



**INFRASTRUCTURE
PARTNERSHIPS
AUSTRALIA**

BUILDING AUSTRALIA TOGETHER



**SUBMISSION:
INQUIRY INTO THE EFFICIENCY AND
PERFORMANCE OF WESTERN AUSTRALIAN
PRISONS**

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Infrastructure Partnerships Australia is a national forum, comprising public and private sector CEO Members, advocating the public policy interests of Australia's infrastructure industry.



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ABOUT IPA

Infrastructure Partnerships Australia is the nation's peak infrastructure body – formed in 2005 as a genuine and enduring policy partnership between Australia's governments and industry.

IPA's formation recognises that through innovation and reform, Australia can extract more from the infrastructure it's got, and invest more in the infrastructure we need. Through our research and deep engagement with policymakers and industry, IPA seeks to capture best practice and advance complex reform options to drive up national economic prosperity and competitiveness.

Infrastructure is about more than balance sheets and building sites. Infrastructure is the key to how Australia does business, how we meet the needs of a prosperous economy and growing population and how we sustain a cohesive and inclusive society.

Infrastructure Partnerships Australia draws together the public and private sectors in a genuine partnership to debate the policy reforms and priority projects that will build Australia for the challenges ahead.

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EXECUTIVE SUMMARY

Western Australia is facing budget pressures as mounting recurrent public services costs, declining revenues and high levels of existing public sector debt erode the capacity for infrastructure investment or indeed, other priorities.

This submission responds to the Issues Paper – titled *Inquiry into the Performance and Efficiency of Western Australian Prisons* (the Issues Paper) – released in November 2014 by the Economic Regulation Authority (ERA) of Western Australia. The ERA is conducting the Inquiry at the request of the Western Australian State Treasurer. This submission argues that, through deliberate reform, Western Australia has an opportunity to improve the performance and monetary cost of prison services in the State.

The cost of delivering ‘core’ public services in Western Australia is growing at several times the rate of inflation. The 2014/15 Western Australian State Budget shows that expenditures across the government sector will increase at rates substantially higher than inflation, including:

- An additional \$447 million in health, or growth of 5.9 per cent over the preceding year;
- An additional \$188 million in education, or 4.3 per cent growth; and
- An additional \$83.5 million in police services, growth of 6.6 per cent.

Through deliberate reform, Western Australia has an opportunity to improve the performance and monetary cost of prison services in the State.

The recently released Government Mid-Year Financial Projections Statement found that health, education, law and order now account for 54 per cent of general government recurrent expenditure.¹ As recurrent expenses consume more of the total State Budget, the Government relies more on borrowings to fund critical infrastructure projects.

However, this approach does not have endless capacity. In August 2014 Moody’s Investors Service downgraded the State Government’s credit rating to Aa1 and warned that budget deficits are likely to blow out beyond current forecasts unless the Government adopts “a more effective budgetary redress plan” to respond to lower iron ore prices. This follows Standard and Poor’s downgrading the State’s credit rating from triple-A to double-A plus in September 2013.

On top of these existing challenges, the State is facing significant projected population growth. The Australian Bureau of Statistics projects that Western Australia’s population will increase from 2.4 million at 30 June 2012 to 6.4 million people by 2061, on medium growth assumptions.² Population

¹ 2014-15 Government Mid-Year Financial Projections Statement <
http://www.treasury.wa.gov.au/cms/uploadedFiles/_Treasury/State_finances/2014-15-Government_Mid-Year_Projections-MYR.pdf>

² On high growth assumptions, the population is projected to increase to 7.7 million; and under low growth assumptions, 5.4 million.

