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ABSTRACT
Private military and security companies are integral components of the defense and intelligence operations of some of the world's most powerful states. Despite the increasingly pivotal role of contractors, analysts have yet to develop theories explaining when governments should outsource national security responsibilities or what conditions cause private defense markets to function efficiently. This inquiry addresses this gap in the literature by demonstrating that varying market structures—that is, the quantity of firms providing similar services and the number and purchasing power of those buying these services—have significant effects on costs, oversight, and company performance in the private defense industry. A principal–agent framework is developed to explain variation in the performance of firms in different markets across the industry. Evaluation of three private defense markets yields the surprising conclusion that monopsony, rather than a competitive market, is the ideal structure for governments outsourcing aspects of national defense.

The demand for services provided by private military and security companies (PMSCs) has grown markedly since the end of the Cold War as governments and international organizations increasingly turn to contractors to perform defense-related activities that were previously carried out by the publicly funded armed forces of states.[1] The majority of these firms do not engage in direct combat operations; however, many countries have become reliant on them to carry out functions vital to the operation of their armed forces.[2] Academic interest in PMSCs has increased in recent years largely due to the United States government's heavy dependence on contractors in Iraq, Afghanistan, and global counterterrorism efforts.[3] Despite the rapid proliferation of research on contractors, the field

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[1]P. W. Singer, *Corporate Warriors: The Rise of the Privatized Military Industry* (Ithaca, NY: Cornell University Press, 2003), 186–220; P. W. Singer, "Corporate Warriors: The Rise of the Privatized Military Industry and Its Ramifications for International Security," *International Security* 26, no. 3 (Winter 2001/02): 188–90.
[2]Molly Dunigan, *Victory for Hire: Private Security Companies' Impact on Military Effectiveness* (Palo Alto, CA: Stanford University Press, 2011).
[3]Allison Stanger, *One Nation Under Contract: The Outsourcing of American Power and the Future of American Foreign Policy* (New Haven, CT: Yale University Press, 2009); Deborah D. Avant, *The Market for Force: The Consequences of Privatizing Security* (Cambridge: Cambridge University Press, 2005).

remains under-theorized and consists largely of conceptual work that delineates the structure of the global industry, descriptive case studies, proposals for enhanced legal regulation of PMSCs, critical assessments of the political economy of outsourcing, and normative critiques that caution against the privatization of defense.[4] Surprisingly, researchers have yet to develop theory that explains some of the central problems and challenges that exist in the industry.[5] Chief among these is the following puzzle: why do some markets for private defense services function efficiently while others are characterized by companies that regularly underperform and shirk their obligations?

The central argument made in this inquiry is that varying market structures—the quantity of firms providing similar services and the number and purchasing power of buyers of these services—have significant influence on principal–agent dynamics in the private security industry.[6] To demonstrate that market structure has a meaningful effect on the behavior of PMSCs as well as on the ability of principals to screen, monitor, and influence these companies, three distinct markets in the industry are assessed: 1) intelligence gathering and analysis in the United States; 2) large-scale logistics provision; 3) close protection. Three conclusions are reached concerning the relationship between market structure, contractor performance, and principals' ability to screen and monitor PMSCs. First, in both a monopsony and oligopsony, market structures in which a small number of buyers dominate demand, PMSCs are less likely to shirk responsibilities because they risk damaging their relationship with the only major buyers in the marketplace. Second, monopolies and oligopolies pose problems for principals because PMSCs have leverage during negotiation and can demand high prices for their services. Third, in competitive markets the rapid formation and dissolution of PMSCs will result in higher rates of adverse selection due to information asymmetry. PMSCs' ability to contract with multiple principals in a competitive market makes them less likely to become dependent on any single buyer of services and more likely to

[4]On the legal regulation of PMSCs, see Laura A. Dickinson, *Outsourcing War and Peace: Preserving Public Values in a World of Privatized Foreign Affairs* (New Haven, CT: Yale University Press, 2011); Laura A. Dickinson, "Contract as a Tool for Regulating Private Military Companies," in *From Mercenaries to Market: The Rise of Private Military Companies*, ed. Simon Chesterman and Chia Lehnardt (New York: Oxford University Press, 2007), 217–39; Francesco Francioni and Natalino Ronzitti, eds., *War by Contract: Human Rights, Humanitarian Law, and Private Contracts* (New York, NY: Oxford University Press, 2011); Christopher Kinsey, "Challenging International Law: A Dilemma of Private Security Companies," *Conflict, Security, and Development* 5, no. 3 (December 2005): 269–93.

[5]Carolyn Gallaher, "Risk and Private Military Work," *Antipode: A Radical Journal of Geography* 44, no. 3 (June 2012): 783–805; Anna Leander, "The Power to Construct International Security: On the Significance of Private Military Companies," *Millennium—Journal of International Studies* 33, no. 3 (June 2005): 803–25; Anna Leander, "The Market for Force and Public Security: The Destabilizing Consequences of Private Military Companies," *Journal of Peace Research* 42, no. 5 (September 2005): 605–22. While research on PMSCs has not produced explanatory theory that identifies causal relationships accounting for variation in the performance of firms across markets, significant critical scholarship does exist that outlines theory describing how outsourcing military-related functions alters the political economy and meaning of global security.

[6]There is significant variation in the terminology used by scholars to discuss private military and security corporations and the private military industry. In addition to PMSC—the acronym used in this inquiry—the following terms are frequently employed: private military contractors, private security companies, private military companies (PMCs), private military firms, and military service providers. For more on this terminological confusion see Sean McFate, *The Modern Mercenary: Private Armies and What They Mean for World Order* (New York: Oxford University Press, 2014), 10–12.

shirk responsibilities. Thus, in the PMSC industry, adverse selection and monitoring difficulties likely negate the cost reductions that principals should expect to receive as the result of competition.

The remainder of this inquiry proceeds in the following sequence. First, I review previous conceptualizations of the PMSC industry and present the study's research design. Subsequently, I develop a principal–agent framework as a means to assess contracting efficiency in the PMSC industry, which leads to the advancement of hypotheses describing how different market structures are likely to influence contracting and oversight in the industry. Case studies of three PMSC markets are then used to test the hypothesized relationship between market structure and contracting efficiency. In the penultimate section, I evaluate the case studies to assess the validity of the inquiry's hypotheses and outline the theory's utility for use in future research in the field. Finally, the conclusion summarizes the study's findings.

Conceptualization of the Private Defense Industry

Despite a recent boom in the quantity of research on PMSCs, advancement of knowledge in the field has developed slowly as scholars have struggled to collect data about the industry and subsequently turn this scarce information into explanatory theory. Notwithstanding this gap in the literature, recent research on private contractors has made progress in two related areas: critical theory and the conceptualization of the markets for force. Critical theory assessments of military outsourcing have described how services offered by contractors influence the larger political economy of force. For instance, Anna Leander notes that the increased reliance on PMSCs "alters the understanding of threats and of how they should be met."[7] In a similar vein, Carolyn Gallaher argues that the growth of the private military industry has helped change global perceptions of risk and transformed the relationship between citizenship and military service.[8] Critical appraisals have thus demonstrated that PMSCs do not simply respond to demand, but also that they help shape the markets in which they operate.

Associated with these critical insights is the empirical question of market structure within the private defense industry.[9] That is, who are the buyers and sellers of PMSC services, where do they operate, and how do they interact in the marketplace? Over the past decade, scholars have shifted from viewing the industry as singular, global, and competitive, to regarding it as a series of disconnected markets, many of them focused on services within states rather than across borders.[10] The

[7]Leander, "The Market for Force and Public Security," 612.
[8]Gallaher, "Risk and Private Military Work," 790–92.
[9]Concept formation is a key early step in the development of a productive research paradigm. See Gary Goertz, *Social Science Concepts: A User's Guide* (Princeton, NJ: Princeton University Press, 2006).
[10]For more on this conceptual shift see Ulrich Petersohn and Molly Dunigan, "Introduction," in *The Markets for Force: Privatization of Security Across World Regions*, ed. Molly Dunigan and Ulrich Petersohn (Philadelphia: University of Pennsylvania Press, 2015), 1–20.

remainder of this section describes this conceptual shift and gives an overview of three different descriptions of PMSC markets in the literature.

A Competitive, Global Market

When academics began examining PMSCs in the late 1990s, they initially conceptualized the industry as a competitive marketplace in which firms could form rapidly and compete for contracts from states, international governmental organizations (IGOs), nongovernmental organizations (NGOs), and multinational corporations (MNCs) across the globe.[11] For instance, in his influential research on private contractors, P. W. Singer characterizes the industry as an "open global market" that is not "an overly capital intensive sector."[12] Furthermore, Singer maintains that the industry as a whole possesses low barriers to entry and that PMSCs need only a "modicum of financial and intellectual capital" to start up and become competitive.[13]

Although Singer describes the market for private defense services as global, he also acknowledges that not all firms "serve the same market."[14] To differentiate between the varying types of services that PMSCs provide, Singer breaks the industry down into three segments: 1) military providers; 2) military consultants; 3) military supporters.[15] In this typology, military provider firms operate in the midst of conflict zones and engage in direct combat with their adversaries.[16] Conversely, military consultant firms provide clients with training, strategic and tactical advice, and organizational assessment, but do not fight on the battlefield. Finally, military support firms engage in a wide variety of ancillary activities including logistics, technical support, and transportation.[17]

Singer's breakdown of PMSCs into categories delineated by general service capability represents an important first step in the process of understanding the industry, and the typology still serves as an important starting point for many researchers examining PMSC markets. Notwithstanding the conceptual leverage provided by his framework, Singer's characterization of the industry as global and competitive, which many researchers have accepted as accurate, represents an overgeneralization and clashes with the existence of firms that cater to domestic, national markets. In addition, the

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[11]Singer, "Corporate Warriors," 192–202.

