <https://www.corecivic.com/reentry>

GEO Care: <https://www.geogroup.com/GEO-Care>

GEO Reentry: <https://www.georeentry.com/about/>

<sup>29</sup> Hart, Oliver, et al. "The Proper Scope of Government: Theory and an Application of Prisons."

In a previous private prison contract with a Kentucky prison, the Defender General said, “I had people in the Prisoners’ Rights Office talking about Kentucky as being the best prison in the state of Vermont.”<sup>30</sup> Even where problems did occur, the company was responsive in taking action to correct the problem. The same can be same of the present relationship with the Mississippi prison. When officials in Vermont objected to the prison’s mail search policy, the company changed procedures.<sup>31</sup>

As with prisons, private companies operating water and related systems also receive moral objections based on their profiting. While lacking in substance, such appeals can be highly effective in persuading the general public. The City of Baltimore, via a 2018 referendum with a 77% approval rate, put an effective ban on private companies managing their water and wastewater systems, codified in the so-called “Water Accountability and Equity Act.” Food & Water Watch, an activist organization that seeks to end all water system privatization, states on their webpage entitled “Corporate Control of Water”:

“Corporations are seeking to control and restrict our increasingly scarce and polluted water supplies. But we must treat water like the priceless resource it is—and as a human right.”  
...Water is essential for life, but increasingly, it is viewed as a source of windfall profits. This is unacceptable. Access to clean water should not be based on who can pay the most...Food & Water Watch opposes the commodification and privatization of water in all forms.<sup>32</sup>

Statements like this reflect an ignorance of not just contracting practices, but also what is required to deliver drinkable water to taps. Over 50,000 municipal water systems exist in the United States, many have been run privately for long periods of time, some for over 200 years. Whether in public or private hands, water is a non-priceless commodity, as users get charged for using it, and water systems operators have find considerable resources to ensure clean water makes it to customers’ taps. Declaring clean water a “right” does not eliminate those considerations. Those funds have to come from somewhere.

Water pollution is an issue to some extent, but just why it is an issue for privately-run systems and not public ones is certainly a headscratcher. The assertion that only those “who can pay the most” get access to water is beyond unfounded, unless “who” is meant to represent the vast majority of customers served by a given system. Many municipalities have programs to provide water for customers who have trouble paying for it, regardless of what type of entity runs the system.

### **Conclusion:** Public Choice, Contracting, and Incentives

A central insight of Public Choice theory, put in its basest terms, is “markets fail, so do governments.” At the heart of every effective decision to outsource or enter a PPP is a determination that the private sector can improve on the status quo. The decision results in a contract, as do collective bargaining agreements with public workers.

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<sup>30</sup> Murray, Elizabeth. “Vermont inmates heading to Mississippi prison with familiar private operator.” *Burlington Free Press*. 19 September 2018.

<sup>31</sup> Keys, Alan J. “Mississippi prison reverses mail search policy after Vermont inmate complaints.” *VT Digger* 13 February 2020. <https://vtdigger.org/2020/02/13/mississippi-prison-reverses-mail-search-policy-after-vermont-inmate-complaints/>

<sup>32</sup> “Corporate Control of Water.” *Food & Water Watch*.

Most every contract with a private sector entity includes performance metrics designed to align incentives between agency and private partner, with financial penalties for failing to meet the performance standards. With the right mix of standards, profits correspond with performance.

If government workers are willing to enter contracts that reward good performance while punishing bad performance, then one might conclude that the propensity for such a contract to be successful differs little from public or private sector, or maybe slightly favor the public sector because contracting with an outside entity may be more expensive than keeping work “in-house.” Government workers not only look to avoid provisions in their collective bargaining agreements, but look to prevent any competitive forces working against them, points to a status quo that likely will result in poor performance.

To give one recent extreme example for a state-level transit agency, the Massachusetts Bay Transportation Authority (MBTA), until the temporary repeal of Sections 52-55 of Chapter 7 in Massachusetts General Laws (known as the “Pacheco Law” after its sponsor), had a very limited ability to contract. The Pacheco Law, under the ruse of “protecting taxpayers,” has provisions that make contracting out almost impossible. In addition to having to prove that the contract would save money (an ill-advised guideline that favors short-term costs over quality and performance), the savings have to be demonstrated by comparing costs, not to inhouse operations based on their *actual* past performance, but based on performance of inhouse operations if they were performed “in the most cost-efficient manner,” a mentality similar to the one that drove the creation of Public Choice in the first place: Why assess performance at all when it is always assumed to be perfect? Even if a proposal makes it through those (and other) trials, the state auditor has full power to deny it from moving forward.