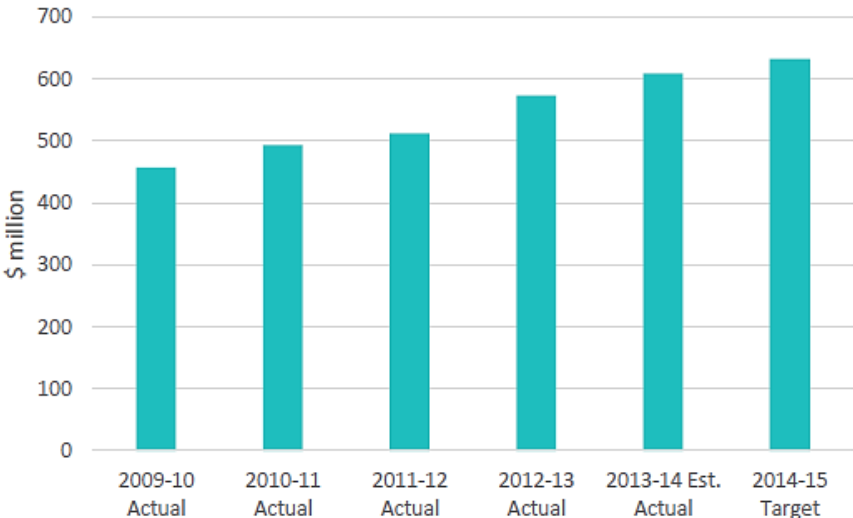
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growth will further increase the demand for infrastructure and services. On current settings – and particularly with the continued use of traditional models of service delivery – the State Government’s recurrent expenses are projected to markedly grow their share of the overall budget, threatening the State’s ability to maintain service scope and quality, and suppressing capacity for productive investment in competing priority areas such as economic infrastructure.

To maintain service quality in the face of growing demand, yet improve efficiency to contain increasing costs, a sustained programme of reform to the State’s public services is critical. Put simply, sustaining the reach and improving the quality of Western Australia’s public services can only be achieved through reforms to make service delivery more efficient.

Prison services self-select as an early candidate for reform. Like other service sectors, the cost of providing prison services in the State is increasing. As identified in the Issues Paper, the total net cost to the State Government of providing adult custodial services was \$608 million in 2013-14, up by 6 per cent on 2012-13 and consistent with the general trend over recent years (illustrated in Figure 1).

Figure 1: Cost of keeping adult prisoners in custody, WA



Source: Department of Corrective Services; ERA

Our analysis of the relative performance of different prisons within Western Australia and other Australian jurisdictions suggests there are substantial opportunities to improve performance and efficiency. There is a substantial body of evidence to support increasing private sector involvement in Western Australia’s prison services to deliver performance and efficiency improvements.

Within that context, this submission contends that Western Australia has an opportunity to pursue prudent reforms which create stronger incentives for the efficient operation of Western Australia’s prison system – and stronger incentives for rehabilitation and the humane treatment of convicts.

Our submission then uses a series of domestic and global case studies to explain concepts and demonstrate the potential benefits of a reformed approach based on contestable supply of prison services.

SUMMARY OF KEY FINDINGS

- Western Australia should seek to increase the involvement of private operators, by making prison services contestable.
- Contestable supply of WA's prison services would deliver substantial benefits, because of the competition between bidders based on the scope, quality, innovation and monetary cost of delivery of prison services.
- Domestic and global experience shows that privately operated prisons are better placed to deliver improved prison and related services at a more efficient cost, because of the increased accountability mechanisms that can be deployed.
- Achieving these efficiencies requires clearly contracted accountabilities on the private operators, supported by substantial sanctions when contracted KPIs are not met.
- Modern contracting approaches will allow Western Australia to seek better rehabilitation outcomes from the corrections system, through KPIs on private operators to reduce the recidivism rate of convicts below the benchmark of publicly operated prisons.

IS THERE A CASE FOR PRIVATE PROVISION OF PRISON SERVICES?

Contestability is an increasingly important theme in public administration, as constrained fiscal settings force an ongoing search for improved quality – and value for money – from public services.

A key aspiration in reforming public service delivery models must be seeking opportunities to stretch the taxpayer dollar further, driving better quality services, at much better value for money.

Western Australia's prison services are a logical area to seek further reform, particularly given the existing positive experience of prison services reform in WA; and the opportunity that reform presents to make the corrections system more effective in its core purpose of rehabilitating offenders.

Correctional services are a pure public good, meaning that the public sector will always retain fundamental responsibility for funding and regulating the system. However, this does not preclude reform or outsourcing of service delivery. As noted by the Final Report of the Queensland Commission of Audit (2013), the:

"...identification of a service as being the responsibility of government does not necessarily imply that government should directly deliver that service."