[12]Ibid.

[13]Ibid., 198–200. Other research emerging at the time paralleled Singer's claims about the nature of the market. For example, Robert Mandel describes PMSCs as "undercapitalized" corporations existing in a market where "barriers to entry are low." See Robert Mandel, *Armies Without States: The Privatization of Security* (Boulder, CO: Lynne Reiner, 2002), 11.

[14]Singer, "Corporate Warriors," 200.

[15]Ibid., 88–100.

[16]Some experts argue that the central difference between PMSCs and other actors that sometimes enter into conflict situations to make a profit—such as mercenaries, warlord militias, and death squads—is that PMSCs do not engage in direct, offensive combat operations. On the distinction between contemporary private military contractors and mercenaries see Elke Krahmann, *States, Citizens, and the Privatization of Security* (New York: Cambridge University Press, 2010), 5–8.

[17]Singer, *Corporate Warriors*, 97.

presence of high barriers to entry in some markets, such as base logistics and high-tech communication services, are significant enough to make the emergence of new competition difficult. Furthermore, the number and types of services provided by PMSCs has ballooned in recent years, requiring a more nuanced characterization of these services and the corresponding markets in which firms compete.

American Monopsony

The United States' sizeable expenditures on contractors in the wars in Iraq and Afghanistan have resulted in some analysts reassessing the structure of the private defense industry. Rather than a global market characterized by numerous buyers and sellers, the United States' position as the major buyer in the industry indicates that the market for PMSC services might better be characterized as a monopsony.[18] This contention has been made recently by Sean McFate, who asserts that the US position as the world's dominant buyer of PMSC services has enabled it to "shape business practices and norms during the industry's formative years."[19] In other words, since the industry grew primarily out of demand created by the American military, specifically by the US Army, it reflects the needs and structure of that organization.[20]

McFate's contribution to the literature is important both for its recognition that markets for defense contractors are not necessarily competitive on the demand side and for the idea that these markets may have been created, or at least heavily influenced, by the dominant buyer in the market. Despite these insights, McFate's conceptualization largely omits markets that exist outside the United States, as well as firms that do not service the US military. Although the US government is the largest buyer of private military services in the world, it is certainly not the only buyer, and markets for such services exist that are neither monopsonies nor directly linked to or dependent upon the US Army. The American market for PMSC services may resemble a monopsony, but the global industry spans many different countries, markets, and service sectors, and is thus better characterized by a range of market types and characteristics.

Many Services and Many Markets

Researchers have advanced a third conceptualization of the private defense industry that contrasts with both a competitive, global market and an American monopsony. In this alternate view, numerous disconnected markets exist for the increasingly broad range of services offered by PMSCs.[21] Each of these separate markets, which often

[18]McFate, for example, argues that the current market for force is a monopsony in which the US Army is the dominant buyer. See McFate, *The Modern Mercenary*, 12.
[19]Ibid.
[20]Ibid., 18.
[21]Lou Pingeot, *Dangerous Partnership: Private Military and Security Companies and the UN* (New York: Global Policy Forum, 2012). Pingeot notes that the services PMSCs offer are extensive and include armed and unarmed guards, security training, risk assessment, intelligence gathering, data mining, surveillance and cyber surveillance, troop training, aviation logistics and maintenance, leasing of aircraft, interrogation, ground transportation, vehicle maintenance, translation, special operations, and only rarely direct combat.

operate within countries rather than internationally, possess a distinct set of characteristics that cause them to behave uniquely. As Ulrich Petersohn and Molly Dunigan note in a recent exploration of the numerous markets for defense related services around the world, "in some areas, the market for force is characterized by the involvement of only domestic firms; in others, the market is marked by the presence of a large number of international actors … the market for force is actually a conglomeration of different types of markets."[22]

One origin of the "many markets" conceptualization of the PMSC industry comes from the work of Deborah Avant, who notes that private defense markets are differentiated not simply by the broad category of service they provide, but additionally by whether the services are to be used within states to maintain order or overseas to project force.[23] According to Avant, the purpose of "internal" PMSC services—such as crime prevention, intelligence analysis, and static facility protection—usually is to ensure stability within countries. Conversely, "external" services are associated with power projection abroad and also with securing state borders.[24]

Recently, Petersohn and Dunigan have expanded upon Avant's insights into the complex and fragmented structure of the industry. Their central premise is that there are many markets for defense services provided by PMSCs, and that conditions in these various markets differ. Petersohn and Dunigan's contribution is also noteworthy for investigating the potential association between market type and the quality of force provided by contractors. That is, in addition to simply trying to provide a description of the industry, they posit a causal relationship between the characteristics of markets and the "state's authority over the use of force and the provision of security as a public good."[25] Petersohn and Dunigan thus hypothesize in very general terms that varying market conditions affect the overall quality of a state's defense capabilities.

Research Design

Beginning by using the decentralized conceptualization of the private defense industry advanced by Petersohn and Dunigan, namely that there are numerous, disconnected markets for PMSC services, this inquiry employs two previously established tools used to obtain leverage in theory construction within several academic disciplines—principal–agent theory and economic market structures—to advance hypotheses about the variation in performance of PMSCs across markets. To date, research on PMSCs has been primarily descriptive or normative.[26] The

[22]Petersohn and Dunigan, "Introduction," 2.
[23]Avant, *The Market for Force*, 16–22.
[24]Ibid.
[25]Molly Dunigan and Ulrich Petersohn, "The Causes and Consequences of Different Types of Markets for Force," in *The Markets for Force*, 162.
[26]On the distinction between descriptive inference and causal inference see Gary King, Robert O. Keohane, and Sidney Verba, *Designing Social Inquiry: Scientific Inference in Qualitative Research* (Princeton, NJ: Princeton University Press, 1994), 34–114; John Gerring, *Social Science Methodology: A Unified Framework* (New York: Cambridge University Press, 2012), 107–141. Accurate description is a necessary precondition for causal inference. As a relatively new research area in international relations, it is not surprising that most work on the PMSC industry to date has been primarily descriptive rather than explanatory in character.

absence of theory explaining the behavior of private defense markets results largely from a dearth of available data about the industry.[27] While it is true that information on PMSCs is scarce relative to other research topics in international relations, this is no reason to avoid developing and testing hypotheses about potential causal relationships that may explain variation in the performance of PMSCs, differences between markets in the industry, and policies that governments and other actors can use to maximize the benefits and mitigate the hazards of outsourcing defense-related activities. Ideally, a complete and transparent picture of the industry would be available; however, the construction of explanatory theory certainly does not require a comprehensive database.[28]

The inquiry's independent variables consist of five ideal-type market structures that have a long tradition of use in economics: oligopoly, monopoly, monopsony, oligopsony, and competitive markets.[29] The hypothesized causal relationships presented in the paper's theoretical section contend that variation in market structure will alter aspects of the principal–agent relationship between contractors and PMSCs by means of affecting processes including adverse selection, bargaining leverage, and shirking. The dependent variable the theory seeks to account for is variation in the overall quality of firms' performance across different markets in the industry or, in other words, efficient contracting versus inefficient contracting.

Since no comprehensive dataset on PMSCs exists, initial tests of the hypotheses presented in this inquiry are carried out using case studies.[30] Case selection was based on three criteria: 1) variation of the study's dependent and independent variables; 2) data richness; 3) policy relevance. By examining a monopsony, oligopoly, and competitive market, cases selected differ on the independent variable of market structure. Similarly, the study's dependent variable of contracting efficiency varies across cases.[31] Contracting in the monopsonistic US market for intelligence services is characterized by low levels of adverse selection and shirking and is thus reasonably efficient. Conversely, shirking, price gouging, and poor oversight besets contracting in both close protection and US base logistics markets. In addition to variation on the

[27]On the difficulty of collecting data about PMSCs see McFate, *The Modern Mercenary*, 8–10.

[28]In fact, some scholars working in the qualitative methods tradition argue that theory can be developed inductively from a single case study. Of course, this theory should then be tested on additional cases that fit a specified domain to determine the theory's overall scope and validity. See Alexander L. George and Andrew Bennett, *Case Studies and Theory Development in the Social Sciences* (Cambridge, MA: MIT Press, 2004), 111–12; Stephen Van Evera, *Guide to Methods for Students of Political Science* (Ithaca, NY: Cornell University Press, 1997), 67–71.

[29]Competitive markets are sometimes referred to as contestable markets in the economics literature. Competitive markets, however, are not necessarily characterized by perfect competition, in which the products or services offered by sellers are essentially indistinguishable.

[30]Although no comprehensive PMSC database exists, the University of Denver's Sié Chéou–Kang Center for International Security and Diplomacy at the Josef Korbel School of International Studies has consolidated information about various aspects of the industry collected by various government agencies and watchdog organizations. See: http://psm.du.edu/articles_reports_statistics/data_and_statistics.html.

[31]Lack of variation on the dependent variable may lead to faulty causal inference. See Barbara Geddes, *Paradigms and Sand Castles: Theory Building and Research Design in Comparative Politics* (Ann Arbor: University of Michigan Press), 89–129.

study's key variables, cases were also selected for data richness.[32] As mentioned previously, information on PMSCs is difficult to acquire and details about many markets remain opaque. For this reason, I chose markets in which significant investigation and information gathering has already taken place. Finally, cases were picked for their public policy relevance.[33] By most accounts, the market for US base logistics and the global close protection market are among the largest in the industry.[34] Similarly, the US market for intelligence services has grown rapidly in recent years and is now estimated to be worth $42 billion annually.[35] Additionally, these three markets are some of the most important in the industry from a global security standpoint. The markets chosen for case studies in this inquiry are thus significant not only for the theoretical leverage they provide but also from a public policy perspective.

