Policy Brief

LAO
50 years of service

Reforming the Prison Industry Authority

SUMMARY

Background

The Prison Industry Authority (PIA) was established in 1983 to improve enterprises employing prison inmates. As of July 1, 1995, the PIA operated 31 types of enterprises at 23 of the state's 31 prisons. It employed about 7,000 of the state's 131,000 inmates as well as 674 state staff in such varied product and service lines as license plates, dairies, meat cutting, optical goods, and specialty printing. Sales of PIA products and services, which are generally limited to public agencies, exceeded $152 million during 1994-95. The PIA reported a 1994-95 net income of nearly $10 million.

Findings

After a number of years of fiscal problems, the PIA has measurably improved its financial position. However, the improved bottom line—which does not reflect little-noticed subsidies the PIA receives from the state—has come in part at the expense of other legislative purposes for the authority. These include the reduction in the cost of prison operations and the rehabilitation of inmates. While the financial performance of the PIA itself has improved, the state has received a poor return on its more than $91 million contribution in buildings and equipment for the program. The PIA's progress has been significantly hampered by an ever-shifting and muddled mission, constraints on inmate productivity, governmental constraints such as the civil service system, and a weak internal governance structure.

Recommendations

In order to improve the PIA's effectiveness, we recommend that the Legislature:

- Resolve significant conflicts over the agency's mission by establishing two primary and complementary goals of (1) financial self-sufficiency and (2) achievement of a reduction in recidivism by improvement in inmate employability.
- Privatize the PIA as an independent, nonprofit, tax-exempt organization, free it of existing constraints so that it could become more entrepreneurial and create new forms of private-sector partnerships. The PIA would lose its monopoly on state government business and could make sales to the private sector under specified conditions.
- Focus a revamped PIA on providing job-training and other services aimed at preventing second-strike offenders from coming back to prison with 25-years-to-life third-strike sentences.

BACKGROUND

Goals and Structure of the PIA

Before the PIA was established, the state's prison work programs were overseen by the Correctional Industries Commission and directly administered by the California Department of Corrections (CDC). The commission was created in 1947. By 1981-82, the correctional industries program employed 2,300 inmates and generated about $26.7 million in sales.

By 1981, the Legislature concluded that the program had not achieved its objectives. According to the legislation which created the PIA (Ch 1549/82), state prison programs operating at the time

> . . . failed to provide productive jobs to prisoners, to meaningfully affect the cost of running the prison system, or to reduce the idleness and underemployment which are rampant in California's prisons . . . . The constraints of state government severely impede the ability of the prison industries program to operate on a self-supporting or profit-making basis.

Thus, the PIA was created to take over work programs from the Correctional Industries Commission, which was subsequently abolished. The Legislature stated at the time that

> . . . a successful prison industries program can best be accomplished by providing the management . . . with a reasonable degree of autonomy and by establishing a special authority to manage and operate prison industries and the funds associated with such programs.

Toward that end, the PIA was created as a semi-autonomous authority within the CDC. This autonomy included a separate fund (Prison Industries Revolving Fund) with a continuous budget appropriation not subject to annual legislative approval. Control of the budget was given to an 11-member Prison Industry Board.

The legislation's statement of intent and statutory provisions specify a series of goals and purposes for the PIA. The goals are shown in Figure 1.

The membership of the Prison Industry Board consists of the Director of the CDC (who is also designated as board chairman), the Director of the Department of General Services, the Secretary of the Trade and Commerce Agency, two public members appointed by the Speaker of the

Figure 1

PIA's Statutory Goals

- ✔ Profitability and, ultimately, financial self-sufficiency.
- ✔ A reduction in inmate idleness, prison violence, and tension.
- ✔ Development of skills and work habits to reduce inmate recidivism.
- ✔ A reduction in prison system and taxpayer costs.

Assembly, two public members appointed by the Senate Rules Committee, two labor representatives appointed by the Governor, and two industry representatives appointed by the Governor.

By law, the PIA General Manager is under contract to the board to serve as the chief administrator of the authority, but also serves at the pleasure of the board chairman, the CDC Director. The CDC Director is the appointing authority for all PIA staff except the General Manager, who is appointed by the board.

Products and Services of the PIA

The PIA operates a series of small- to mid-sized businesses engaged in varied product and service lines, as shown in Figure 2.

State law prohibits the direct sale of PIA products and services to the private sector in California. (Sales are permitted under state law to private parties in other countries, but have rarely occurred.) Nearly all sales are made to state and some local governmental agencies, and state law generally requires state agencies to maximize the

Figure 2

PIA Product Lines

✔ **Agriculture**

- Dairy
- Crops
- Poultry
- Egg production

✔ **Services**

- Meat cutting
- Bakery
- Coffee roasting
- Resource recovery
- Specialty printing
- Micrographics
- Dental lab
- Laundry
- Optical
- Key data entry

✔ **Manufacturing**

- Furniture assembly/refinishing
- Wood products
- Metal products
- Metal signs
- License plates
- General fabrication
- Bindery
- Paper products
- Fabric products
- Silk screening
- Fiberglass products
- Shoe factory
- Mattress factory
- Textile mill
- Cleaning products
- Reupholstery
- Concrete precast

purchase and use of PIA-made goods or services at prices set by the Prison Industry Board.

The CDC is by far the PIA's biggest customer, representing about 56 percent of sales during 1994-95 primarily for inmate clothing, prison furniture, laundry services, and agricultural produce used to feed inmates. The Health and Welfare Agency is the second largest purchaser of PIA goods (primarily eyeglasses for Medi-Cal patients), followed by the Department of Motor Vehicles (which buys license plates, signs, and special printing). Local agencies constitute less than a 3 percent share of PIA sales.

Impact of the PIA On the Prison System

The PIA is one of a number of work and education programs to which inmates may be assigned. It is by no means the largest, as can be seen in Figure 3.