Indeed, a range of contestable delivery models have already been applied successfully to prisons and related services across Australia over the past 30 years, with upsides for the taxpayer through benchmark competition and through improved custodial service delivery.

Australia's first privately operated prison was commissioned in Queensland in January 1990. Subsequently, each mainland state has procured at least one privately operated prison. For its part, Western Australia has two privately operated prison facilities, being Acacia Prison and the Wandoo Reintegration Facility. Notably, Acacia Prison has been the best performing prison in the State in terms of cost per prisoner per day and is a strong performer when independently reviewed by the Inspector of Custodial Services.

Far from representing a loss of public sector control, Victoria's Auditor-General noted the improved accountability which accrues through contracted services, observing:

"Agreements with private contractors have enabled the Government to achieve one of its prison reform objectives of transferring significant financial risks to the private sector...[as well as] certain operating risks...[with] the onus on contractors to deliver services which meet the Government's standards."³

In this way, well-structured outsourcing of correctional (or other public) services can enhance the level of control for the public sector, because it removes the inherent conflict of interest where the public sector is at once the purchaser and provider of prison services.

The former NSW Corrective Services Commissioner, Ron Woodham, observed in a 2009 inquiry into prison services in that state that private operation of prisons does not see governments "contract

³ Victorian Auditor General (1999) Victoria's prison system: Community protection and prisoner welfare.

out” their responsibilities for correctional services, but rather “contract in” efficient service providers to deliver those services for government.⁴

Global experience has also shown that reforms which introduce a mix of providers into a service market, such as prison services, creates a powerful mechanism to increase efficiency across publicly and privately operated services, because of the opportunity to benchmark performance across a variety of facilities and providers. In this way, reform provides a basis for sustained ‘yardstick’ or ‘benchmark’ competition.

Blumstein, Cohen and Seth noted the positive impact of contestable supply within prisons systems, noting:

“[privately operated prisons are]... not and need not be an all-or-nothing proposition. While entire sectors in some countries have been privatized in many a mix of government-owned and privately-owned (and/or privately-operated) enterprises coexist, functioning side by side.

Prisons are a significant example of such a public/private mix... The existence of prisoners under a state’s jurisdiction that are held in privately owned or operated facilities can have a beneficial effect on the rate of growth in expenditures on publicly held prisoners.”⁵

In considering the opportunity to enhance the efficiency, humanity and rehabilitation outcomes of WA’s prison system, the State need not contemplate the outsourcing of every aspect of prison services. Rather, the decision to offer a particular facility or service to the market should be based on a direct consideration of that asset or service.

Some aspects of WA’s corrections system may not currently lend themselves to efficient delivery by private operators (for example, where they lack sufficient scale or where the private sector may not be best placed to manage delivery risks). However, this can shift over time in line with changing service delivery models, public acceptance and political feasibility, and decisions should be reassessed periodically.

Within this context, many aspects of the prison system are already suitable for private provision, offering Western Australia an immediate opportunity to commence contestability based reform to the prison system.

WHAT ARE THE BENEFITS OF INCREASING PRIVATE PARTICIPATION IN PRISON SERVICES?

Substantial reform to public sector delivery models are rarely achieved without equally substantial community debate and (often strident) opposition from affected stakeholder groups, including the existing workforce and public sector unions.

⁴ Woodham, R. (2009) Evidence given, Inquiry on the Privatisation of Prisons and Prison-related Services, 23/02/09.

⁵ Blumstein, J; Cohen, M and S. Seth (2007) Do Government Agencies Respond to Market Pressures? Evidence from Private Prisons.

These debates are characterised by strong claims and counterclaims between the proponents and opponents of reform. While this is a healthy process that serves to engage the public in the debate, it can often see facts lost within the broader debate.

This section considers the experience of prison reform and the benefits that have been observed.

Cost savings

That the private sector is generally able to deliver services at a lower cost than the public sector is a relatively unchallenged aspect of the debate, and one that has been well evidenced in WA and elsewhere.