Since the hypotheses advanced in this inquiry are tested on just three markets, the present explanatory scope of the study's larger theory is limited. Except in rare instances, a theory's utility cannot be judged by its ability to explain a small number of cases.[36] In the future, hypotheses presented in this study can be tested on additional markets in the private defense industry to determine the theory's explanatory power and range. In addition, the principal–agent framework developed in this inquiry is a novel approach to examining PMSC contracting and may be employed by scholars in subsequent efforts to understand the industry.

Assessing Contracting Efficiency and PMSC Performance

What distinguishes efficient contracting from costly contracting in PMSC markets? Contracting with PMSCs is efficient when principals are able to assess accurately firms' capabilities before entering into a formal agreement, adequately monitor the behavior of PMSCs while an agreement is ongoing, and sanction PMSCs if they do not adhere to the terms of the contract. Conversely, if adverse selection, shirking, or an inability to sanction PMSCs characterizes contracting, then it is inefficient and principals will incur costs as a result of these transaction and monitoring deficiencies. This section develops a framework for assessing contracting efficiency in

[32] Van Evera, *Guide to Methods for Students of Political Science*, 78–79. Van Evera argues: "[T]he more data we have the more questions we can answer. Hence more tests are possible, hence data–rich cases are preferred, other things being equal."

[33] Policy relevance may serve as an important factor in case selection criteria as long as other methodological concerns have been addressed. For more information on policy relevant theory see George and Bennett, *Case Studies and Theory Development in the Social Sciences*, 263–85; Van Evera, *Guide to Methods for Students of Political Science*, 83–84; Gary Goertz and James Mahoney, *A Tale of Two Cultures: Qualitative and Quantitative Research in the Social Sciences* (Princeton, NJ: Princeton University Press, 2012), 184–85. Goertz and Mahoney refer to "substantively important" cases in qualitative research rather than to "policy relevant cases."

[34] See McFate, *The Modern Mercenary*, 15. According to McFate, 65% of US contractors in Iraq worked on base logistics, while 12% worked in the security/protection sector.

[35] Simon Chesterman, "'We Can't Spy … If We Can't Buy!': The Privatization of Intelligence and the Limits of Outsourcing 'Inherently Governmental Functions,'" *European Journal of International Law* 19, no. 5 (July 2008): 1055–74.

[36] George and Bennett, *Case Studies and Theory Development in the Social Sciences*, 115–17.

Table 1. Assessing contracting and monitoring in the PMSC industry.

Contract Stage	Process	Indicators of Inefficient Contracting
Screening	Adverse selection	Poor PMSC performance
Negotiation	Bargaining leverage	Guaranteed reimbursement/Vague benchmarks
Monitoring	Shirking	Formal complaints against PMSCs
Sanctions	Competition	Inability to enforce penalties or substitute firms

the industry by using principal–agent theory and describes the processes that can make contracting costly and inefficient for clients of PMSCs.[37]

Principal–Agent Theory and Contracting in the PMSC Industry

In principal–agent theory, both the principal and the agent are assumed to act in their own self-interest. That is, the principal seeks to acquire the highest quality labor at the lowest price whereas the agent attempts to obtain the highest fee while fulfilling only the minimum amount of work specified in the contract.[38] These opposing motivations can cause difficulties for principals as the result of information asymmetries, which occur if principals have incomplete knowledge about agents' capabilities before execution of contracts and an inability to effectively monitor agents' behavior after a contract is in force. There are four stages to the principal–agent relationship: 1) screening; 2) negotiation; 3) monitoring; 4) sanctions.[39] Table 1 summarizes mechanisms associated with each of these stages and lays out indicators that can be used to evaluate the contracting and monitoring processes.

Screening

The first problem associated with information asymmetry occurs prior to the execution of a contract during the screening phase.[40] At this time, principals review the qualifications of different bidding firms and eventually come to a hiring decision.[41] Lack of complete information about candidate PMSCs often leads to adverse selection, which

[37]For more on principal–agent theory and government contracting, see Peter D. Feaver, *Armed Servants: Agency, Oversight, and Civil-Military Relations* (Cambridge, MA: Harvard University Press, 2003).
[38]Sebastian Drutschmann, "Informal Regulation: An Economic Perspective on the Private Security Industry," in *Private Military and Security Companies: Chances, Problems, Pitfalls and Prospects*, ed. Thomas Jäger and Gerhard Kümmel (Weisbaden, Germany: VS Verlag, 2007), 445–46.
[39]Ibid.
[40]For more on information asymmetry as a concept in economics, see George A. Akerlof, "The Market for 'Lemons': Quality Uncertainty and the Market Mechanism," *Quarterly Journal of Economics* 84, no. 3 (July 1970): 488–500.
[41]This assumes that the contract is competitive rather than no bid or sole source. In some cases, government agencies may forgo competitive bidding processes and award contracts to a single PMSC outright and then negotiate terms with that firm. This can occur for two reasons. First, in some instances there may be only a single PMSC that is capable of completing a specified task. Second, if a government agency believes that a lengthy screening process may delay delivery of a vital service that could threaten national security or that is urgently needed by units in a conflict zone then it may bypass a competitive bid process and issue a sole-source award. In some instances, government agency officials may be pressured to use sole-source contracts by their superiors, thus putting constraints on their ability to choose between PMSCs. At times, no-bid contracts were used by US government departments and agencies in the wars in Iraq and Afghanistan. For more on uncompetitive bid processes in US government defense contracting, see Ruben Berrios, "Government Contracts and Contractor Behavior," *Journal of Business Ethics* 63, no. 2 (January 2006): 119–130. Berrios notes, however, that most defense contracts are awarded on a competitive basis.

occurs when principals hire an inferior firm due to misrepresentations in their bid. That is, because it is not always possible for principals to verify the claims made by candidate firms, they may mistakenly select second-rate companies that misrepresent their capabilities. In addition, firms with less competence may engage in "low-ball" bids, which are ultimately selected by principals because it is not possible to distinguish between the capabilities of firms prior to contracting. Simply put, if a principal is unable to judge among the quality of firms, it will often choose the cheapest option. Thus, since hidden information about candidate firms often exists before the execution of a contract, there is the possibility of adverse selection resulting in high costs to principals after a contract has been executed.

Negotiation

Negotiation is the second phase of the principal–agent relationship and involves the two parties determining terms for a contract. It occurs after a principal has selected a firm but before a final contract has been executed. During this phase, principals attempt to structure contracts so that payment will be contingent upon agents meeting predetermined benchmarks. Typically, principals attempt to avoid guaranteeing full compensation unless firms achieve a certain level of performance. Principals may also seek to secure contracts with fixed costs in which prices are determined before services are delivered rather than cost reimbursement or cost-plus agreements that shift the risk of overruns onto principals.[42]

In addition, principals may try to structure agreements so that a greater proportion of funds are disbursed toward the end of the contract period. In this way, principals attempt to prevent agents from shirking responsibilities as expiration of an agreement nears. Overall, principals try to construct contracts that are detailed, specific, and incentive laden, so that agents are aware of their responsibilities and have reason to fulfill their tasks. Conversely, during the negotiating process, agents attempt to secure the highest guaranteed compensation possible while including few concrete indicators of acceptable performance. In this way, agents can avoid having to achieve fixed results that might be difficult to realize and yet ensure that they will receive full compensation.

Monitoring

Monitoring is the third phase of the principal–agent relationship and involves supervision carried out by principals during the term of the contract. In this phase, principals attempt to determine if agents' behavior complies with contractual requirements. At this point in the process, information asymmetry often weakens the incentives of both parties. Specifically, the contracted firm may try to shirk its responsibilities; that is, it will do as little work as possible

[42]For more on the types of defense contracts the government executes with PMSCs, see ibid., 120–21.

while sending misleading signals to the principal that it is fulfilling its obligations. Contracted firms have incentive to shirk because their jobs are often costly and time consuming. Thus, shirking may enable a contracted firm to save valuable resources and maximize profit.[43] Furthermore, because principals cannot monitor the entirety of agents' activities, a degree of "agency slack," or independent discretion, is typically granted to contracted firms.[44] As Peter D. Feaver notes, in many principal–agent relationships the behavior of the agent is impossible for the principal to observe fully.[45]

Sanctions

Sanctions, the fourth step in the principal–agent relationship, are penalties levied on agents for failure to adhere to terms of an executed contract. Sanctions typically entail principals withholding payments. In addition, sanctions can consist of imposing fines as well as designating a firm as ineligible to bid on future contracts. An effort to impose sanctions on an agent typically occurs only if the principal has detected systematic negligence by the contracted firm during the monitoring process. During the negotiation phase, principals often contractually specify their ability to use different types of sanctions. Therefore, levels of dependency between principal and agent at the time of negotiation will have an important effect on the extent to which principals can sanction contracted firms. Finally, since the principal–agent relationship in the PMSC industry is governed by a legal contract, agents can challenge the imposition of sanctions in court if they believe they have met the terms of the contract. Similarly, principals may seek relief from the court system if they determine agents have not fulfilled the provisions of an executed agreement.

Summary

Under ideal conditions, principals should have accurate information about PMSC capabilities, contractually require PMSCs to achieve specified benchmarks, comprehensively monitor PMSC performance, and be able to sanction PMSCs that shirk their obligations. However, because of information asymmetries that arise as the result of principal–agent dynamics, PMSC clients often fall prey to adverse selection, shirking, and an inability to effectively oversee and sanction private military firms. What conditions exacerbate contracting inefficiencies and costs? The following section argues that the structure of the market in which PMSCs operate has a significant effect on the ability of principals to screen, negotiate, monitor, and sanction PMSCs efficiently.

[43]Jan Stöber, "Contracting in the Fog of War … Private Security Providers in Iraq: A Principal–Agent Analysis," in *Private Military and Security Companies*, 122.
[44]James Cockayne, "Make or Buy? Principal–Agent Theory and the Regulation of Private Military Companies," in *From Mercenaries to Market*, 197.
[45]Feaver, *Armed Servants*, 74.