By law, most of the 7,000 inmates who work in PIA enterprises are eligible to earn credits that reduce the time they must serve in prison. Many earn as much as one day off their sentence for each day they work for the PIA. Because of so-called "Truth in Sentencing" revisions in state law, including the "Three Strikes and You're Out" law enacted in 1994, some offenders convicted of certain violent and serious crimes and repeat offenders now may only be eligible for credits that would reduce their total time in prison by a maximum of 15 percent or 20 percent. Some offenders, including some with life terms or with disciplinary problems, are not eligible for work credits.

The work-credit program has two significant ramifications for the prison system.

First, by reducing the time some offenders stay in prison, the work-credit program potentially reduces CDC operational costs, which now average $21,375 per inmate, annually. (These savings are partly offset to the extent that offenders released earlier on parole are subsequently reincarcerated for new crimes or for violation of the terms of their parole.)

Second, by reducing the number of inmates housed in prisons, the work-credit program reduces the number of additional prison cells the state would otherwise have to build in the future. Because of severe overcrowding in prisons and steady growth in the prison population, the CDC projects that it will exhaust all space in the prison system in late 1998 and that several billions of dollars are needed for construction of additional prisons between now and the year 2005. Without the work-credit program, the CDC would exhaust the available space sooner and more prisons would have to be constructed. Current estimates are that a new prison complex to house 4,400 inmates—based on two inmates per cell—costs about $300 million.

Figure 3

Work and Education Programs in the Department of Corrections[a]

Program	Number of Assigned Inmates	Percentage of Inmate Population
Support Services	38,152	30.1%
Vocational Education	10,849	8.6
Academic Education	10,557	8.3
Prison Industry Authority	**6,923**	**5.5**
Conservation Camps	4,158	3.3
Other	789	0.6
Community Work Crews	401	0.3
Joint Venture	154	0.1
Total Assigned	71,983	56.7%
Total Prison Population	**126,866**	

[a] As of July 1995.

"Many . . . studies [have] highlighted strengths and weaknesses in the PIA and other findings which remain relevant today."

LAO Evaluation Of the PIA

The PIA is one of the most closely studied agencies in state government. In addition to the recently completed review of the authority by the Bureau of State Audits (BSA), the authority's operations have been scrutinized in recent years by MGT Consultants, a private management consultant retained by the PIA; the Little Hoover Commission; and the Senate Advisory Commission on Cost Control in State Government. Many of these studies highlighted strengths and weaknesses in the PIA and other findings which remain relevant today.

Our office has over the years reviewed the state's correctional work and education programs, including the PIA, and last year offered the Legislature several preliminary recommendations in regard to SB 617 (Polanco), still-pending legislation that would have changed the PIA's budgetary process and the statutory obligation of state agencies to purchase PIA goods.

In this report, we have evaluated the PIA's fiscal performance, its impact on the prison system, its inmate and non-inmate workforce, the authority's managerial performance, and the key factors which we believe have hampered the authority's effectiveness. Our findings are summarized in Figure 4 (next page) and discussed below.

"The overall improvement in the PIA's bottom line has allowed the authority to build up a substantial cash reserve."

Figure 4

LAO Findings

- ✔ The PIA's financial performance has improved significantly.
- ✔ The state has received little direct financial return from its investment in the PIA.
- ✔ The PIA's good financial performance has come at the expense of other state goals, such as lower state costs or rehabilitation of large numbers of inmates.
- ✔ The PIA is hampered by civil service restrictions, constraints on inmate productivity, and managerial weaknesses.

PIA's Financial Performance Has Improved

The PIA is posting record sales and reporting an operating profit, and has improved its underlying financial strength by building up a substantial cash reserve and paying down its debts. This financial turnaround reflects improved productivity within the PIA, greater purchases from state agencies due to the improved fiscal condition of state government, and continued growth in the inmate population housed by the CDC, the PIA's biggest customer.

Sales, Net Income Have Grown. The PIA's financial performance has been uneven over the years, but reached a historical high point in sales and net income in 1994-95, as shown in Figure 5. Sales of PIA products and services exceeded $152 million during that fiscal year and are currently projected to reach a new high of almost $156 million during 1995-96. After the cost of its goods and sales and administrative expenditures are deducted, the PIA reported a 1994-95 net income of nearly $10 million. In 1995-96, net income is expected to be about $5 million.

The PIA's strongest recent financial gains, by product line, have come in fabric products, wood products, its shoe factory, and the textile mill (although the mill has persistently run at a net loss, that loss is smaller than in the past). Enterprises which have recently become less profitable include license-plate manufacturing, meat cutting, the dairy operation, and cleaning product sales. Based on information provided by the PIA, the unique circumstances in an industry, rather than any more general trend, explain why certain enterprises are profitable and others are not.

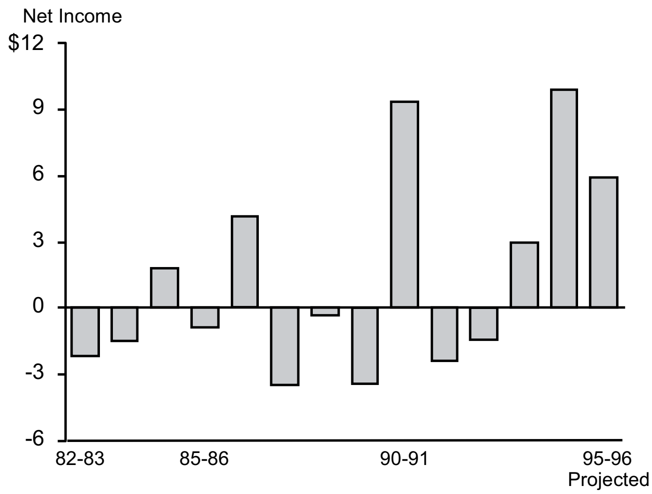
Underlying Financial Strength. The overall improvement in the PIA's bottom line has allowed the authority to build up a substantial cash reserve. As of June 30, 1995, the PIA had retained $30.3 million in cash, as shown in Figure 6. The cash total is projected to exceed $33 million by June 30, 1996. During the 1980s, the PIA's reported year-end cash balance never exceeded $6.1 million.