As noted in the Issues Paper, Western Australia's privately-operated Acacia Prison has the lowest cost per prisoner per day in the State. Costs at Acacia are circa \$183 per prisoner per day, comparing favourably to the State average of \$342 per prisoner per day and the national average of \$297 per prisoner per day.

Around Australia and across the globe, there is substantial evidence to show that privately-run prisons operate more efficiently than publicly operated prisons.⁶

This capacity to deliver comparable and better services, at lower cost, is accepted to accrue through the additional incentives and control applied by private sector managers, over their public sector peers, coupled with the price, scope and quality of service competition between private bidders.

Quality of Service and Accountability

The broad acceptance (even by opponents) that the private sector will, generally, deliver corrective services for less money, sees the debate quickly turn to discussions about how these savings are achieved. For example, opponents will often argue that these cost efficiencies come at the cost of service quality. American prison expert Charles Logan summarises these quality issues concisely:

“Will privatisation increase the quality of imprisonment due to the innovations by private companies? Or will commercial companies cut corners to save costs and thereby lower quality?”

What are the advantages and disadvantages of government control versus competition as a quality control mechanism? Can the advantages of competition be obtained without involvement of the private sector? How can the contracting process be used to specify and clarify standards?”⁷

These are legitimate and important questions to raise because good contracts will deliver good outcomes, while poor contracting will deliver poor outcomes.

Australia's experience of privately operated prisons has been almost uniformly positive, delivering improvements in the quality of prison services, alongside reductions in cost.

⁶ Volokh, A (2002) A Tale of Two Systems: Cost, Quality, and Accountability in Private Prisons, Harvard Law Review.

⁷ Logan, C. (1990) Private Prisons: Cons and Pros, Oxford University Press, p39.

Accountability is the principal driver for the substantially better results under private operation.

All of Australia's privately operated prisons operate under service contracts which see the public sector specify the minimum service and performance levels, with the private sector then competing based on who can provide the best services, at the most efficient cost.

This accountability to agreed service standards, backed by substantial financial sanctions for partial or non-performance, provides a level of direct accountability that is not possible under traditional public service delivery models. Of course, the use of private contractors also removes the inherent conflict of interest that arises when the public sector is purchaser, provider and regulator.

In WA, accountability is maintained through the independent Office of the Inspector of Custodial Services, which provides a sound and contemporary example of the additional controls that can be exercised through a contracted provision of prison services.

The initial private operator of WA's Acacia Prison experienced a range of challenges in meeting the conditions of the contract. In response, the state then offered Acacia to the market, discharging the initial operator and securing a new operator on behalf of the state. Following a subsequent inspection, the WA Inspector of Custodial Services observed:

*"the Inspector's view that privatisation of prisons...can be beneficial as long as they are made properly accountable....can now ...be seen to be fully vindicated."*⁸

The ability to fine or discharge the operator in the case of underperformance creates a strong incentive for quality standards to be met – an incentive not available through traditional public sector delivery. The former NSW Commissioner of Corrective Services noted the additional accountabilities available under sound contracts when he observed:

*"If a private operator had to run their prisons the same way as some of the public prisons have been operating in the past, they would almost certainly have been put out for re-tender."*⁹

Opponents sometimes argue that the profit motive serves to reduce the quality or humanity of prison services in privately operated prisons. It is hard to understand this contention within an Australian context, given that private prison operators face substantial penalties or termination when services fall below what is required.

This risk is therefore easily dealt with through a proper specification of standards within a given contract.

Indeed, the UK Government has used contestable supply of prison services as a key aspect of its 'Decency Agenda', with privately operated prisons allowing prisoners more time out of their cell, or other improvements to make the prison system more humane. This has provided positive flow-on impacts in terms of prisoner rehabilitation and overall performance of the corrections system.

⁸ Harding, R (2008) Privatisation comes full circle in Western Australia: improved performance at Acacia, Media Release from the Office of the Inspector of Custodial Services.