Table 2. Market structure and principal–agent dynamics in the PMSC industry.

	Monopsony/Oligopsony	Competitive Market	Oligopoly/Monopoly
Screening	Low levels of adverse selection	High levels of adverse selection	Low levels of adverse selection
Negotiation	Principal has bargaining leverage	Contract determined by collective decisions of the marketplace	PMSC has bargaining leverage
Monitoring	Firms less likely to shirk because there are few buyers	Regular substitution of PMSCs makes monitoring difficult and shirking more likely	Repeated contracting leads to effective monitoring but lack of competition makes shirking more likely
Sanctions	Principals able to substitute for shirkers	Reputation effects weed out underperformers	Difficult to effectively sanction firms

Hypotheses on Market Structure and Contracting in the PMSC Industry

The central argument made in this inquiry is that differing market structures have significant effects on principal–agent dynamics in the private defense industry. Market structures thus constitute the study's independent variables.[46] This section presents the likely consequences varying market structures will have on efficient contracting in the industry. The following market structures are examined: 1) monopsony; 2) oligopsony; 3) competitive market; 4) oligopoly; 5) monopoly.[47] The hypotheses discussed in this section are presented in simplified fashion in Table 2.

Monopsony and Oligopsony

A monopsony is a market structure in which a single actor is the only significant buyer of a good or service. In an oligopsony, rather than one buyer, there are a small number of buyers coupled with numerous sellers. In both these market types, buyers' demand constitutes a significant portion of overall market demand and buyers therefore wield considerable influence over suppliers, who have few alternative outlets for their products or services. How are monopsony or oligopsony likely to influence principal–agent dynamics in PMSC markets?

With respect to screening, the low number of buyers in a monopsony or an oligopsony will cause PMSCs to be wary of misrepresenting their capabilities for fear of damaging future relationships with the small number of principals. For this reason, levels of adverse selection should be low. In the negotiation phase, governments or other actors buying defense services in these market structures should be able to influence PMSCs to accept terms favorable to principals. Without the principal as a client, it is likely that private defense firms in these markets will either go

[46]In reality, markets often do not conform exactly to the ideal-type structures that scholars use to characterize them. As with most classification systems in the social sciences, ideal-type market structures are analytic abstractions that simplify reality so that the significant theoretical features of a phenomenon can be identified.

[47]Monopsony and oligopsony are examined jointly in this inquiry because their implications on principal–agent dynamics are similar. Likewise, monopoly and oligopoly are examined jointly. Although these market structures are evaluated together, it is possible their influence on contracting efficiency may vary slightly. However, for the purposes of theoretical parsimony, as well as space constraints, they are here analyzed jointly.

out of business or be forced to downsize. This dependence places PMSCs in either a monopsony or oligopsony in a weak bargaining position. Moreover, because principals can select alternative firms that offer roughly the same quality of service, they likely will be able to compel competing PMSCs to accept lower prices for their services.[48]

In addition to the ability to obtain lower prices for private defense services, principals in a monopsony or oligopsony can use their advantageous position to influence the terms of contracts with PMSCs. For instance, principals can contractually demand that PMSCs meet certain benchmarks of performance at given time intervals. If these benchmarks are not met, principals can enforce contractually agreed upon penalties including delay of payment, denial of payment, or even termination of the contract. Similarly, if shirking is detected, principals have numerous options for substitution and can quickly seek alternative suppliers for a service. These types of benchmarks and penalties are more easily included in contract language if the principals operate in a monopsony or oligopsony and can use their bargaining leverage, that is, the threat to award contracts to another PMSC, to force PMSCs to accept terms stipulating high levels of performance.

Competitive Market

In a market characterized by relatively high levels of competition, there are many firms that sell similar goods or services and many buyers that make purchasing decisions based on both the quality and price of the product.[49] A large number of buyers and sellers typically signifies that no single actor can substantially alter the market price of a good or service. How will high levels of competition influence the principal–agent relationship in PMSC markets?

With respect to screening, in a competitive market the initial review and assessment of PMSCs by principals will likely be difficult as well as costly. Because of the large number of firms, potential buyers must spend significant time learning about suppliers and determining what level and scope of service each provides. To make matters worse for principals, the frequent formation and dissolution of firms means that gathering accurate information about new PMSCs is challenging.[50] That is, the regular entrance of new service providers into the market suggests that principals often will be evaluating PMSCs for the first time. There will be little information about the abilities of these newly formed companies and thus a greater probability that adverse selection will

[48]Unlike in a monopsony, where there is only one buyer, principals in an oligopsony must take note of the actions of the market's other large buyers, whose decisions could influence future prices and contract terms.

[49]In economics, perfect competition is distinguished from competition based on the quality and type of goods or services provided by the supplier. If products are differentiated in terms of quality, the market is classified as competitive. If suppliers provide essentially the same quality of good, then the market is said to exhibit perfect competition. Since the services provided by PMSCs are not identical, this study refers to the market structure as competitive rather than as one of perfect competition.

[50]A market with many suppliers is likely to have low barriers to entry and, therefore, is likely to have a fair amount of turnover.

occur. Similarly, new buyers entering the market will be unlikely to possess sufficient knowledge about the industry to make an optimal decision when choosing among competing candidate firms. Without previous experience in the marketplace, new buyers of private defense services are more likely to make mistakes when initially screening PMSCs, which often have incentives to misrepresent their capabilities. Thus, in a competitive market, costs to principals associated with adverse selection will likely rise.

Negotiation in a competitive market is likely to result in lower costs for services than in an oligopoly or monopoly but higher overall costs than in a monopsony or oligopsony. The cost for services should largely be determined by the collective behavior of actors in the market. Thus, efforts by either principals or PMSCs to haggle over compensation will simply result in substitution by one side or the other. As with price, contractual points addressing performance benchmarks and imposition of penalties will also likely converge to reflect market requirements. Therefore, benchmarks set for PMSC performance in a competitive market are likely to be more demanding than in markets with few suppliers but less demanding than in markets with a small number of buyers. Because substitution with another PMSC of similar capability is a realistic prospect, principals will seek to draft contracts of short duration so they will not be forced to stick with firms that underperform.

Monitoring in a PMSC market characterized by competition is likely to present several difficulties for principals. As a result of frequent contracting and substitution by both principals and agents, it may be difficult to implement regular monitoring structures, practices, and patterns. That is, each time a contract is executed with a new PMSC, a new monitoring regime must be established and implementation of this regime must be regularized. Unless contracts are renewed over a period of years, this is likely to make the monitoring process difficult to standardize. It is also likely that short-term contracting gives PMSCs a better chance of successfully shirking responsibility, as principals are more likely to detect systematic underperformance over a long period than during a short-term agreement.

With respect to sanctions, in a competitive market the length of contracts is likely to be shorter than in other market structures. Because both principals and PMSCs have other options in the marketplace, neither is likely to seek a long-term agreement. That is, both sides may frequently look to test the waters in an effort to find a better deal. Principals are likely to negotiate short-term contracts with PMSCs and penalize them with nonrenewal if firms do not meet the criteria outlined in the agreement. Over time, firms that regularly underperform are likely to cease being hired as the result of deterioration of their reputation and brand. Similarly, firms with a strong record of fulfilling contractual obligations should likely see more demand for their services.

To summarize, in a market with many buyers for the services of PMSCs, the cost of contracting private defense firms is likely to be higher than in a monopsony or oligopsony. As Avant has noted previously, a market in which

PMSCs are able to contract with numerous principals is likely to increase the costs of monitoring and make enforcement of PMSC behavior more difficult.[51] Thus, even though competitive markets are usually touted as an ideal market structure, in the private defense industry they may result in higher costs for principals, which are often governments using tax revenues to augment national defense. To avoid this increase in costs, governments should do their best to limit the entry of new principals into the marketplace and so prevent PMSCs from contracting with additional clients. Furthermore, while a relatively large number of private defense firms is necessary for a competitive market to exist, governments should attempt to limit the formation of too many firms in order to reduce costs associated with screening and adverse selection.

Monopoly and Oligopoly

Monopoly and oligopoly are the supply-side equivalents to monopsony and oligopsony. A monopoly is a market structure in which there is only one major seller of a good or service while an oligopoly is a market structure where there are only a small number of sellers.[52] In these types of markets, the actions of one firm can have a significant effect on overall market conditions, including direct influence on the price of a good or service.[53] How will monopolistic and oligopolistic structures affect principal–agent dynamics in PMSC markets?

Since there are a small number of PMSCs in both monopolies and oligopolies, problems associated with adverse selection during screening will be reduced. Principals will likely be able to gather extensive and accurate information about the few PMSCs in the marketplace and should be able to make accurate decisions about the capabilities of these firms. The diminishment of adverse selection problems in these market types, however, will not resolve other difficulties associated with the principal–agent relationship. Specifically, although information about PMSC capabilities is readily available, contractors' bargaining leverage in monopolies and oligopolies can make the negotiation process more difficult for buyers. The relative paucity of PMSCs competing for contracts means that threats by principals to select alternate companies might not be as compelling as they would be under conditions of competition, oligopsony, or monopsony. This will make PMSCs less likely to submit to contractual requests such as fixed benchmarks of performance.

In both monopolies and oligopolies, principals face a double-edged sword with respect to monitoring and sanctioning PMSCs. Monitoring may be easier than in

[51]Deborah Avant, "The Emerging Market for Private Military Services and the Problems of Regulation," in *From Mercenaries to Market*, 186.

[52]Typically, a market is characterized as an oligopoly if fewer than five firms account for more than 60% of total sales of a good or service.