The cash buildup might have been even higher had not the PIA aggressively been paying down its long-term debts (primarily a 1985 loan from the General Fund). As of June 30, 1991, the PIA had $22 million in long-term

Figure 5

PIA Financial Performance Uneven But Improved

(In Millions)



"The recent stronger performance of the PIA has been fueled by major growth in the CDC prison population . . ."

debt on its books. Four years later, the authority's long-term liabilities stood only at $3.6 million. The decrease in debt reflects the PIA's February 1995 payment of $4.5 million of its outstanding General Fund debt ahead of schedule.

The improvement in cash reserves and the lower long-term debt, as shown in Figure 6, (next page) both have a positive impact on the PIA's annual reports of net income. The buildup in cash permits the PIA to avoid incurring new borrowing expenses that would reduce net income. The paydown in debt reduces the existing borrowing expenses and thus boosts the annual net income.

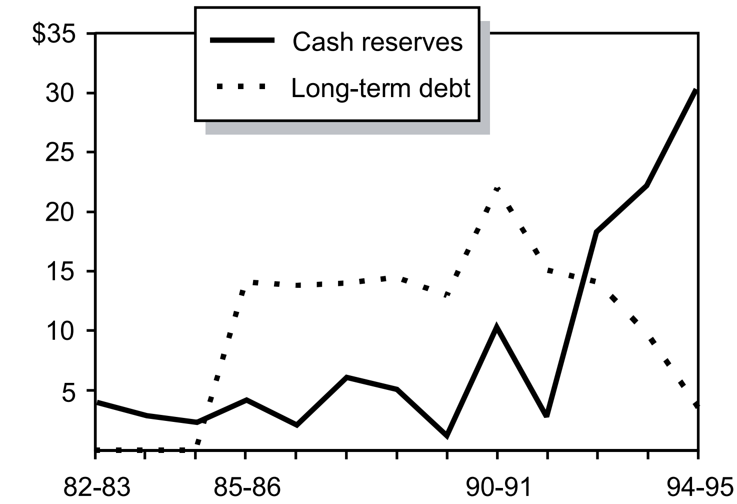
Reasons for the Turnaround. The PIA's past losses largely stemmed from start-up costs associated with the rapid and costly expansion of PIA industries in the mid-1980s, the PIA's mistaken investment in some failed enterprises, inefficiencies in the use of inmate labor, raw materials, and inventory management, and sour customer relations stemming from poor workmanship in PIA products.

The recent stronger performance of the PIA has been fueled by major growth in the CDC prison population, which tends to drive up purchases of PIA-made clothing and other goods purchased for inmates. The state's improved budgetary situation also may be stimulating purchases by other state agencies that were placed on hold or put off during several years of severe limits on governmental expenditures.

Figure 6

PIA Cash Reserves Growing And Long-Term Debt Shrinking

(In Millions)



" . . . the PIA's annual income statement does not fully reflect the costs to the state of operating the authority's programs."

Also, productivity in both the inmate and non-inmate segments of the PIA workforce has improved.

Little Direct Financial Return to the State From the PIA

The PIA's improved net income statement overstates its true financial performance because it does not reflect significant state subsidies for capital outlay, below-market rents, workers' compensation benefits for inmates, guarding costs, or the premium paid by some other state agencies required to purchase PIA goods. Thus, the original legislative goal of PIA self-sufficiency has not yet been fully achieved and the state does not appear to have received any significant direct financial return on its major investment in correctional industries.

State Operations Subsidies. Although the PIA paid $4 million to the CDC during 1994-95 to offset utilities, rent, and other costs incurred on its behalf by the department, some operational and capital outlay costs are, in actuality, absorbed by the CDC or within the budgets of other state agencies or budget items. Thus, the PIA's annual income statement does not fully reflect the costs to the state of operating the authority's programs. For example, the salaries of correctional officers who supervise inmates assigned to PIA enterprises are generally paid by the CDC without PIA reimbursement. Also, while the PIA picks up the cost of workers' compensation benefits for its civil service workforce, the CDC provides workers' compensation for the inmate workforce.

Another subsidy is the additional expense to state agencies given no recourse by present state law but to purchase PIA-made goods, sometimes of inferior quality, at as much as double the price in the private market. A recent audit by the BSA estimated that state agencies could save $12 million annually if they were free to make purchases from other sources instead of the PIA.

Capital Outlay Funding Subsidies. Many of the PIA's enterprises are housed in facilities constructed and equipped with a portion of the bond funds appropriated for the construction of new state prisons. When the PIA took over the operations of the now-abolished Correctional Industries Commission in 1983, the assets transferred to the PIA were valued on its balance sheet at $17.7 million. As of June 30, 1995, the CDC had directly contributed an additional $91 million in capital facilities, equipment, and other assistance to the PIA, not counting additional payments to retire the debt.

Further state contributions are anticipated. According to the CDC, $5.8 million worth of capital outlay and equipment are being provided for a PIA optical lab and a PIA laundry at a new women's prison, and $17 million has been earmarked for PIA enterprises at six new prisons now planned by the CDC.

Although the PIA has paid rent for its use of CDC facilities, often assessed at a rate of pennies per square foot, the nominal amounts received do not nearly offset the millions of dollars in annual borrowing costs of the lease-payment and general obligation bond funds spent to build and equip PIA facilities. We believe these continued capital subsidies of PIA operations are inconsistent with the statutory goal of self-sufficiency established for the authority in 1983.

Little Direct Financial Return to State. Our review has found that the state has received little direct financial return on its direct outlay for PIA buildings and equipment, even though the law creating the authority authorizes direct payments to the state of PIA funds deemed to be surplus.