⁹ Woodham, R (2009) *Inquiry into Prisons and Prison-related Services*, Corrected Proof

<[https://www.parliament.nsw.gov.au/prod/parliament/committee.nsf/0/d402a297b07708cfca257569000c6db1/\\$FILE/090223%20Corrected%20proof.pdf](https://www.parliament.nsw.gov.au/prod/parliament/committee.nsf/0/d402a297b07708cfca257569000c6db1/$FILE/090223%20Corrected%20proof.pdf)>

Indeed, as a 2002 Harvard Law Review article noted,

“no rigorous study found that quality at private prisons [is] lower than quality at public prisons on average, and most find [that] private prisons [outscore] public prisons on most quality indicators.”¹⁰

INCENTIVES MATTER

The benefits of private delivery of prison services (and public services more broadly) are largely due to the additional and different drivers private providers face when compared to public providers, increasing the incentive to deliver on performance and efficiency objectives. These drivers include:

- ✓ The contested cost and quality competition between contractors to win the contract;
- ✓ The discipline on each provider to retain a good corporate reputation, to win other contracts;
- ✓ Regular measurement of service quality and delivery against contract KPIs;
- ✓ Financial sanctions for non-performance; and
- ✓ The threat of contract termination for sustained non-performance.

One of the most substantial opportunities available through greater contestable supply of WA’s prison services will be the opportunity to expose a private provider’s profit to the fundamental objectives of the justice system.

Incentives matter in outsourcing – and Western Australia will need to carefully consider the outcomes and contract structures which best achieve the State’s fundamental aims.

For example, if the sole outcome sought was a reduction in the monetary cost of the prison system, it could create perverse outcomes, such as prisoners being confined for large portions of the day to reduce staff costs, or see a reduction in diversion and education programmes or other things. While this may reduce the direct cost per prisoner, it would likely increase the wider costs to society and public sector – and would obviously fail to meet the community’s reasonable expectations that Australian correctional systems be humane and decent.

For this reason, we submit that Western Australia’s reforms to prison services should seek to create a strong range of incentives that support the fundamental aims of the prison system – the rehabilitation of prisoners.

Decreasing recidivism reduces the demand for correctional services, and therefore alleviates pressure to build additional prison capacity. Additionally, reducing the reoffending rate of released prisoners benefits the community through increased security and safety, and through the wider contribution of rehabilitated convicts to the economy and society.

The overall efficiency of the prison system can be improved where private sector providers can derive profits through the delivery of programmes and facilities designed to reduce the in-flow of

¹⁰ Volokh, A (2002) A Tale of Two Systems: Cost, Quality, and Accountability in Private Prisons, Harvard Law Review.

inmates. Conversely, the prison system will achieve poor efficiency outcomes where providers' revenue grows as the number of inmates increases.

Firstly, the costs of incarceration are significant. As stated above, the average cost per prisoner per day in WA is \$342. On top of this there are costs associated with the use of police resources to investigate, arrest and charge suspects, and there are further costs incurred in the courts whereby the taxpayers fund judges, defendants' legal representation, and additional legal and administrative personnel to operate the courts system. The Productivity Commission found that in 2009 judicial services cost Australian governments more than \$10.7 billion. On top of these costs sits the economic cost of crime to society.

There are examples from around the world of key performance indicators in prison services contracts targeting recidivism rates. This reflects the growing recognition that, over the long-term, investment in reducing crime will have a greater economic and social impact than paying to keep offenders in custody.¹¹

By government designing the correct incentive structures in the contracts with private prison operators, the private operators are incentivised to innovate, and ultimately improve outcomes for prisons, prisoners, the judicial system and society more broadly.

The following case studies seek to demonstrate the importance of well-designed incentives in prison services contracts – with a particular focus on recidivism. They each illustrate a different approach to private participation in prison services, with innovations in delivery.

The first case study on United States prisons outsourcing, provides a cautionary note to this submission, showing the consequences of structuring a system with perverse incentives.

The subsequent case studies, on recent innovations in the Australian, New Zealand and United Kingdom prison systems, show that appropriately structured incentives can encourage providers to improve performance and more efficiently deliver the objectives of the prison system.

LIMITING PERVERSE INCENTIVES: THE US PRIVATE PRISON SYSTEM

There is substantial evidence that shows that private prison operators in the US deliver correctional services at a lower cost than the public sector; but the system provides no incentive to rehabilitate prisoners.