[53]Oligopoly is a relatively common market structure. Because firms in an oligopoly can have such a strong effect on overall market conditions, they sometimes share information in an effort to work together to reduce risk and control an entire market in a strategy known as collusion.

monopsonies, oligopsonies, or competitive markets because there are simply fewer firms for principals to scrutinize. That is, regular communication and interaction between principals and PMSCs in these markets likely will result in more efficient monitoring of their behavior. While monitoring of PMSCs may be more efficient, effectively enforcing sanctions in both monopolies and oligopolies is likely to be challenging. Because there are only a few large firms providing services, small penalties levied against one firm may not be a sufficient deterrent to prevent shirking. Furthermore, government threats of severe sanctions or denial of future contracts against PMSCs are not credible because there are few alternative suppliers. Finally, since PMSCs in monopolies and oligopolies are often fairly large companies that possess significant financial resources, they can potentially challenge penalties in court for extended periods of time. Principals may be less likely to attempt to impose severe sanctions if they believe that PMSCs can afford to engage in drawn-out court battles.

Summary

This section argued that market structure influences the principal–agent relationship in private defense markets. In monopsonies and oligopsonies—markets with dominant buyers of defense services—adverse selection and shirking are likely to be reduced because PMSCs are reluctant to harm their reputation with the only sources of demand. Monopsony and oligopsony thus represent preferable market structures for principals in the private defense industry. In monopolies and oligopolies, levels of adverse selection are likely to be low and monitoring is relatively efficient; however, when PMSCs do not adhere to their obligations, there is little principals can do to sanction firms because there are few alternate suppliers. In competitive markets, prices for services are likely to be lower than in markets with few suppliers; however, low barriers to entry result in high levels of adverse selection and difficulty in establishing monitoring practices. In these market types, the costs associated with contracting are likely to cancel out the savings principals receive as the result of competition between PMSCs. The following sections assess the hypotheses presented in this section by testing them on three different PMSC markets.

Monopsony Case Study: The Market for Intelligence Services in the United States

In recent years, pressure on the US government to expand its intelligence gathering and analysis capabilities in an effort to prevent terrorist attacks against American interests has led to increased outsourcing in this market.[54]

[54]Glenn J. Voelz, “Contractors and Intelligence: The Private Sector in the Intelligence Community,” *International Journal of Intelligence and Counterintelligence* 22, no. 4 (2009): 586–613; Raphael S. Cohen, “Putting a Human and Historical Face on Intelligence Contracting,” *Orbis* 54, no. 2 (March 2010): 232; Chesterman, “‘We Can’t Spy … If We Can’t Buy!’,” 1055–1074.

Simon Chesterman notes that many facets of the intelligence process, including electronic surveillance, rendition, interrogation—and even analysis—are increasingly being handed over to private corporations.[55] In their investigation into government military and intelligence outsourcing for the *Washington Post*, Dana Priest and William M. Arkin, like Chesterman, point out that contractors presently are involved in almost all aspects of intelligence work: "Contractors kill enemy fighters. They spy on foreign governments and eavesdrop on terrorist networks. They help craft war plans … They are the historians, the architects, the recruiters in the nation's most secretive agencies … They are among the most trusted advisors to the four-star generals leading the nation's wars."[56] Present estimates are that the United States hires over seventy thousand contractors and spends about $42 billion per year on private intelligence services; this accounts for roughly seventy percent of the total American intelligence budget.[57]

Identifying the Market Structure for Intelligence Services in the United States

The market for intelligence services in the United States is best characterized as a monopsony.[58] The American government is the primary buyer of intelligence services provided by private corporations, and the rise of firms in this sector has coincided with increased post-9/11 counterterrorism spending, thus indicating that the market revolves around government demand.[59] In fact, a third of the firms operating in the private intelligence market were formed after the 9/11 attacks in order to fill increased demand from the US intelligence community.[60]

Although the US government is often characterized as a unitary actor in literature on outsourcing, the numerous departments and agencies making up the American intelligence community are the organizations directly responsible for contracting with private firms.[61] The decentralized nature of the procurement process, however, does not mean the government loses the leverage it possesses by

[55]Chesterman, "'We Can't Spy … If We Can't Buy!'," 1055.
[56]Dana Priest and William M. Arkin, "National Security Inc.," *Washington Post*, 20 July 2010, http://projects.washingtonpost.com/top–secret–america/articles/national–security–inc/.
[57]Chesterman, "'We Can't Spy … If We Can't Buy!'," 1055; Voelz, "Contractors and Intelligence," 587; Priest and Arkin, "National Security Inc."; Cohen, "Putting a Human and Historical Face on Intelligence Contracting," 232.
[58]Monopsony is an atypical market structure; however, in the private defense industry it occurs with some frequency because governments are the major buyers of many defense services supplied by the private sector. For instance, see McFate, *The Modern Mercenary*, 12. McFate notes that in the United States the growth of the private defense industry corresponds with an increase in US government demand for services.
[59]Several sources note that the US government is the primary client of most American firms supplying defense and intelligence services. For example, see Berrios, "Government Contractors and Contract Behavior," 120; McFate, *The Modern Mercenary*, 12. On the large number of corporations providing intelligence services to the US government see Dana Priest and William M. Arkin, "A Hidden World, Growing Beyond Control," *Washington Post*, 19 July 2010; Priest and Arkin, "National Security Inc."
[60]Dana Priest and William M. Arkin, *Top Secret America: The Rise of the New American Security State* (New York: Little Brown and Company, 2011), 194.
[61]The CIA, DoD, DHS, NSA, and FBI are among the primary departments and agencies involved in hiring private intelligence firms; however, all sixteen major US intelligence agencies contract with private firms to assist them in their work.

being a monopsonist in this market. For one thing, roughly half of the firms supplying intelligence services to the government contract with just one agency.[62] In these cases, problems that might reduce government leverage over contractors, such as lack of information sharing between agencies and interagency competition over firms' services, are not present. In addition to this structural reality of the intelligence marketplace, the president and Congress use several resources in an effort to impose uniform standards on the outsourcing process. Presidents routinely issue orders on contracting practices and outline policy objectives to department and agency leaders.[63] In addition, the Office of Management and Budget (OMB) exerts considerable influence over the procurement process to ensure it is aligned with the president's policies.[64] Similarly, the Government Accountability Office (GAO), Congress' independent audit and investigation agency, reviews outsourcing decisions to assess the efficiency of intelligence contracting across agencies and departments.[65] Finally, Congress exerts oversight of the US intelligence community by holding frequent hearings investigating contracting practices and questioning department and agency heads about defense and intelligence outsourcing.[66] Consequently, while the government does face its own principal–agent dilemma related to the delegation of contracting responsibilities across agencies, its characterization as a monopsonist in this market is accurate because it is the dominant buyer of intelligence services in the United States and also exerts ultimate procedural and policy control over outsourcing.[67]

On the supply side of the intelligence market, there are thousands of firms competing to secure government contracts. Unlike the market for close protection, however, barriers to entry for firms supplying intelligence services are relatively high. To obtain a contract, a company must either have advanced technological skills, operate machinery or software that government employees cannot manage themselves, or possess human resources that significantly augment the US government's capabilities.[68] Corporations active in the industry publicly acknowledge the

[62]Dana Priest and William M. Arkin, "Companies," *Washington Post*, 20 July 2010, http://projects.washingtonpost.com/top–secret–america/companies/. Priest and Arkin constructed a dataset, available on *Washington Post* website, that lists 1,930 firms contracting with the US intelligence community. The dataset lists the number of individual agencies each firm contracts with. Priest and Arkin find that 48% of firms providing intelligence services to the United States contract with just a single government client.

[63]On the chief executive's influence over agency and department contracting practices see Berrios, "Government Contractors and Contractor Behavior," 121; Voelz, "Contractors and Intelligence," 596–97. For example, in the late 1990s President Clinton instructed department and agency leaders to make past performance a key factor in future awarding decisions. Similarly, the Obama administration's concern that contractors were carrying out inherently governmental functions resulted in a 2009 directive to reign in outsourcing in areas such as detainee interrogations.

[64]Voelz, "Contractors and Intelligence," 593–97.

[65]Ibid., 593–604.

[66]Berrios, "Government Contractors and Contactor Behavior," 128; Voelz, "Contractors and Intelligence," 596–97.

[67]Principal–agent problems related to delegation of responsibilities across internal organizational units are not unique to the government. In fact, many large companies face similar challenges.