We would note that, on several occasions since 1991, the state has received short-term interest-free loans from the PIA-controlled Prison Industries Revolving Fund in order to address the state's overall cash shortages. Last year, such borrowing had the effect of depriving the PIA of $700,000 in interest earnings it could otherwise have received from the Pooled Money Investment Account, the main fund in which the state invests its surplus cash. This amounts to a direct financial benefit paid to the state by the PIA, because it permitted the state to avoid costs of borrowing additional funds.

Aside from these interest-free borrowings, however, the state has gotten no other direct financial return on its $91 million investment to date in the PIA. Had the law permitted the state to invest the $91 million in the

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"... the PIA employs only about 5.5 percent of the overall inmate population ..."

Pooled Money Investment Account instead of the PIA, it could have earned a significant financial return exceeding $46 million. State law provides for the transfer of surplus PIA funds to the state General Fund, but the PIA reported that it has never executed such a transfer of funds since its creation.

Evaluating the PIA's Impact on the Prison System

The PIA's improved financial performance has come in part at the expense of other statutory purposes established for the authority, such as a reduction in the cost of prison operations and the rehabilitation of as many inmates as possible. This is primarily because the PIA's inmate workforce has remained static even as the overall prison population has grown rapidly.

A Murky Mission. As study after study has documented, the PIA has an ever-shifting and muddled mission, due primarily to the multiple and often conflicting missions set forth in the statute which created the authority.

For example, the PIA's focus on labor-intensive enterprises may respond to its stated mission of employing as many inmates as possible to reduce idleness, but it may be at odds with the goal of being as profitable as possible. Also, because the private sector has increasingly relied upon labor-saving high technology to provide products and services, an emphasis on labor-intensive enterprises may conflict with yet another stated mission—that the PIA provide job skills to inmates that will make them more readily employable upon their parole from prison.

As a result, the mission pursued by the PIA has varied over time from manager to manager. In the mid-1980s, the PIA attempted to maximize inmate employment, while more recently, the PIA has placed greater emphasis on productivity and improved customer satisfaction.

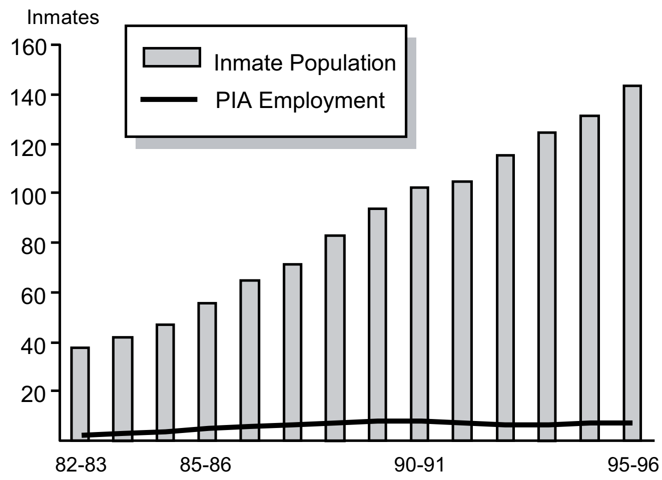
Impact on CDC Operations. This change in mission emphasis has had a major impact on CDC operations and expenditures. In the early 1980s, the PIA and the CDC agreed to a mutual goal by which 42 percent of the inmate assignments at newly built prisons would be filled by PIA enterprises. After a period of rapid growth, however, the CDC and the PIA abandoned the 42 percent goal and now have no set quota for PIA assignments in new prisons. At present, the PIA employs only about 5.5 percent of the overall inmate population, as Figure 7 shows, and steady inmate population growth could cause the figure to decline further in the future.

The CDC has partly filled this inmate-job gap by expanding the number of academic education, vocational education, and support services assignments. But inmate population growth has outstripped the growth in inmate assignments. After nearing what it defines to be full assignment of all eligible inmates in the early 1980s, the CDC reports that 15,000 inmates are

Figure 7

Prison Population Outpacing Growth In PIA Employment

(In Thousands)



". . . PIA's slow-growth strategy . . . makes it more difficult for the state to achieve potential cost-savings . . ."

now eligible to participate in work and education programs but are left idle for lack of assignments. The number of idle inmates is projected to reach 26,000 by June 2000, or the equivalent of six prisons full of inmates.

The lack of inmate assignments has the effect of driving CDC operational budgets higher. For example, if all of the presently idle inmates had work or education assignments, the reduction of prison time otherwise served by those 15,000 inmates might eventually save the state as much as $50 million per year in inmate support costs. The PIA's slow-growth strategy, by which it has chosen to provide no or only limited enterprises at new prisons, makes it more difficult for the state to achieve these potential cost-savings in the budget for CDC operations.

In addition, the slow-growth strategy, and the state's lack of inmate assignments, has ramifications for the state's prison construction budget. Because idle inmates are not earning full work credits that would reduce the time they stay in prison, a lack of assignments results in a need for additional prison space for thousands of inmates. If all eligible inmates had work or education assignments, the state might be able to reduce the need to construct some prisons in the future.

Recidivism Impact Unknown. Academic studies of correctional work programs operated by the federal government and by other states have shown that effective inmate work programs can significantly reduce the rate at which inmates who are paroled return to prison for new crimes.

*❝. . . it appears unlikely that the PIA has had a significant impact on the **overall** recidivism rate of the prison system.❞*

It is unclear, however, what impact PIA enterprises are having on the rate of recidivism of the inmates assigned to the authority. Neither the PIA nor the CDC could provide any data regarding the recidivism rate of PIA workers (nor for inmates participating in the other prison work and education programs). Nor has any data been collected to show whether certain PIA enterprises are more effective than others in making inmates more employable, thereby preventing their return to a life of crime.