In 1984, prison overcrowding and rising costs saw private companies begin to construct privately owned prisons to provide additional capacity. In 2013 the proportion of US inmates incarcerated in private prisons had grown to circa 8.4 per cent.

The US approach sees these private operators receive a fixed payment per prisoner incarcerated per day.

¹¹ It is noted in the Issues Paper that prisoner rehabilitation is an explicit objective of the WA prison system and one that is within the control of the provider – alongside incapacitation.

Far from providing an incentive to rehabilitate prisoners through drug, mental health, education or other treatment programmes, each private prison relies on a headcount of prisoners to drive revenue.

With more prisoners equalling more revenue, it appears unlikely that this approach creates a strong incentive to seek meaningful rehabilitation. Indeed, any meaningful focus on rehabilitation would be irrational for the operators, because it would directly risk their own source of revenue.

While private prisons in the United States have delivered lower costs in terms of housing individual prisoners, the policy settings do little to reduce wider societal costs of crime and the corrections system.

Understanding how private operators respond to incentives provide important lessons for policymakers on the structure of the prison system – and the structure of service contracts.

The following case studies provide examples of how incentives can be structured so that the objectives of the private provider and the public sector align. By investing in programmes and facilities that promote effective rehabilitation, taxpayer value for money is improved over the long-term.

TOWARDS FIRST PRINCIPLES: VICTORIA'S RAVENHALL PRISON PPP

The Ravenhall Prison Public Private Partnership (PPP) provides a strong contemporary example of an Australian prison procurement which is seeking far more from the private operator. This project sees the State seeking to align the private sector's incentive for profit with the first principles sought by the public sector in corrections – the rehabilitation of prisoners.

The Ravenhall Prison site is located in West Melbourne and, when operational, will house 1000 inmates, with the space to expand to house an additional 300 inmates.

Ravenhall requires the operator to achieve a 12 per cent reduction in reoffending rates, compared to the average across Victoria's public sector prisons. This output requirement provides the consortium with total freedom to innovate to achieve the reduction, with the State's role limited to measuring performance.

With a potential annual reward of circa \$3.6 million available (circa two per cent of the annual \$180 million availability payment), the Ravenhall PPP is designed to incentivise innovation and experimentation in prisoner care, including diversionary and rehabilitative programmes. Indeed, Ravenhall will include a dedicated 75 bed forensic mental health unit, in recognition of the statistically high proportion of prisoners with mental health problems.

The contract for Ravenhall has only recently been let, with the prison now under construction, meaning that there is not yet an opportunity to assess and measure actual performance in terms of improved recidivism rates. However, the most recent ABS figures show that more than half of

Victoria's prison population are repeat offenders,¹² making the Ravenhall project an important 'pathfinder' in seeking new options to reduce the cost, impact and frequency of crime.

TOWARDS FIRST PRINCIPLES: WIRI PRISON FULL SERVICE PPP, NZ

Victoria's Ravenhall prison was itself inspired by the recent procurement of the new prison at Wiri in South Auckland, New Zealand.

This procurement saw the NZ Government provide an output specification, detailing the outcomes sought from the prison (including a measurable reduction in recidivism) – together with an Affordability Threshold, providing guidance of the costs that the public sector was willing to pay.

The contractor, SecureFuture consortium, won the \$860 million contract which represents a 17 per cent discount compared to if the prison was procured through conventional means. The project will see the contractor design, build, finance, maintain and operate the new 940 bed male prison. Construction is estimated for completion in mid-2015, with an operating concession term of 25 years.

The contract is based around a performance regime to deliver effective and efficient correctional services. In this way, the contract incentivises the contractor to ensure the prison is fully available on a continuous basis, deliver enhanced reasoning and rehabilitation (R&R) outcomes, and perform at the level specified in the contract. The contract provides 'carrots' and sticks' with financial and other positive incentives for good performance, and financial and other sanctions for part or non-performance.

The contract sees additional incentive payments to the consortium where it exceeds targets, with the size of the incentive payment determined by the relative scale of improvement.

For instance, if SecureFuture can reduce the re-offending rate of Qualifying Prisoners (that is, prisoners that meet a certain criteria, such as minimum sentence of three months) by 10 per cent compared to those incarcerated in publicly-run facilities, a bonus payment of \$500,000 is paid to the contractor on an annual basis.

