

Privatizing



In 2010, Americans are far more likely to interact with private security officers than with regular police officers. Indeed, by our count, members of traditional police forces now represent just one-quarter of the combined public and private security forces. And for reasons all too familiar to economists, police forces, like other monopolies, are hobbled by high costs.

Arguably more important, though, the men and women in blue have been slow to innovate. Over the past 20 years, the threat from sophisticated economic crime – Internet and credit card

REUTERS/MARIO ANZUONI

the Police

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fraud, identity theft, brand-name counterfeiting, intellectual property theft – has drastically increased. But the public police, lacking both adequate training and organizational flexibility, have been forced to cede most of the task of coping with these crimes to specialized private security forces. Meanwhile, states and localities in fiscal trouble have been outsourcing traditional police services like guarding prisoners and property to cheaper, less credentialed private sector workers.

Where will this end? Current trends suggest that, sooner rather than later, public police will



largely be confined to handling violent crime and major threats to public order. The societal consequences are harder to predict, but could prove to be profound.

THE CHANGING NATURE OF SECURITY

In the 1970s, there were roughly seven public law enforcement officers for every five private security officers. By the 1990s, the ratio was just one public cop for every three private ones. One benign reason is that the sorts of crime that can't be easily outsourced have fallen sharply. Familiar crimes against property are down by at least one-quarter since the early 1990s, while robbery and murder are down by half.

The public police are still responding to record levels of 911 calls. But that is a reflection of the inefficiency of the system, not the level

of the threat; somewhere between 94 and 99 percent of burglar alarm calls are false alarms of one sort or another.

Terrorism increasingly fills the vacuum created by falling crime rates. New York City has a special 1,000-member unit dedicated to combating it. Long Beach, Calif., the home of one of America's busiest seaports, has similarly diverted 1,000 officers to terrorism. But in smaller cities and suburbs, where most Americans live and work, it is hard to make the case that homeland security is a legitimate diversion for police efforts.

Meanwhile, changes in the cultural and physical environment have also affected the relative demand for private police. Constrained by government budgets, the number of public police officers has remained almost constant in the last decade. And this has meant that the demand for security in quasi-public places like shopping malls, gated housing developments and hospitals, which seems to be quite elastic with respect to consumers'

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income, has increasingly been met with private services.

Courts and legislatures have played a role here, too, by broadening the scope of responsibility of business owners for the public's safety. The attacks of Sept. 11 led to tighter security requirements for chemical, nuclear, water and transportation facilities. And the accumulation of private safety mandates was well under way before 9/11.

The Clery Act of 1990, for example, requires institutions of higher learning that take federal money to record and disclose crimes near their campuses. Many universities and hospitals responded by establishing their own police forces. Our school, Temple University, has more than 100 sworn and armed officers – making it one of the largest police departments in Pennsylvania. Massachusetts General Hospital in Boston employs 350 officers and 4 investigators with full police powers.

More generally, the view that government should shed services with marginal social value, like police response to burglar alarms, has increased demand for private security. More than 30 communities have adopted “verified response” policies under which private security firms must confirm an actual or attempted break-in before police respond.

Now add the impact of relatively new categories of nonviolent crime. Complaints of identity theft – a crime that is typically beyond the expertise of public police forces – grew tenfold from 2000 to 2008. And much the same goes for a host of other white collar crimes – many of them an outgrowth of the digital revolution – that require specialized personnel to investigate.

THE VULNERABILITY OF PUBLIC POLICE MONOPOLIES

In many ways, public police departments be-

have like a typical monopoly, charging high prices for services with inelastic demand, dividing the surplus among stakeholders (here, mostly employees) and resisting pressures to innovate. Like other monopolies, police departments are largely unaccountable to their customers and make little effort to measure or disclose their performance.

Private guard services, by contrast, do not enjoy the benefits of monopoly, and, not surprisingly, their employees' wages are just half those of their public counterparts. But in most cases, the quality of the service doesn't suffer: patrolling malls, responding to false alarms and the like do not generally require the expertise of sworn officers.

Predictably, then, cash-strapped government agencies are turning to private services when they can. Private armed officers guard the transit systems of Miami and St. Louis. Private armed guards earning \$34,000 a year are being substituted in Hernando County, Fla., for sheriff's deputies earning about twice as much. The Southfield, Mich., Police Department cut the cost of processing newly arrested prisoners in half by hiring the Wackenhut Corporation to do the job.

Private services have major advantages over public forces at the high end, too. For one thing, police departments can't offer the six-figure salaries needed to attract the sorts of forensic accountants who can match wits with the brightest white-collar criminals. For another, a public department can't offer the discretion that corporations value in investigating fraud and other white collar crimes.