However, it appears unlikely that the PIA has had a significant impact on the *overall* recidivism rate of the prison system. That is because only a small fraction of the 110,000 inmates released to parole each year have ever worked for the PIA.

The enactment of Three Strikes makes recidivism of certain inmates potentially much more costly to the state prison system. Specifically, any second-strike offender who is paroled and then commits a new crime would be at significant risk of being reincarcerated as a third-strike offender with a sentence of 25 years to life. A typical third-strike offender would, over the period of his or her incarceration, result in an operational cost of at least $428,000 to the state prison system, plus the $124,000 needed on average to build a prison cell for such a high-security offender.

Several Factors Are Hampering the PIA

Our evaluation of PIA operations has identified several key factors that have hampered the authority's enterprises. These include existing civil service restrictions, constraints on inmate productivity, and managerial weaknesses within the PIA.

Civil Service Rules and Other State Regulations. The legislation which created the PIA expressed the intent that the authority operate much like a private business and contained specific statutory provisions to free the authority from the existing procedural requirements of the civil service system. However, in late 1982, before the PIA commenced operations, the State Personnel Board asserted that the PIA statute was superseded by civil service requirements provided in the California Constitution. The PIA thereafter agreed to submit various personnel decisions to the Department of Personnel Administration and to the board, and has continued to do so today.

As a result, the PIA finds itself today bound by civil service rules and with significant limits upon its ability to act as an entrepreneur. The constraints imposed by civil service conflict with the PIA's efforts to become more like a private business, limiting its ability to hire, fire, and reassign staff with the skills it needs in a rapidly changing business environment. It is also frustrating efforts to implement a pay-for-performance salary structure. The BSA has estimated that some civil service workers at the PIA earn 30 percent more than their private-sector counterparts.

The state's complex procurement process has placed similar constraints on the PIA's ability to purchase raw materials needed for its production lines in a timely and cost-effective fashion. In general, these state procurement processes require that the PIA route purchase orders through the state Department of General Services, a practice that can take three to nine months to accomplish.

Constraints on Inmate Productivity. The PIA does not fully control its selection of inmate workers, but generally must accept the selections made by internal CDC committees and security personnel at each prison. Although the PIA does establish academic and work experience requirements for many of its positions, the CDC can and often does override these requirements for security and for other reasons. Neither the PIA nor the CDC has established criteria which formally link the length of stay of an inmate to their eligibility for a PIA assignment. The high turnover rate in the PIA workforce (145 percent per year) suggests that many inmates with little time left to serve in prison are being assigned to the PIA, then paroling soon after the PIA invests in their training and before they have put their newfound skills to work for PIA enterprises. Because the PIA may have to accept unskilled or inadequately educated workers, and quickly loses skilled workers, these arrangements reduce PIA productivity.

There are other problems. The assigned PIA workforce often lacks necessary education and training, good work habits, and motivation. Also, lockdowns resulting from prison violence significantly interfere with PIA production deadlines. During 1994-95, the PIA lost out on 1.3 million hours in inmate labor due to lockdowns and other causes, or about 14 percent of its total production schedule. That equates to about $18.4 million per year in lost sales production, and constitutes a major setback to the PIA goal of profitability.

Managerial Weaknesses. Since its creation, PIA management has made some progress toward becoming more business-like and customer-oriented. The PIA management has implemented results-oriented Total Quality Management (TQM) programs, installed computerized systems to better track product costs, established a program to shorten delivery times for some products, and bolstered its marketing and market research teams.

But the PIA has been hampered by a statutorily mandated structure that divides the lines of authority, thereby undermining accountability. In addition, despite the presence of the Prison Industry Board, internal governance

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> “The weak organizational structure of the PIA has led to poor internal management of its enterprises.”

has been weak and lacks the necessary checks and balances for a $152 million per year enterprise. Finally, there has been relatively little ongoing legislative review of the PIA given its continuous appropriation of funding support that exempts the authority from the annual state budget process.

- ***Divided Line of Authority.*** By law, the PIA General Manager serves under contract to the Prison Industry Board. However, the same statute says the General Manager also serves at the pleasure of the Director of the CDC, theoretically giving the Director veto power over the decisions of all other board members when it comes to administrative control of the PIA. Existing law likewise provides that the CDC Director, not the board or the General Manager, is the appointing authority for the PIA staff, again raising the question as to who is in charge at the PIA.
- ***Weak Internal Governance.*** The board is made up of part-time unsalaried appointees who meet infrequently (by law, at least four times yearly) to conduct PIA business. Board members lack the resources to conduct in-depth analyses and evaluation of PIA budgets and operations, and many contracts and other business decisions relating to the daily operation of the PIA are never presented to the board for approval.
- ***Limited Legislative Review.*** Because of the PIA's continuous appropriation of funding support, agency revenues and expenditures have rarely been reviewed by the Legislature.

The weak organizational structure of the PIA has led to poor internal management of its enterprises. As the BSA recently documented, the PIA has found itself burdened with far more products than it can successfully handle, excessive levels of inventory and warehouse space, an inadequate system to control product costs, and a significant number of money-losing enterprises.

The PIA is now a larger operation than many other state agencies subject to much tighter legislative scrutiny and direct legislative control. We are concerned that the PIA lacks proper checks and balances to ensure that its resources are well-spent and that the agency is held accountable to its statutory mandate.

LAO Recommendations

A Changing Environment

The prison, governmental, and economic environment in which the PIA must operate has changed significantly since its inception. The size of the prison system has more than quadrupled since 1983 primarily as a result of tougher sentencing laws. State government has moved from an era of double-digit annual revenue increases to a period of significant fiscal constraints. Meanwhile, the California economy has evolved away from manufacturing toward a more diverse services-based economy. Although the PIA has made some administrative shifts in its mode of operation over time in response to these changes, the basic statutory framework for the authority has not changed significantly since it was established. We believe some changes in that framework are now warranted that will address some of the authority's problems and improve its effectiveness.