Fortunately, MBTA and the state of Massachusetts did well during the temporary repeal period to identify opportunities for contracting to improve its operations, a mission dedicated “to advance performance, not privatization.” In a series of annual reports to the state legislature, MBTA identified improvements not just in contracting out services, but merely providing a credible threat to contract out services.<sup>33</sup> The most extreme example, MBTA’s cash management operations, which were outsourced to Brinks, achieved 75 percent savings in the first year, with “(b)etter security and far greater transparency.”. But after merely threatening to outsource, the MBTA was able to renegotiate with its Carmen’s Union to save \$200 million in a new collective bargaining agreement.

While contracting out and achieving 75% savings for a single service is certainly an outlier, the MBTA’s experience does provide valuable Public Choice insight in how government workers operate with little-to-no incentive to perform well: as self-interested individuals who respond to those incentives, not as benevolent civil servants dedicated to providing the best available services at the lowest possible cost (which the Pacheco Law’s provisions assume). Instead of trying to be more efficient, unionized government workers are more likely to look to expand their ranks. While stern negotiating can push back against that mentality, credible threats to the collective bargaining status quo from outsourcing provide a better position from which agencies can work to improve services.

But if privatization is prohibited, credible threats to poorly performing government workers are difficult to come by. Free from competition, workers get the power to *not* subject themselves to greater

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<sup>33</sup> Massachusetts Bay Transportation Authority. *Annual Report to the Legislature: Waiver from Provisions of Sections 52-55 of Chapter 7 of Massachusetts General Laws*. September 2018. <https://malegislature.gov/Bills/190/SD2757.pdf>

accountability, performance, and transparency. That may be a good outcome for those workers, but their jobs exist to provide for the general public, not make their own work lives as easy as possible.

While privatization and contracting out are not a panacea, they have a proven track record of improving outcomes for agencies, with subjecting their potential to do much more. The trillions of dollars needed to repair, replace and upgrade infrastructure in the coming decades will need considerable private sector resources to manage effectively, and to avoid repeating many of the same problems of today. Fin

Unfortunately, many of the places that could most benefit from private sector help in managing government infrastructure and services lie in areas where opposition is effective. Harrisburg's mayor rejected a privatization offer in 2019, but the U.S. EPA has remained dissatisfied with his inhouse plan to reduce combined sewage overflows, and the mayor also decided to delay assessing a stormwater fee, placing additional pressure on finances. Mobile, Alabama has tunnels and bridges at or near their useful life on Interstate-10, handling traffic loads greater than for which they were designed, but a potential PPP by the Alabama Department of Transportation to build and improve that infrastructure was rejected last year.

On the other hand, if alternate solutions without the private sector do not develop, the problems do not go away, and privatization may be revisited. The town of Long Hill, New Jersey rejected a wastewater system privatization several years ago, only to approve one a couple of years later.<sup>34</sup> One would almost expect that other rejections may undergo reconsideration soon.

State governments have many important roles in providing and overseeing public services and public infrastructure. The use of contracting out to private companies has proven to be valuable risk management tool for agencies, allowing outside resources to tackle problems that agencies have trouble managing the risk for themselves. For functions where state agencies oversee local government, encouraging competitive sourcing, PPPs, and privatization has and can continue to provide benefits to local governments and the states that oversee them. Even if a private option is not ultimately chosen, the competitive process is likely to improve the public sector's work, too.

While opposition to privatization continues to be strong, time and history are not on their side: Banning privatization shuts off options, and rejecting a privatization proposal without an alternate strategy will likely work to make the problems worse. Other parts of the world have undergone extensive privatization activity over the last few decades. The U.S. experience, while not as extensive, still provides many examples of success, allowing states to make more effective use of taxpayer resources.

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<sup>34</sup> Caffrey, Michelle. "Why a N.J. town changed its mind about selling its sewer system to American Water." *Philadelphia Business Journal*. 3 January 2020. <https://www.bizjournals.com/philadelphia/news/2020/01/03/why-a-n-j-town-changed-its-mind-about-selling.html>