This payment incentive increases to \$1.5 million if a 15 per cent reduction can be achieved. This payment model incentivises continual improvement, innovation and investment over the long-term. Specific payments in the regime are focused on reducing the rate of Māori prisoners reoffending.

The contract also provides for penalties where the contractor fails to achieve a range of minimum standards in terms of agreed custodial, rehabilitation and reintegration levels.

¹² Australian Bureau of Statistics, *4517.0 - Prisoners in Australia, 2014* <
<http://www.abs.gov.au/ausstats/abs@.nsf/Lookup/by%20Subject/4517.0~2014~Main%20Features~Prisoner%20characteristics,%20states%20and%20territories~10000>>

Additional penalties apply in the event of serious failures in security, prisoner safety, or in the case of escapes, deaths or injuries. These negative incentives are uncapped, providing a very clear link between the contractor's profitability and the minimum standards of decency, humanity and community and prisoner safety. Custodial KPI payment deductions are also applied from the first transgression, with deductions increasing significantly for repeat breaches.

To meet R&R targets, the consortium will deliver programmes that address specific causes and types of offending, as well as education and job training and promoting links with family and the wider community.

The prison itself reflects these incentives, with a design that supports prisoners to develop additional social skills and better understand their responsibilities in society. The prison includes innovations like in-cell kiosks which will provide prisoners with the opportunity to learn and to maintain family contact. Technologies will also allow management to better understand an inmate's progress.

'Through-the-gate' support, whereby prisoners are assisted during their reintegration into the community will also be implemented, together with supporting volunteer programmes.

A Community Liaison Office will provide alcohol and drug relapse support, money management, debt counselling and work placement programmes. These tailored programmes are designed to assist former prisoners to reintegrate effectively into society, in turn reducing the prisoner's incentive to commit further crimes.

As with Ravenhall Prison which followed, Wiri seeks to structure incentives and rewards on the private operators to reflect the first principles sought from the corrections system; to improve the decency of prisoner treatment and provide better rehabilitation outcomes – all at better value for money.

Social Impact Bonds are another example of an innovative approach to purchasing service outcomes that aligns the interests of the public sector and private sector providers and investors.

PETERBOROUGH PRISON SOCIAL IMPACT BOND, UK

Social Impact Bonds (SIB) are another example of an incentive structure designed to align private and public good outcomes. SIBs, also known as Social Benefit Bonds, are *"a new financial instrument in which private investors provide up-front funding to service providers to deliver improved social outcomes. If these outcomes are delivered, there are cost savings to government that can be used to pay back the up-front funding as well as provide a return on that investment."*¹³

An SIB sees the government enter into a contract with an intermediary and social services provider. Under the contract terms, the intermediary organisation provides funds to the social service provider to enable them to deliver innovative programmes designed to improve social outcomes for a target group in the community. If the agreed outcomes are achieved, the government pays the

¹³ NSW Government <http://www.treasury.nsw.gov.au/site_plan/social_benefit_bonds>

intermediary organisation their principal investment plus the additional return on investment, which is a function of the improved outcomes achieved.

The UK's Peterborough Social Impact Bond was launched in 2010 and is designed to reduce the reoffending rate of 3000 short-term prisoners (people incarcerated for less than 12 months) at Her Majesty's Prison Peterborough, over a seven-year period. The 3000 inmates have been split into three cohorts based on time, with each cohort containing around 1000 inmates. Support services are provided both inside prison and post-release, and ultimately aim to facilitate inmate's successful reintegration into the community.

Under the Peterborough SIB contract, return on investment is a function of the reduced recidivism rate. Investors would receive an early payout with a 2.5 per cent return on their principal investment if recidivism could be reduced by 10 per cent for any three of the cohorts, or 7.5 per cent across the cohorts combined. The rate of return increases as the reduction in reoffending beyond this target grows, with a cap of 13 per cent annual internal rate of return.

Determination of programme performance is made by comparing Peterborough SIB results against a benchmark figure, which is a national comparison group with characteristics comparable to the Peterborough short-term prison population.

