RPPI Privatization Center

PRIVATIZATION WATCH

REASON PUBLIC POLICY INSTITUTE ◆ PRIVATIZATION CENTER No. 252 ◆ December 1997

[Email the editor at Adriantm@aol.com]

[Call the Privatization Hotline at 310/391-6525]

[Check out the RPPI web site at www.reason.org]

Inside this Issue

PRIVATE PRISONS MAKING THE HEADLINES

Private Correctional Firm Cleared in Texas Incident

In early September, all eyes turned to Brazoria County, Texas, when a video tape allegedly showing guards abusing inmates in a privately operated prison came to light. The tape became public as part of a lawsuit against Capital Correctional Resources, Inc. (CCRI), which leases a wing of the Brazoria County jail to house out-of-state inmates.

At the time of the incident, the inmates in the CCRI facility were from Missouri, and in response to the video tape and the outcry that accompanied it, the state of Missouri withdrew its inmates from the facility. The next two weeks saw a flood of commentary in the press, radio, and television about the dangers of private operation of prisons and the lack of appropriate oversight. And the Texas Commission on Jail Standards encouraged states who send their inmates to private prisons in Texas to also send inspectors to monitor conditions and contract compliance.

The not very widely covered sequel to the story is that, after viewing the entire video tape, the court threw out the case of brutality against CCRI for lack of evidence. The video clearly showed that all the instances that appeared abusive involved Brazoria County sheriff's deputies, not CCRI guards.

CCRI still holds the lease to the facility, and it is seeking a new contract with another state to house its inmates.

Second Annual Conference on Privatizing Correctional Facilities Held in New York City

In mid-September over 130 people came to New York to share information and ideas on private prisons. Their deep interest in the subject was demonstrated by the $1,795 they paid to attend the two day conference, put together by a professional conference firm, World Research Group.

For many attending the conference, the highlight came at lunch on the first day of the conference. A crowd of public correctional peace officers stormed into the ballroom and took the stage. "Privatization will not happen as long as we have breath in our bodies!" thundered Norman Seabrook, president of the New York Correctional Officers' Benevolent Association. "And if you do privatize a prison in our states," he continued, "we'll burn it down!"

See PRIVATE PRISONS on page 4

MAKING MONOPOLIES COMPETE

Australia's National Competition Policy

In 1991, responding to international economic competition, the Council of Australian Governments (COAG), made up of leaders from federal, state, territorial, and local governments, agreed to establish a national competition policy (NCP). In 1995, after considerable analysis and spirited debate, the Australian government passed the Competition Policy Reform Act (CPRA), which applies to most economic activities in Australia. The CPRA, which has been accepted by all jurisdictions, applies equally throughout Australia and automatically overrides any state or territorial laws or regulations that are inconsistent with the CPRA.

The CPRA amended existing competitive-conduct rules and extended their coverage to state and local businesses. It further created new federal bodies, including the National Competition Council, to oversee competition policies, assure coordination among state and federal policies, and assess progress in implementation.

Another significant part of the 1995 CPRA was that the "shield of the crown" was removed. In forming the Commonwealth of Australia as a constitutional monarchy in 1901, the states had retained control over certain areas of the economy, such as electricity, gas, water, railways, roads, and ports. Certain other areas, such as telephones and airports, came under federal government jurisdiction. The "shield of the crown" doctrine immunized government entities from antitrust legislation.

See AUSTRALIA on page 5

Continued from page 1

AUSTRALIA CORPORATIZES GOVERNMENT MONOPOLIES

Since Australia had relied heavily on direct government investment from early colonial days, nearly all major infrastructure activities were closed government monopolies, in the form of departments, boards, and so forth. State and federal governmental agencies provided goods and services and often produced the inputs required for such activities. Thus, a characteristic of these state-owned monopolies was their vertical integration.

Some economic activities fell under federal jurisdiction by default, because they were new, unknown, or undeveloped technologies at the time of federation. In 1937 the states agreed to pass uniform laws to legalize Commonwealth regulation of air navigation, following a failed attempt at a constitutional referendum. This 1937 legislative agreement was not completely dissimilar from the COAG agreements that led to the 1995 CPRA. COAG meetings are similar to meetings of U.S. governors, but agreements at COAG meetings appear to set the stage for federal legislation that will not be rejected by later judicial challenges on constitutional grounds.