[68]Many contractors in this sector are former intelligence officials with skills and knowledge that can not be easily learned. On the "revolving door" between government intelligence work and private sector contractors, see Tim Shorrock, *Spies for Hire: The Secret World of Intelligence Outsourcing* (New York: Simon and Shuster, 2008), 365–78. Some experts contend that hiring these individuals as contractors helps keep talented individuals in the service of the US government. For example, see Cohen, "Putting a Human and Historical Face on Intelligence Contracting," 250.

dominant role the government has in the marketplace. For instance, General Dynamics (GD), one of the largest intelligence service contractors in the United States, has publicly stated: "[W]e have tailored our organization to deliver affordable, best-of-breed products and services to meet those [government] agencies' unique requirements."[69] This type of corporate restructuring—intended to meet the changing demands of a single client—is characteristic of a monopsonistic market structure. Furthermore, GD's behavior is not unique, as many companies in the intelligence market have either been formed specifically to win government contracts or rely on the government for the bulk of their business.[70]

The Principal–Agent Relationship in the Market for Intelligence Services

While firms contracted to perform intelligence services do not always succeed in fulfilling the terms of their agreements, there does not appear to be a culture of impunity and recklessness that many argue is present in other PMSC service industries, such as those for close protection and static security. In fact, although PMSCs carrying out functions once performed by state militaries is a relatively recent phenomenon, there is an extensive tradition of US intelligence agencies contracting with private firms to assist with collection of information deemed vital to US security interests.[71] As Raphael S. Cohen notes, in the United States, "intelligence contracting pre-existed the creation of formal intelligence bureaucracies."[72] For this reason, he contends that firms in the industry are "reliable and … fundamentally intertwined with the art of intelligence gathering."[73]

Because of the long tradition of interaction between private firms and US intelligence agencies, and because firms risk stoking the ire of the only buyer in the market if they are discovered to be engaging in systematic delinquency, there is a relatively low level of misconduct in this sector of the private defense industry. Similarly, regular contracting between the government and firms in the sector means that adverse selection is less likely to occur. That is, over decades of working with companies in the intelligence market, the US government is well aware of the capabilities of firms and is unlikely to make suboptimal decisions choosing among them. Overall, the record of firms in the PMSC intelligence market is respectable. Chesterman notes that among PMSCs involved in intelligence gathering, although there are instances of underperformance, these are few and far between.[74] Similarly, Cohen argues that the long history of successfully outsourcing intelligence

[69]Quoted in Priest and Arkin, *Top Secret America*, 179.
[70]Ibid., 156–76.
[71]Voelz, "Contractors and Intelligence," 588–91.
[72]Cohen, "Putting a Human and Historical Face on Intelligence Contracting," 232.
[73]Ibid.," 233.
[74]Chesterman, "'We Can't Spy … If We Can't Buy!'," 1058. In this section, Chesterman is referring to companies that help intelligence agencies gather and analyze information.

tasks demonstrates that the practice is not inherently flawed and that private firms regularly fulfill their obligations.[75]

The best documented recent case of misconduct in this sector involved human rights violations that occurred during interrogations directed by the private defense firms CACI International and Titan Corporation at Abu Ghraib prison in Iraq. [76] After an internal investigation, the Army found that six CACI employees were culpable for instructing US troops to carry out cruel and degrading interrogations of inmates at the prison.[77] A case against CACI filed by former inmates of Abu Ghraib remains in the courts, but no charges have been filed against individual CACI employees.[78] Chesterman points out that there has been just one case of a contractor convicted of a crime related to interrogations during the entire "War on Terror."[79] Nonetheless, the US government did not renew contracts with CACI for interrogation services in Iraq after the grievous misconduct at Abu Ghraib came to light.[80]

Assessment of the Market for Intelligence Services

Unlike the markets for close protection and static security, in which regular misconduct and contract violations by PMSCs appear to be endemic, the market for intelligence services has a relatively strong record of agents performing the tasks assigned to them by principals. US firms supplying intelligence services have only one major buyer, the US government, and thus are wary of underperforming and potentially ruining their relationship with their only major client. A tradition of working with PMSCs and knowing the capabilities of firms such as Lockheed Martin, MITRE, and SAIC reduces the risk of adverse selection. Similarly, repeated interaction between the US government and the same firms allows for more regularized monitoring and evaluations than exist in other sectors of the industry. With respect to sanctions, firms that do not fulfill their obligations or are guilty of misconduct often do not have individual contracts renewed; however, the government rarely entirely excludes large firms working in the intelligence sector from contracting with US departments and agencies, even if they have not lived up to all the requirements of previous agreements.

Competitive Market Case Study: Close Protection and Static Security

Close protection and static facility defense are two services provided by dozens of PMSCs.[81] Close protection consists of guarding high-profile individuals, including

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[75]Cohen, "Putting a Human and Historical Face on Intelligence Contracting," 250–51.
[76]Titan Corporation was purchased by L–3 Communications in 2005.
[77]P. W. Singer, "Outsourcing War," *Foreign Affairs* 84, no. 2 (March–April 2005).
[78]A US federal appeals court recently reinstated the case against CACI. See Catherine Ho, "Abu Ghraib Suit Against Contractor CACI is Reinstated," *Washington Post*, 30 June 2014, https://www.washingtonpost.com/business/capitalbusiness/abu-ghraib-suit-against-contractor-caci-is-reinstated/2014/06/30/9f98d0e2-0074-11e4-8fd0-3a663dfa68ac_story.html.
[79]Chesterman, "'We Can't Spy … If We Can't Buy!'," 1063.
[80]It should be noted, however, that CACI still regularly consults and contracts with the Department of Defense on many other projects.
[81]Firms that offer close protection services also frequently provide static security and risk assessment services.

political leaders, corporate executives, religious figures, and celebrities. Static facility protection entails assessing risks and defending physical infrastructure, installations, and other stationary assets from attacks. Although firms providing protection services are often thought of as quintessential PMSCs, they account for a relatively small total percentage of overall contracts in the industry by value.

Identifying the Market Structure

Because the market for close protection and static security consists of dozens of PMSCs and hundreds of clients, it is best characterized as competitive.[82] On the demand side, there are many principals purchasing close protection and static security services. Over the past decade, US and UK departments and agencies have become major buyers of these services due to increased threats of terrorism in conflict zones including Iraq and Afghanistan.[83] In addition to governments, international organizations and NGOs with employees and offices in high-threat locations often contract with PMSCs to augment security provided by host-nation governments.[84] Finally, large corporations with business interests in high-threat locations also regularly hire PMSCs to assess risks, protect employees, and guard static physical assets.[85]

On the supply side, dozens of PMSCs are able to offer close protection services because barriers to entry are relatively low. Compared with logistical services or information technology services—which require large-scale capital investments, high costs for research and development, and advanced technical capabilities—close protection is a comparatively simple business to start up. The major cost associated with developing close protection and static defense capabilities is in training employees. However, many of these costs can be circumvented if firms are able to recruit individuals who have previously been trained and possess the required skill-set, including many former US military personnel and federal agents.

The Principal–Agent Relationship in the Market for Close Protection

Dealing with PMSCs providing static security and close protection services has proven difficult for principals in several phases of the contracting process. Screening PMSCs in this type of market structure results in relatively high levels of

[82]Although many firms offer close protection and static security services, the quality and scope of these services is not identical. That is, some firms provide higher quality service than others. In addition, some firms are "boutique companies" that accommodate small-scale clients while others cater to large-scale clients such as governments and international organizations.
[83]Beginning in the 1990s, the Clinton administration began to outsource the task of protecting US diplomats and embassies to private contractors. The bombings of US embassies in Kenya and Tanzania in 1998 caused an increase in demand for diplomatic security in countries in conflict zones or in which US representatives were potential targets for terrorism. In an effort to be cost-effective, the task of enhancing security was largely delegated to PMSCs.
[84]Pingeot, *Dangerous Partnership*, 9.
[85]PMSCs such as Aegis Defense Services and Andrews International regularly provide risk assessment and protection services to companies in the oil and gas industries.

adverse selection due to the rapid formation and dissolution of firms and the large number of PMSCs providing these services. In a service area where barriers to entry are low and firms can form quickly, principals face significant challenges in assessing the true capabilities of companies. Perhaps no recent situation better exemplifies the difficulty of screening PMSCs in the close protection market than the Iraq War.

Shortly after the downfall of the Saddam Hussein dictatorship, it became clear that the US armed forces would not be the primary organization tasked with protecting US civilians and government installations in Iraq. Realizing that it lacked the number of personnel necessary to protect its civilian employees, the US government quickly called upon private firms to fill the gap. Established PMSCs, including Triple Canopy, Blackwater, and DynCorp, were awarded contracts to protect US diplomatic staff and facilities around the country.[86] Moreover, dozens of firms that formed shortly before or even during the war were also contracted by the US government to provide close protection and static defense services.[87] Several firms went from being "undercapitalized start-ups" to profitable companies earning upwards of $75 million in annual revenues in just a handful of years.[88]

There are two main reasons the US government contracted with multiple firms for close protection and static security in Iraq. First, the personnel necessary to protect the civilian contingent in Iraq was significant, especially as insurgent groups emerged, grew in strength, and increased the level of violent attacks from 2005–2007. No single firm could supply the staffing necessary to protect the large US civilian contingent in Iraq. In fact, the demand for PMSC personnel was so great that at times there were more private security contractors in Iraq than regular troops.[89] Second, by contracting with numerous PMSCs, the US government was able to encourage competition among firms in the bidding process and likely paid a lower overall price for close protection and static security services.[90]

The performance and monitoring of firms providing close protection and static security in Iraq was riddled with problems. The most well-documented cases of shirking are associated with the company formerly called Blackwater International.[91] Blackwater agents have been criticized for systematic violations, including improper use of weapons, excessive violence, failure to operate vehicles properly,

[86] Nathan Hodge, *Armed Humanitarians: The Rise of the Nation Builders* (New York: Bloomsbury, 2011), 195–96.

[87] Steve Fainaru, *Big Boy Rules: America's Mercenaries Fighting in Iraq* (New York: Perseus, 2008), xiv. Custer Battles is one of a number of firms that formed around the time of the Iraq War.

[88] J. T. Mlinarcik, "Private Military Contractors and Justice: A Look at the Industry, Blackwater, and the Fallujah Incident," *Regent Journal of International Law* 4 (2006): 134.

[89] Trevor Taylor, "Private Security Companies in Iraq and Beyond," *International Affairs* 87, no. 2 (March 2011), 446; Jonathan Stray, "What Did Private Security Contractors Do in Iraq?" *Overview*, 21 February 2012, https://blog.overviewdocs.com/2012/02/21/iraq-security-contractors/.

[90] Some contracts awarded to firms providing close protection services were not competitive. For instance, in 2003 Blackwater was awarded a no-bid contract to protect L. Paul Bremer, the chief of the Coalition Provisional Authority in Iraq.