We concur with many of the findings and recommendations recently offered to the Legislature by the BSA for reform of the PIA, and in particular its suggestions for improving internal management and accounting of PIA enterprises. However, we have a somewhat different approach to offer in our set of recommendations, particularly in regard to the mission and organizational structure for the PIA.

The LAO Proposal

The Florida Model. The LAO proposal for the reform of the PIA is patterned after PRIDE (which stands for Prison Rehabilitative Industries and Diversified Enterprises, Inc.) of Florida, a nonprofit, self-funded corporation created in 1981 by the State of Florida to operate its prison work programs. In our view, PRIDE serves as a model for achievement of the dual missions we recommend be established for the PIA—greater financial self-sufficiency and a reduction in recidivism by making inmates more employable.

Our review of the Florida model indicates that PRIDE is relatively self-sufficient and does not receive the major subsidies which have accrued to the PIA.

For example, while the PIA has received $91 million in capital facilities and equipment from the state, PRIDE has funded its own facilities and equipment for new enterprises. Also, where the PIA has regularly been receiving operational subsidies from the state, PRIDE of Florida regularly contributes 1.5 percent of its sales back to the state, including a $1.2 million payment in 1994-95 to help offset the cost of inmate incarceration. In 1994-95, PRIDE recorded $85 million in sales and a net income of $5.5 million.

Under Florida law, as in California, PRIDE can sell its products and services only to governmental agencies and not to the private sector. However, unlike California, state agencies in Florida are not required to purchase any goods from PRIDE. PRIDE competes for state contracts like any other bidder. Thus, state agencies are not subsidizing PRIDE enterprises by overpaying for products, as is sometimes the case with the PIA.

PRIDE has also succeeded in significantly reducing the recidivism rate of inmates assigned to its prison enterprises. Florida officials point to data indicating that only 15 percent of PRIDE's inmate workers returned to

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"The new organization would be an independent, nonprofit entity empowered to be more entrepreneurial."

prison over four years. The reduction in recidivism is the basis of Florida officials' claim that hundreds of millions of dollars in prison costs have been avoided because of PRIDE. Overall, 51 percent of Florida inmates eventually return to state prison. The low recidivism rate of PRIDE workers strongly suggests the job-training, counseling, and job-placement services provided by the privatized agency are changing post-release behavior. Our specific recommendations for improving the PIA are shown in Figure 8 and discussed below.

Our Concept of Reform. We recommend that the Legislature rewrite the statute (Penal Code Section 2800, et. seq.) which created the PIA to resolve significant conflicts over the agency's mission. Specifically, the Legislature should enact legislation which would establish two primary and complementary goals for the PIA: (1) financial self-sufficiency and (2) the achievement of a reduction in recidivism by improvement in inmate employability.

The new organization would be an independent, nonprofit entity empowered to be more entrepreneurial. As such it could enter into new forms of partnerships with the private sector in an unprotected market that could expand, under specified circumstances, to include at least some sectors of private-sector sales. The state would get a share of sales revenue.

Figure 8

The LAO Concept of Reforming the PIA

Privatize the PIA as an independent nonprofit organization with a mission of achieving self-sufficiency and a reduction of inmate recidivism. The program would be targeted at reducing the entry of "third strikers" into the prison system.

- Restructure the PIA management.
- Improve the PIA fiscal accountability.
- Require the PIA to become more self-sufficient.
- Improve the state's financial return from PIA.
- Stabilize and improve the inmate workforce.
- Establish pay for performance.
- Eliminate protected markets.
- Open the door to private partnerships.
- Establish clear rules for fair competition.
- Measure mission performance.

A revamped PIA would be directed to provide, as its finances permitted, vocational education, job assignments, pre-release job counseling, and post-release job placement services aimed especially at second-strike offenders who are at the most risk of coming back to prison with 25-years-to-life third-strike sentences under the Three Strikes law.

The Case for Reform

Time Is Right to Privatize the PIA. In *The 1996-97 Budget: Perspectives and Issues,* (starting on page 173), we discuss the concept of privatization. We outline an approach that policymakers could use to ensure that good decisions are made regarding whether a program is an appropriate candidate for privatization and, if so, what type and form of privatization is best. In our view, the objective of privatization should be improving the effectiveness and efficiency with which public services are provided.

We believe our proposal for the PIA meets the tests we set forth for privatization. Among our criteria, for example, is having the "right" conditions for privatization, such as the existence of strong competitive forces that would ensure a government monopoly does not merely become a private monopoly. In this case, we believe that a privatized PIA would face sufficient private-sector competition in the sale of goods and services to avoid a monopoly situation.

Privatization of the PIA, in our view, is a logical progression from its present status as a semi-autonomous state agency. Privatization would allow fulfillment of the originally stated legislative intent that the PIA become more business-like and operate without state subsidy.

It is also the organizational form most likely to achieve the mission for the authority that we have proposed, and the only one that would substantively address all three of the major factors that we have identified that hamper its present operations—governmental constraints, constraints on inmate productivity, and managerial weaknesses. For example, a privatized PIA is likely to have greater success creating a more profit-oriented and entrepreneurial culture within its non-inmate workforce. As a practical matter, a privatized PIA would likely be more successful in hiring badly needed cost-accounting expertise that has proven hard to get through the existing civil service hiring process.

The administration has proposed, as part of a package of changes in the state procurement process contained in AB 3307 (Brewer), that the PIA lose its long-protected market of state agency procurement. If that occurs, the authority will have to become more competitive with the private sector to survive. Privatization will make the PIA more competitive. In our view, a traditional governmental structure for the PIA is unlikely to achieve that purpose.

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Fiscal, Policy Advantages Seen. We believe the LAO concept for reform of the PIA offers several fiscal and policy advantages.