Large closed governmental monopolies are inconsistent with the NCP. To address this problem, the Australians initialized a process called corporatization. Corporatization actually takes place when a former government department registers itself as a company. Coterminous with this registration is the reorganization of the government business enterprise's accounting and managerial structure to replicate normal business practices, with emphasis on "bottom line" accountability and responsibility to the shareholders.

A former government entity that has been corporatized may remain under government ownership or be privatized. The NCP structure includes nonprofit corporations such as the National Electric Market Management Company and the National Electric Code Administrator, created to oversee the operation of the national electric market.

The NCP requires corporatization of many government agencies, and it goes further by requiring agencies to disaggregate their vertically organized functions into separate businesses and create a "level playing field" for competition with the private sector. For example, state electrical systems that formerly provided generation, transmission, and distribution are being broken up into corporatized entities providing these services on separate functional bases. Often the same function, such as electrical generation, has been subdivided into a number of corporate entities that can compete against each other.

In effect, the vertical components have been dismembered and recreated as discrete business entities. The NCP approach could be envisioned as a vertical pillar being dissected and the separate parts being laid horizontal on a level field. Each of these formerly interrelated parts theoretically represents an autonomous, competitive business entity.

Victoria's corporatized entities providing electrical generation, transmission, and distribution have largely been privatized. The New South Wales government recently attempted to privatize its electrical system. However, the ruling Labor Party administration encountered strong rank-and-file opposition and was forced to back off on its proposed sale to the private sector.

The question of asset valuation is a major concern. In Australia, this problem is exacerbated by the limited taxing powers of the various states. Many privatization opponents in New South Wales argued that the electricity revenues acted as surrogate tax revenues and as such gave the state a degree of financial independence from the Commonwealth.

Clearly, there are disparate views as to what the net future benefits will be and what discount rate should be imputed to set a capitalized asset valuation for a corporatized government entity. The capital value problem is illustrated by a perpetual annuity. If a perpetual annuity yields $10 per annum, its value may be calculated simply by dividing the yield by the discount rate. If the discount rate is 10 percent, the value of this annuity is $100 ($10/.10). Should the discount rate fall to 5 percent, the capitalized value of the annuity increases to $200 ($10/.05). In this situation, the only issue is the discount rate. In selling off a public asset, such as an entire electrical system, without a comparable market, there are nearly infinite variations on how members of the body politic can perceive both the yield and the discount rate.

All jurisdictions encompassed by COAG have enacted a competition code and competition principles. Because the states and territories of Australia have limited taxing powers, the federal government has instituted a financial rewards system to encourage the various states and territories to implement competitive policies. Assessments of competitive progress to justify awards are made by the National Competition Council. The first assessment was issued on June 30, 1997, when A$406 million in incentive payments were awarded to states and territories. ♦

—Brian Browne, private consultant, bb2@hooked.net

ASSET SALES

LARGEST ASSET SALE IN U.S. HISTORY

In the U.S. government's largest asset sale ever, the Department of Energy sold its interest in the Elk Hills Naval Petroleum Reserve to Occidental Petroleum for $3.65 billion. Occidental bought 78 percent of the reserve, and Chevron owns the other 22 percent. Occidental outbid 22 others, including Chevron and ARCO, by paying more than 50 percent above the government's original estimate of what the oil field was worth. Occidental was willing to pay the higher price because the company plans to use advanced technology to extract significantly higher quantities of crude oil and add substantial new reserves. They plan to boost daily oil production from 48,000 barrels per day to 80,000. Secretary of Energy Federico Peña said, "The government is not in the business of oil production, and Oxy will have the resources to operate it much more efficiently."

Most of the sale proceeds will go to reduce the federal deficit, although 9 percent, or more than $300 million, will go to the California Teachers Retirement System as part of a settlement of an ownership dispute between the state of California and the federal government. ♦

—Lisa Snell