[91] Blackwater has since changed its name twice, first to Xe Services and then to Academi. In 2014, Academi merged with Triple Canopy to form Constellis Holdings. See Kate Brannen, "Blackwater's Descendants Are Doing Just Fine," *Foreign Policy*, 1 July 2014, http://foreignpolicy.com/2014/07/01/blackwaters–descendants–are–doing–just–fine/.

and violations of drug and alcohol policies.[92] In addition to contract violations in Iraq, Blackwater consistently broke US law and defied US authority in other aspects of its business operations. In August 2012, the company agreed to pay a $7.5-million-dollar fine related to arms smuggling. The company was also accused of possessing automatic weapons in the United States without a license, lying to federal agents, disseminating classified state secrets to foreign governments, and illegally shipping body armor overseas.[93]

Blackwater is not the only PMSC in the close protection and static defense sector to violate contract terms or shirk duties. DynCorp, one of the major corporations protecting State Department personnel in Iraq and Afghanistan, has been found guilty of regularly overbilling the US government for services.[94] In addition, the company violated the Foreign Corrupt Practices Act by bribing overseas officials to speed up the issuance of visas and permit approvals.[95] Overall, the State Department assessed DynCorp's performance in Iraq as lackluster, and in a July 2010 evaluation gave DynCorp a rating of one out of five for overall "customer satisfaction."[96]

PMSCs in the close protection and static security sector hired by international organizations have also been criticized for their regular violation of contract terms. For instance, in recent years the UN has become a major client of PMSCs and has steadily increased the number and total dollar value of contracts.[97] A major recipient of UN security contracts is UK firm G4S and its subsidiary ArmorGroup. In 2008 in Afghanistan, ArmorGroup was tasked with protecting several UN and US sites. To fulfill a number of these contracts, ArmorGroup subcontracted with Afghan warlords to supply personnel rather than using their own guards.[98] ArmorGroup has also been accused of mismanagement and misconduct by former employees as well as by the US government while the firm was responsible for protecting the US embassy in Kabul.[99] The findings of a report published by the Project on Government Oversight maintain that guards regularly worked extended shifts of fourteen hours at a time and engaged in a culture of "hazing" that resulted in a "pervasive breakdown" in the morale and quality of defense service at the embassy.[100]

[92]"Blackwater Boss Grilled Over Iraq," *BBC News*, 2 October 2007, http://news.bbc.co.uk/2/hi/middle_east/7024370.stm.
[93]Michael Biesecker, "Company Once Known as Blackwater Settles Arms Case," *Boston Globe*, 8 August 2012, https://www.bostonglobe.com/news/nation/2012/08/07/company–once–known–blackwater–settles–arms–case/ohZl8zoE5gwFTXaihevj3N/story.html.
[94]V. Dion Haynes, "DynCorp Billed U.S. $50 Million Beyond Costs on Defense Contract," *Washington Post*, 12 August 2009, http://www.washingtonpost.com/wp–dyn/content/article/2009/08/11/AR2009081103461.html.
[95]August Cole, "DynCorp Says It May Have Broken U.S. Law," *Wall Street Journal*, 19 November 2009, http://www.wsj.com/articles/SB10001424052748704533904574543974050882150.
[96]David Isenberg, "0 + 1 + 0 + 0 + 0 = DynCorp," *Huffington Post*, 23 February 2012, http://www.huffingtonpost.com/david–isenberg/dyncorp–government–contracts_b_1295623.html.
[97]Pingeot, *Dangerous Partnership*, 23–24.
[98]Ibid., 30.
[99]Ginger Thompson, "Misconduct Claimed at U.S. Embassy in Kabul," *New York Times*, 1 September 2009, http://www.nytimes.com/2009/09/02/world/asia/02embassy.html?_r=0.
[100]Danielle Brian, "POGO Letter to Secretary of State Hillary Clinton Regarding U.S. Embassy in Kabul," Project on Government Oversight, 1 September 2009, http://www.pogo.org/our–work/letters/2009/co–gp–20090901.html.

Assessment of Market for Close Protection and Static Security

The market structure for close protection and static security services is best characterized as competitive. There are dozens—if not hundreds—of firms offering similar but not identical services; the numerous buyers of these services include governments, international organizations, NGOs, and MNCs. Because of low barriers to entry, firms can enter the market easily. This results in high levels of adverse selection because principals lack sufficient information about the capabilities of new firms. Because contracts are generally short-term and because firms can contract with a number of principals, shirking and poor performance plague this service sector.

Has general poor performance in protection markets resulted in substitution by principals? Certainly some of the smaller firms that operated during the 1990s and in the early years of the Iraq War have been penalized and gone out of business. In the case of larger firms, however, principals have not been so quick to award contracts to other PMSCs or to develop capabilities internally so that outsourcing would become unnecessary. The State Department did not renew some of its contracts with Blackwater in 2010 after the Iraqi government refused to grant the PMSC a license to operate in the country. However, the State Department did not subsequently terminate all contracts with Blackwater and continues to work with its successor corporation in other areas of the world.[101] The effect of systematic violations and bad publicity on Blackwater's reputation, however, has led analysts to believe that the company's business has been damaged. This is often cited as one of the reasons that, over the past three years, Blackwater has changed its name twice, first to Xe Services and then to Academi. Other large firms such as DynCorp, Triple Canopy, and G4S continue to contract regularly with governments and international organizations for close protection and static security services despite past shortcomings in the services they provided.

Oligopoly Case Study: The US Market for Logistics and Base Operations

PMSCs are typically thought to provide military services such as close protection and training courses for armed forces and police. However, PMSCs are also integral to the construction, maintenance, and day-to-day operations of military installations, both within the United States and in overseas theaters of conflict. Tasks associated with operations and facilities management include vehicle and equipment maintenance, water treatment and distribution, grounds maintenance, basic IT services, fuel supplies, food services, and even laundry management.

Identifying the Market Structure

Logistics, facilities maintenance, and base management are the most lucrative sectors of the PMSC industry.[102] Because of the large-scale capital and material

[101]Brannen, "Blackwater's Descendants Are Doing Just Fine."
[102]Deborah D. Avant and Renée de Nevers, "Military Contractors and the American Way of War," *Daedalus* 140, no.3 (Summer 2011): 89–90.

requirements involved in these services, there are just a handful of firms able to operate in the sector, including KBR, Fluor, DynCorp, and Babcock International.[103] Three of these four companies are publicly traded on major stock exchanges and all have annual revenues of over $1 billion.[104] These corporations provide a wide range of services to the US government and to certain foreign governments, and they likewise contract with corporations in such businesses as construction, oil services, and mining. Because just a few large firms dominate the market for base operations and facilities management, and because these firms also contract with other principals, the market structure is best characterized as an oligopoly.

The Principal–Agent Relationship in the Market for Base Operations

The small number of firms offering large-scale military support services means that the US government lacks options for substitution. Thus, while there is competition in the industry, firms have some assurance that it is unlikely they will be completely excluded from the market. Adverse selection problems are not the major source of difficulty for principals in this market because there is significant knowledge about the capabilities of firms offering services. Instead, the government faces major problems related to negotiation, oversight, and sanctioning.

With respect to negotiation, firms in the logistics sector are awarded some of the largest and most lucrative contracts in the PMSC industry. For instance, from 2002–11 in Afghanistan, contracts to firms providing logistics, base operations, and facilities services totaled almost $57 billion dollars. In comparison, approximately $3.8 billion was spent on protection services.[105] Logistics services are expensive because of the massive up-front costs involved for contractors. While risk assessment and protection services require minimal inputs to start-up and run operations, the same is not true for firms in the logistics sector. Therefore, the overall cost of these contracts tends to be higher; however, the lack of significant competition means that firms can underperform without fear of being seriously sanctioned by the government. In addition, the fact these firms also contract with other companies in the private sector reduces the government's leverage over them.

KBR and DynCorp, two major firms in the sector, have both been found culpable of systematic underperformance while under contract to provide logistics services for the US military in Iraq and Afghanistan. KBR was the sole provider of

[103]Babcock International is based in the UK. A Kuwait-based firm, Agility Logistics, has in the past offered significant logistics services to US troops based in Kuwait and Iraq. Other PMSCs are also involved in base management and logistics services but generally at a more specialized level.

[104]DynCorp is held privately by Cerberus Capital Management.

[105]United States Government Commission on Wartime Contracting in Iraq and Afghanistan, *Transforming Wartime Contracting: Controlling Costs, Reducing Risks* (August 2011), 23. The Commission on Wartime Contracting was a bipartisan commission established by the US government in 2008 to assess government military contracting in Iraq and Afghanistan. The commission's final report to Congress, which contains findings and recommendations for legislative and policy changes, is available at: http://www.wartimecontracting.gov/docs/CWC_FinalReport–lowres.pdf.

facilities management and base operations to the US Army in the early years of the wars in Iraq and in Afghanistan under the Army's Logistics Civil Augmentation Program (LOGCAP) III.[106] As the sole source provider of these services, KBR's cost estimates, billing practices, and performance were found to be seriously deficient. In a review of KBR's cost estimations and billing, the US government's Commission on Wartime Contracting (CWC) concluded: "As sole provider, without the discipline of task order competition, KBR proposals included large amounts of questioned and unsupported costs identified by the Defense Contract Audit Agency (DCAA). KBR billings also included large amounts subject to challenges for disallowance."[107] In essence, KBR was using its temporary monopoly as sole source provider of logistics services to inflate costs, thus earning more on contracts and overbilling the government for services performed.

With respect to implementation, the CWC described KBR as engaging in a consistent pattern of underperformance and misconduct. These citations include: illegal kickback payments, general "unpreparedness" to carry out awarded contracts, failure to report key data about vehicle use to appropriate authorities, and a systematic pattern of faulty construction and electrical wiring at numerous facilities constructed by the company.[108] KBR's underperformance caused the US government to contract with other suppliers of logistics services when LOGCAP IV, the follow-up to LOGCAP III, was announced. Under LOGCAP IV, Fluor and DynCorp were added along with KBR as primary contractors for the provision of logistics services to the US military in Iraq and Afghanistan.