Our approach would require the PIA to become more truly financially self-sufficient, thus saving state funds. For example, under our approach, the PIA would hereafter have to bear the full costs of new capital facilities and equipment, eliminating a major ongoing state subsidy. Also, the PIA would no longer have a monopoly on the business of state agencies; in effect, the PIA would lose a subsidy received from other state agencies forced to pay whatever the PIA decided to charge them for its products and services.

We believe our approach would also help to mitigate the fiscal pressure facing the state from unskilled and hard-to-employ "second strikers" who would otherwise likely return to a life of crime. Judging from the results of correctional work programs operated in other states, particularly Florida, a well designed PIA training and work program has the potential to substantially reduce recidivism rates of members of this critical target group. The framework we have proposed, which deemphasizes the current goal that the PIA employ as many inmates as possible, opens the door for wider use by the PIA of cost-effective modern technology in its delivery of products and services in place of low technology, labor-intensive production methods. Inmates trained in modern production techniques are likely to be more employable and thus less likely to return to a life of crime after their release on parole.

While a privatized PIA may be effective in achieving the goals outlined above, we believe other legitimate goals, such as maximizing inmate employment, would best be addressed primarily through other CDC programs. It would be more cost-effective, for example, to achieve the goal of reducing inmate idleness through expansion of less capital-intensive programs, such as support services assignments or community work crews.

Revising the PIA Charter

Consistent with the concept described above, reform of the PIA should include a number of specific programmatic changes, some of which could be written into the new statutory charter for the authority.

Restructure PIA Management. Administrative control and authority for appointment of PIA staff of the newly privatized authority would be vested with the General Manager, who would serve under contract and at the pleasure of the governing board of the new nonprofit organization. The newly created PIA governing board (which would replace the present Prison Industry Board) would, as at present, include representatives of organized labor, industry, the CDC, the Department of General Services, and the Trade and Commerce Agency. Additionally, it would include representatives of the public with expertise in marketing, accounting, human resources, and agriculture. The Director of the CDC would no longer automatically serve as the chair of the PIA governing board. Instead, the chair would be elected by a board majority.

We believe these changes would remedy the confused lines of authority within the PIA.

Improve PIA Fiscal Accountability. All PIA contracts and expenditures would be subject to approval of the governing board, which would be obligated to meet at least 12 times annually. Board members would serve part-time, and would receive a part-time salary for four-year terms, in recognition of the expanded responsibilities and more frequent meeting schedule. The board would be provided sufficient resources to review budgets and proposals for new enterprises presented by the PIA General Manager. The PIA would continue to provide an annual report to the Legislature, but it would contain a more detailed accounting of past and prospective business activities, expenditures, and inmate and non-inmate staffing levels. A summary of the PIA's projected net income statement and capital outlay would be provided within the budget document prepared by the Department of Finance for display purposes, but the PIA budget itself would not be subject to the annual legislative appropriation process. The PIA would continue to be subject to various audit agencies.

We believe these changes would provide the checks and balances required to ensure fiscal accountability for an organization of the PIA's size and complexity.

Ensure Greater Self-Sufficiency. The PIA would be authorized to borrow money from the General Fund and other public sources (as well as private sources) to finance its capital outlay needs and expand its enterprises as its internal resources permit, but would be obligated to pay off any loan in full at the same interest rate as that paid by the Pooled Money Investment Account. The PIA could also continue the current practice by which the CDC builds and equips facilities using general obligation or lease payment bonds and then makes the facilities available to the PIA. In this event, however, the PIA would be obligated to pay rent under a lease either to the CDC or to the General Fund (depending on the budget from which the debt was to be repaid) at a rate sufficient to fully retire the debt on any borrowed funds used on behalf of the authority.

We believe these changes would reduce the PIA's dependence upon state funding for capital outlay and equipment.

Improve the State's Financial Return. The Legislature should direct the PIA, through the Budget Act, to

> *". . . the PIA would be obligated to pay rent [to the state] at a rate sufficient to fully retire the debt on any borrowed funds used on behalf of the authority."*

"[PIA would prioritize] . . . new employment to inmates who have two- to six-year sentences left to serve in state prison . . ."

make a one-time transfer of PIA cash to the CDC for support of programs. (We believe that, upon privatization, as much as $20 million of the $33 million in projected cash reserves would be surplus to the PIA's needs.) The funds would be redirected through the Budget Act for the expansion of other education and work programs at the CDC in order to significantly increase employment of all eligible inmates. As a consequence, the remaining $2.4 million balance on the PIA's loan from the General Fund would be deemed paid. Thereafter, in lieu of any compensation for security coverage, inmate workers' compensation, and any other potential subsidies by the CDC, the state General Fund would receive a payment of 1 percent of PIA's annual gross sales in any year that the authority's business enterprises did not record a net loss of income.

We believe these changes would provide the state with a significant return on its investment in the PIA.

Stabilize and Improve the PIA Inmate Workforce. As its budget permits, the PIA could assume responsibility for funding and staffing of vocational education programs that corresponded to its prison enterprises; inmates who successfully completed the programs would then be shifted by the PIA into work assignments. This approach to vocational training programs would financially benefit the state. However, the PIA would also benefit from being able to train inmates to the needs and standards of its enterprises. The PIA would be directed to seek available federal and state job-training funds to finance these activities, which are already permissible under current law.

The CDC and the PIA also would be directed by statute to prioritize any new enterprises or new employment to inmates who have two- to six-year sentences left to serve in state prison, particularly those serving a second-strike prison sentence. The PIA would keep these inmate workers until their parole date if they were performing satisfactory work. Inmates with sentences shorter than two years, or longer than six years, would generally be assigned to other work or education programs. Exceptions to these rules would be permitted to minimize disruption of existing enterprises and meet the security needs of the CDC.

We believe these changes would provide the PIA with a more stable and productive inmate workforce.