The first assessment showed that recidivism fell by 8.4 per cent. While this fell short of the 10 per cent KPI which triggered an early payout, it nonetheless shows a substantial improvement on the benchmark.

While the third cohort of the Peterborough SIB was cancelled in 2014 by the UK Government, the programme remains on target for a 2.5 per cent minimum payout if it maintains the reduced recidivism rates for the second cohort. The Peterborough SIB demonstrates the utility of approaches which seek to align public and private incentives toward complex social service delivery.

Based on the positive Peterborough experience, the UK is now undertaking a major policy reform that will fundamentally change the delivery of prison services. The SIB programme is being transformed into a national rehabilitation programme under the Ministry of Justice, called 'Transforming Rehabilitation'.

The new programme remains measurement and results-oriented, similar to the Peterborough SIB, but it will be structured in a way that resembles performance-based contracting. The Transforming Rehabilitation programme will reach 50 times more prisoners than the Peterborough SIB and have an annual budget 30 times larger than the maximum payable on the third cohort of the Peterborough SIB.

The Transforming Rehabilitation model will be based on incentive contracts, with similarities to the performance contracts within the Ravenhall and Wiri PPP contracts.

An SIB programme is currently being delivered in Australia, and while not targeted at prison-related services, it provides another example of a tiered repayment system where returns for investors

depend on service outcomes. It also shows that governments here in Australia are experimenting with the way they purchase service outcomes.

NEWPIN SOCIAL BENEFIT BOND, NSW

As with the Peterborough experiment in the United Kingdom, Australia's governments and investors are beginning to pilot new programmes to improve the quality and reduce the costs of public services, through a focus on first principle outcomes.

Australia's first issue of social impact bonds raised \$7 million from investors to support UnitingCare Burnside. The investment expands on existing programmes which seek to safely reunite children to troubled families, or ideally, to intervene before children are removed from their families.

Under the Newpin SIB scheme, if the restoration rate of children with families reaches 60 per cent then investors are paid their full principal on maturity plus an additional 7.5 per cent return on their investment. This rate of return increases to 12 per cent if the restoration rate reaches 65 per cent (the target rate), and up to 15 per cent if the restoration rate reaches 70 per cent. This tiered payment scheme encourages continual improvement, with higher returns for better service outcomes.

Every time a child in foster care is restored to their family, the NSW Government saves more than \$40,000 a year, demonstrating the significant financial case for the programme.¹⁴ There is also substantial evidence that shows that long-term outcomes for children are substantially better, if they are able to be safely returned to their family, rather than care.

While Newpin is not prison related, it demonstrates the growing appetite from private investors and policymakers to seek better outcomes by exposing equity investment to the first principles sought from social services.

CONCLUSION

Infrastructure Partnerships Australia thanks the ERA for the opportunity to submit on this important public policy issue.

IPA submits that progressive experimentation and reform offers the opportunity for Australian jurisdictions to evolve traditional input based public services markets toward competitive, contestable and outcome based models – offering better outcomes for the community, clients and taxpayers alike.

¹⁴ The Australian Financial Review, 18 November 2014

<http://www.afr.com/p/special_reports/bonds/sbb_makes_sense_for_both_families_VXu44w2muPFGBcz5QA
RNNK>

By focusing on outcomes and better incentivising providers to meet the real objectives sought by the public sector, reform models like those outlined in this submission appear to provide a meaningful opportunity to improve the financial sustainability of public fiscal settings and improve services to the community.

A uniting benefit on outcome based contracting models, whether through PPPs, competitive outsourcing or SIB type models, is the reliance on empirical data measuring actual performance. In this way, the use of a mixed market of public and private providers in areas like corrections offers the opportunity to improve the effectiveness and efficiency of social service delivery in Australia.

This measurement of outcomes and use of positive and negative financial and contractual incentives allows for continuous improvement and experimentation to discover the optimal mix between private equity and debt, and the requirements of the public sector.

While reform along the lines contemplated in this paper is likely to be contentious in some sections of the community – and strongly opposed by public sector unions – there is little doubt that reform to service delivery and the use of a range of providers offers the opportunity to substantially increase transparency across public service delivery – and enhance the level of control by the government sector.