The lack of responsiveness on the part of the police to constituents' special needs, particularly in large cities, often leads to outsourcing. For example, Chicago created special service zones where businesses pay additional taxes for private armed patrol officers to maintain order. The city wants to

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expand their authority, allowing them, among other activities, to cite motorists for some traffic violations. Los Angeles has some 30 business improvement districts that serve the same end. And they seem to work well: the Rand Corporation found that violent crime had decreased on average 8 percent more in these districts than in the rest of Los Angeles. (The study also concluded that crime was not pushed into neighboring districts that lacked private patrols.)

Cost isn't the only reason that public policing is losing ground; the police have been slow to incorporate new deterrence strategies. For example, merchants in San Francisco pay private patrols to disperse loitering crowds in front of stores, while the public police simply react to crime that has already occurred.

Monopolistic public police are slower – sometimes, painfully slower – to adopt technology than the competitive private police. For example, even in 2010, many police detectives in Philadelphia lack voice mail. And, in contrast to private security forces, few police departments have used video surveillance cameras to supplement patrols in busy walkways and streets. Temple University was using 632 cameras in 2009, more than the public police used in the entire city of Philadelphia. Consider, too, that private security forces now often employ smart digital cameras, which make it possible to search for and identify weapons and individuals.

Monopolies generally shun transparency, and the public police are no exception. Unlike the private sector, where disclosure rules of one sort or another usually offer a yardstick to measure performance, detailed and timely data on crime trends were not common until the CompStat management and reporting system was adopted by New York City (and then Baltimore) in the late 1990s.

Information is necessary but not sufficient to improve police accountability; there must be consequences to success or failure. Yet civil service rules preclude using bonuses and increments to salaries to reward performance. In the long run, police can use promotions to this end, but they are easier to use as incentives for low-ranking officers – the top of the job pyramid is too small. Further, civil service rules make it difficult to terminate officers for poor performance.

Private corporations, even those with market power, can go bankrupt. Indeed, they usually do if a lack of competition makes them complacent and inefficient. But inefficient police departments live on. And even when they are subject to political pressure to improve, they are often judged by criteria that do not reflect true societal benefits. For example, in order to increase arrest rates, police often pursue the easy cases – prostitution, gambling, underage drinking, marijuana possession – instead of the ones that matter most.

By contrast, private police are judged by how well they satisfy the desires of their clients, who usually have a clearer view of what is valuable. Accordingly, private police are less interested in arresting criminals than in deterring criminal behavior.

Private police also have the advantage of working in niches that are less constrained by civil liberties issues. Since they have only limited powers to arrest suspects, they aren't bound by Miranda notices. And since they typically operate on private property with the permission of the owner, they don't need search warrants to check employee lockers and e-mail, and to seek evidence of drug use.

INDUSTRY STRUCTURE

The private security industry is highly competitive. Both the investigative and patrol arms of the industry have top-four-firm



concentration rates (the combined market share of the four largest firms) below 40 percent, which is generally considered the boundary between competitive and oligopolistic markets. Using different data, a U.S. Congressional Research Service report found that in 2003 the top 10 firms generated 67 percent of the industry's revenues, while the remaining 33 percent was shared among some 5,000 regional enterprises.

Note, moreover, that there are very low barriers to entry into the patrol and guard service segments of the industry. Labor is drawn from a large pool of semi-skilled workers. No significant regulatory requirements and few economies of scale exist, limiting incumbents' market power. As a result, the industry is extremely dynamic. Akal Security, which began operations in 1980, was the fourth largest guard company by 2003, with 5 percent of the national market. The industry

leader, Securitas, experienced a reduction in market share from 24 percent in 2003 to 18 percent in 2008. There is substantial entry and exit in the industry. For example, in 1997, the turnover rate was almost 20 percent.

Another indicator of the degree of competition is the fact that price increases have lagged behind industry costs – and behind average costs of other labor-intensive service industries. From December 2004 to December 2008, overall costs increased by 9.2 percent while the price index for security services increased just 5.2 percent. Meanwhile, all services in the PPI rose 18.5 percent over the same period.

Not surprisingly, many security companies have sought the relatively safe harbor of niche markets, where demand is less elastic and providers enjoy some protection from entry. Securitas now focuses on investigations, security consulting and mobile patrol, along with

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specialized guarding of telecommunications, high-technology and banking facilities. Wackenhut guards 30 of the 104 nuclear plants in the United States. Others have specialized in niches ranging from executive protection to hospital security. But it should be emphasized that no submarket is really safe from competition; accordingly, industry leaders must run to stay in place.