Establish Pay for Performance. The PIA salaries for non-inmate workers should be adjusted to be more comparable to the private sector. Where appropriate—as in sales representative positions and key managerial positions—compensation of the PIA staff should be partially tied to appropriate measures of job performance. A more general profit-sharing plan with employees could also be authorized. We recognize that a number of labor-related issues would need to be addressed during the conversion to privatized status, including any labor agreements in force at the time and the provision of retirement benefits at the privatized authority. The Legislature should state its intent that the PIA avoid any unnecessary disruption of its existing non-inmate workforce during the transition.

We believe these changes would make the PIA's non-inmate workforce more productive.

Do Away With Protected Markets. As part of its proposal for reform of state procurement practices, the administration has proposed that, after a waiting period of several years, the requirement that state agencies purchase PIA-made goods and services be phased out, doing away with its protected market. We agree with the proposal—with the proviso that private-sector market opportunities for the PIA be expanded simultaneously, permitting the authority to sell goods and services to the private sector, under specified circumstances, as discussed in more detail below. The statutes in 28 other states permit such private-sector sales.

We believe these changes would prompt the PIA to become more business-like and cost-competitive.

Establish Clear Rules for Fair Competition. In our view, the PIA should not be restricted from establishing enterprises involving goods and services produced for sale to state and local governmental agencies on the basis that such an enterprise might have a negative impact on an existing private business or industry. In such cases, we believe the potential benefit to the taxpayers should be given more weight than industry concerns. However, we believe clear statutory standards should be established to prevent unfair competition from occurring whenever the PIA establishes enterprises involving goods and services produced primarily for sale to the private sector. If an enterprise is producing goods for sale to the private-sector market, the PIA should be required to pay its inmate workforce at least wages comparable to those paid to non-inmate employees for similar work. Such an enterprise would also be prohibited if the PIA governing board determined, following a public hearing, that it would divert a specified percentage of existing private-sector jobs or a specified percentage of the existing market share to the PIA. The appropriate percentages would be fixed in statute.

We believe these changes, coupled with the elimination of capital subsidies, would reduce the ongoing controversy about whether particular PIA enterprises constitute unfair competition with private labor and industry.

Open the Door to New Private Partnerships. Proposition 139, which was approved by California voters in November 1990, repealed a state constitutional ban on the contractual use of inmate labor by any private party. The measure also established the Joint Venture program, by which

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"*. . . the PIA governing board and General Manager should be held accountable for PIA's success in reducing the recidivism rate of inmates . . .*"

private companies may establish factories on the grounds of state prisons which employ inmate labor. The Joint Venture program operates separately from the PIA.

In addition to the Joint Venture program, Proposition 139 specifically authorized the creation of other, similar programs by which inmate labor would be contracted out to private parties.

Our proposal would authorize the PIA to contract to provide products and services under contract to private-sector partners, and further authorize the PIA to contract with private partners to provide management of PIA enterprises or marketing or distribution of its goods. Similar partnerships with private parties have been established with correctional enterprises in other states. For example, PRIDE has been licensed by a private company in Florida to recycle used tires into Rebound, a combination of rubber particles and compost that is used to renovate sporting fields.

In the case of private partners willing to pay inmates wages comparable to those paid to non-inmate workers for similar work, the PIA would be permitted, when security concerns would not be compromised, to bus its assigned inmates to private factories or farms or trash-recycling centers. In such cases, a fixed share of inmate earnings would be diverted to compensate the state for the cost of their room and board, provide victim restitution, support inmate families, and to create an inmate trust fund accessible only after parole. Upon their parole, PIA inmate employees would be exempted from requirements that they return to their county of commitment if the PIA itself or a PIA partner wished to hire them for a non-inmate staff position (as the law already allows for inmates assigned to Joint Venture enterprises). Another form of private partnership would also be encouraged: as a nonprofit tax-exempt organization, corporate and private donations to the PIA would be tax deductible.

We believe these changes would open the door at the PIA to private-sector capital, managerial skills, and market opportunities.

Measure Mission Performance. Just as they should be held accountable for the financial performance of the authority, the PIA governing board and General Manager should be held accountable for PIA's success in reducing the recidivism rate of inmates participating in the PIA workforce. The CDC and the Employment Development Department should be directed to cooperate with the PIA in routinely assessing the effect of PIA programs on post-release employment and recidivism. The results would be made a part of the annual report provided to the Legislature on the PIA's performance, and would provide the PIA with additional incentives to provide vocational training, job placement, and other services intended to reduce inmate recidivism.

We believe these changes would promote achievement of both proposed

PIA missions—greater self-sufficiency and less recidivism through improved inmate employability.

CONCLUSION

Just the Beginning. In our view, reform of prison inmate programs should not stop at the PIA. Given that the PIA now employs only about 5.5 percent of the total inmate population, we believe that other academic education, vocational education, and work programs which now provide a much larger number of inmate assignments warrant further review and reform by the Legislature.

We believe that the time is ripe to redefine the mission and restructure of the PIA. Thirteen years have passed since the Legislature and the Governor enacted the present program, which has improved its financial performance but failed to achieve its major purposes. In our view, basic reform of the PIA is long overdue. We would also note that two years have passed since the Legislature and the Governor enacted the Three Strikes law. More than 16,000 second strikers are already housed in state prison, and about 800 more are arriving each month. We believe it is critical that the state take steps now to reduce the number of second strikers now in prison from returning to state custody with long-term and costly third-strike prison sentences. The CDC currently has no specific program or strategy aimed at addressing the fiscal pressure posed by second-striker recidivism. We believe a privatized PIA, focused on reducing recidivism by this target group, would provide significant long-term dividends by holding down the growing costs of the prison system.

This Policy Brief was prepared by Daniel C. Carson, under the supervision of Craig Cornett. This report and others are available on the LAO's World Wide Web page at http://www.lao.ca.gov. The Legislative Analyst's Office is located at 925 L Street, Suite 1000, Sacramento, California, 95814. To request publications call (916) 445-2375.