Brand protection is an interesting niche, both because the need is so great and because it suggests how private security is forming symbiotic relationships with the public agencies. Louis Vuitton, Coach and Chanel contracted with Stumar Investigations to conduct an undercover investigation of merchants selling fake goods in Philadelphia because the city's police department wouldn't invest the resources.

The police generally put a low priority on such cases because of the high cost and the low level of public concern. Once the evidence has been collected by private investigators, however, the police do have an incentive to act because the cost of arrests is low, and there is positive publicity to be gained. In this case, the company eventually secured the cooperation of the Philadelphia police in raiding four stores and arresting their owners.

Public companies have additional incentives (beyond competence) to use private investigation. They are typically more interested in solving a problem than in punishing the perpetrator.

For example, hospitals are eager to avoid police involvement because of the high cost of enmeshing highly paid physicians and other medical personnel in court proceedings. When private security identifies wrongdoers, they are simply fired. Much the same is true for many white collar crimes: the victimized businesses generally put a higher priority in

minimizing bad publicity and executives' time than jailing the bad guys.

THE WAY FORWARD

In perspective, it's not surprising that so much of the growth in security services has taken place in the private sector. Americans have enjoyed a long downward trend in violent crimes that demand the attention of traditional police – and a long upward trend in the demand for the sorts of services that fall outside their purview. But in large measure, this switch toward private security is a symptom of the weakness of government in general (and government monopolies in particular) to hold down costs and to innovate in response to changing needs and technologies. Our best guess is that the future holds more of the same: narrowing of the services provided by public monopolies in the face of pressures to deliver a different mix of security services at lower prices.

That's largely good news because the transition promises significant savings. Since wages make up roughly two-thirds of police expenditures, the potential for reducing unit labor costs by about 30 percent through privatization should yield savings of about 20 cents on every taxpayer's dollar spent on police functions. Further, given the greater potential for managerial and technological innovation in the private sector, there is every hope for savings beyond those associated with reducing obvious waste.

Police departments will continue to shed tasks ranging from burglar alarm response to investigation of accidental property damage to animal control. (Watch for some pushback, though, as police departments fight to maintain their jobs by insisting they are indispensable in containing minor drug infractions, traffic violations, and vice crimes like gambling and underage drinking.)

But don't expect the transition to be as simple as watching markets do their thing. There will always be a need for the public sector police, and no bright line can be drawn between services that should be provided by the public monopoly and those that should be provided by private firms. Indeed, public police ought to be allowed to compete where private security services are plentiful, as long as they charge no less than their long-term average costs for services. (This restriction on pricing is necessary to avoid cross-subsidization in which police undercharge for compet-

security functions – is the impact on quality. And at first glance, it appears that privatization is a boon in this regard.

The private security market is highly competitive, and competitive firms are generally more responsive to the wishes of their customers than their counterparts with market power. So, private firms are more likely to deliver higher quality services and to innovate in the face of changing needs and technologies. By the same token, one could make the case that private security forces are less likely to abuse their authority because they aren't as insulated

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itive services and overcharge for services still within their monopoly.)

Now consider the reality that most police functions, including the ones that can be managed privately, generate considerable externalities. We're all better off living in a low-crime environment, even if the crime deterred would not have affected us directly. And in light of these externalities, we cannot expect free markets to determine the efficient level of police services. There must be collective judgment about the "optimal" rate of crime, in which the cost of deterrence at the margin is equilibrated with the social benefits.

Note, too, that, in contrast to business monopolies, local police departments lack the discretion (or the incentive) to operate at efficient scale. Public police departments are constrained by the size of their jurisdictions. And it will be difficult to manage consolidations that allow for economies of scale.

The biggest question here – the one that shadows any analysis of the privatization of

from accountability as police and public prison personnel, who are shielded from the consequences of misbehavior by civil service protection and, sometimes, unions.

But one need not turn to fictional dystopias like the one in the movie *Avatar* to see that the privatization of police functions does generate the potential for abuse. In Luzerne County, Pa., two local judges were recently found guilty of taking \$2.6 million in kickbacks to sentence juveniles to time in private detention centers. And there are no data to test whether private policing has proved a greater threat to civil liberties or the corruption of the courts.

What we do know is that in a world of tight public budgets and rapidly evolving security challenges, the trend toward privatization is almost inevitable. It will be up to public officials (and the media) to monitor the ongoing consequences and to keep a clear sense of the public's stake in the way the private security industry evolves. **M**