Under LOGCAP IV, DynCorp has emerged as a major provider of logistics services to the US military. Like KBR, however, DynCorp's record is marred by poor performance and a systematic pattern of overbilling the government. The CWC's assessment of DynCorp's record notes that the company performed inadequately in "management, acquisition, receiving/records management, [managing] physical inventories, equipment utilization, and maintenance."[109] In addition, DynCorp failed to fulfill its duties on contracts it won to carry out electrical repairs and to provide fire protection at military facilities throughout Afghanistan.[110]

Assessment of the Market for Logistics Services

The PMSC market for logistics is best characterized as an oligopoly because of the small number of powerful firms offering services. Just a handful of companies, including KBR, DynCorp, Fluor, and Babcock International, have the capacity to provide the logistics services that the US military and other governments require to maintain their forces in foreign theaters of conflict and on overseas bases. The

[106] Ibid., 75.
[107] Ibid.
[108] Ibid., 77–89.
[109] Ibid., 88.
[110] Ibid., 88–89.

small number of companies in the logistics sector means that adverse selection due to information asymmetry is likely to be lower than in some other sectors of the industry.[111] Because there are few options for substitution, firms in the sector often attempt to charge a premium for their services. Regular long-term contracts with the same firm enable principals to detect misconduct and underperformance; however, effectively penalizing PMSCs is difficult. Even if firms' performance is found to be subpar, substitution is difficult. For instance, KBR and DynCorp remain major contracting partners with the US government despite consistently poor performance records in Iraq and Afghanistan.

Assessing the Theory and Future Research Questions

The three cases examined in this inquiry demonstrate that there is strong evidence linking market structure to contracting efficiency and company behavior in the PMSC industry. In the study's theoretical section, hypotheses were advanced concerning four stages of the principal–agent relationship—screening, negotiation, monitoring, and sanctioning—and the likely influence variation in market structure would have on each stage. With respect to screening, as predicted only the competitive market for protection services was characterized by adverse selection, which occurred as the result of information asymmetries caused by the rapid formation and dissolution of firms. In the negotiation phase, the hypothesis advanced about firms' bargaining leverage in oligopolies was reinforced by the presence of lucrative, cost-plus contracts awarded to PMSCs operating in the base logistics market. This market is characterized by just a handful of large companies on the supply side. In the monitoring phase, low levels of shirking in the monopsonistic US intelligence market contrasted with higher levels of shirking in both base logistics and protection markets; this finding was also in line with hypotheses presented in Table 2.

Although hypotheses about screening, negotiations, and monitoring were reinforced by findings from the cases, there was one area of the principal–agent relationship where the behavior of principals did not correspond to predictions: sanctioning. In both the markets for intelligence and protection, PMSCs that underperformed were not penalized severely and continued to work with principals that had contracted them. Although these findings weaken the inquiry's hypotheses associated with sanctions in the PMSC industry, they do not necessarily invalidate the study's broader arguments, which largely reinforce the association between market structure and contracting dynamics across other stages of the principal–agent relationship in the private defense industry.

[111] This does not mean that adverse selection is completely removed from the screening process in oligopolies.

What utility does the inquiry's larger theory possess if evidence gathered in case studies yielded results counter to hypotheses in the sanctioning phase? When theory construction in a research area is its early stages, as is the case with explanatory theory assessing aspects of the PMSC industry, advancement of knowledge typically occurs through an iterative process in which deductive theory is developed, tested on empirical material, and then reassessed based on the results.[112] If a theory demonstrates little ability to explain reality, it should be discarded; however, if a theory is able to account for a significant portion of empirical material examined, it should not be abandoned because of disconfirming evidence discovered when testing one of the numerous hypotheses it generated.[113] Instead, when this occurs, researchers generally seek to identify omitted variables that may account for the unanticipated results.[114] In fact, when causal theory is first being developed in a research program, one purpose of carrying out case studies is to identify new variables that may need to be incorporated into a larger theory.[115] To date, research on the private defense industry has produced little in the way of causal theory; therefore, it is to be expected that an iterative process of theory construction will take place at the outset of the endeavor. The theory developed in this inquiry has demonstrated the capacity to explain a significant portion of actors' behavior across different markets in the industry, with only the general lack of penalties emerging as a surprising outcome. In addition, the case studies used as initial tests of hypotheses have helped identify new variables that may account for the low levels of sanctioning across the industry. The following section addresses explanations that might account for the scarcity of sanctioning in the private defense industry and suggests directions for future research in the field.

Directions for Future Research

A general lack of sanctioning remains prevalent across the private defense industry. As Chesterman notes, many PMSCs operate with little prospect of meaningful accountability for their actions.[116] If market structure alone cannot account for the low prevalence of penalties against PMSCs, why else might principals avoid punishing companies' bad behavior? Two explanations that may account for the scarcity of penalties against PMSCs are path dependence and the effects of ongoing business relationships within the industry. Path dependence, which in its most simple characterization is defined as "history matters," may account for a lack of sanctions if principals seek to avoid the

[112]George and Bennett, *Case Studies and Theory Development in the Social Sciences*, 239–48.

[113]Discovery of new independent variables through case study research does not necessarily invalidate a theory; rather, it may narrow a theory's explanatory scope. Discovering new or omitted variables is one of the fundamental purposes of carrying out case study research. See Ibid., 109–24.

[114]Ibid., 111–14.

[115]Ibid., 111–12.

[116]Simon Chesterman and Angelina Fisher, "Conclusion: Private Security, Public Order," in *Private Security, Public Order: The Outsourcing of Public Services and Its Limits*, ed. Chesterman and Angelina (New York: Oxford University Press, 2009), 222–26.

costs, time, and labor associated with hiring a new firm after a PMSC has underperformed.[117] That is, even though some PMSCs shirk their duties, principals may avoid searching for a replacement contractor because of expenses associated with hiring an alternate company. In addition to path dependence, personal relationships and corruption might also explain the absence of significant sanctioning.[118] PMSCs and government agencies often work with each other on numerous contracts. Over time, repeated interactions develop into business associations built on trust and personal judgment. These relationships may cause principals to overlook poor performance and to treat PMSCs leniently when they fail to live up to contract terms. In addition, corruption associated with the so-called "revolving door" that exists between government agencies and PMSCs may result in a general reluctance to penalize firms that one day could serve as employers of officials currently working in government.[119]

In addition to identifying new explanations that may account for a lack of sanctioning in the industry, the arguments developed in this inquiry have broad potential to generate new research questions in the field as well as to be used in efforts to explain the varying characteristics of a number of additional private defense markets. Presently, research on PMSCs is expanding from a focus primarily on American markets to include studies characterized by a broad, global outlook.[120] While departments and agencies within the US government remain the largest buyers of private defense services and continue to be important subjects of inquiry, researchers are assessing outsourcing of defense in other countries, including the United Kingdom, Canada, the Czech Republic, Germany, Kenya, and more.[121] Concepts and arguments about market structure and its influence on the principal–agent relationship in PMSC markets presented in this study can be applied to the above cases. In each instance, theoretical leverage in explaining the characteristics of the market can be examined using the method outlined in this study: determining what specific defense service is being offered, ascertaining the buyers and sellers in the marketplace, identifying the structure of the market, and assessing if this structure alters contracting dynamics between PMSCs and their principals. The theory and method of analysis put forth here offer a replicable approach to explaining

[117]For more on path dependence see Paul Pierson, *Politics in Time: History, Institutions, and Social Analysis* (Princeton, NJ: Princeton University Press, 2004).

[118]Berrios, "Government Contractors and Contractor Behavior," 121–22.

[119]For more on the revolving door between government and private firms see Voelz, "Contractors and Intelligence," 604–6.

[120]The focus on US-based contractors as well as foreign firms contracting with US departments and agencies is largely due to the role these PMSCs played in the wars in Iraq and Afghanistan. As the US military presence in these countries has decreased, interest in PMSCs has expanded beyond these specific conflicts.

[121]Carlos Ortiz, "The Market for Force in the United Kingdom: The Recasting of the Monopoly of Violence and Management of Force as Public–Private Enterprise," in *The Markets for Force*, 52–71; Elke Krahmann, "Private Military Services in the UK and Germany: Between Partnership and Regulation," *European Security* 14, no. 2 (2005): 277–95; Christopher Spearin, "The Canadian Market for Force," in *The Markets for Force*, 132–44; Oldřich Bureš, "The Market for Private Force in the Czech Republic," in *The Markets for Force*, 71–86; Kennedy Mkutu, "The Private Security Industry in Kenya: Issues and Challenges," in *Private Military and Security Companies*, 177–203.

variation in contractor performance across all private defense markets. The utility and scope of the theory will ultimately be determined by its future ability to explain this variation.

Concluding Thoughts

This inquiry addresses how different market structures influence contracting dynamics in the private defense industry. The study's central argument is that variations in market structure alter the corresponding principal–agent relationship between clients and contractors, sometimes favoring principals and other times favoring PMSCs. To date, little research has examined the distinct characteristics of different private defense markets or explained how these markets function. The framework developed in this inquiry serves as a useful theoretical tool that accounts for variation in firm performance and contracting behavior within different markets across the private defense industry.

In addition to contributing to the emerging theoretical literature on PMSCs, the findings reached in this study have important policy implications. Contrary to conventional wisdom about the advantageous effects of privatization and competition, governments should be wary of free-market solutions in the defense industry due to the high likelihood of both adverse selection and shirking. Instead, a public-private hybrid that resembles a monopsony represents a more secure situation for countries considering outsourcing elements of their national defense. This conclusion implies that governments should strictly regulate and limit the contracting behavior of PMSCs—in effect shaping private defense markets—in order to make firms largely dependent upon the state. In this way, governments will be able to reap many of the benefits of privatization while still maintaining strict control over key facets of their national defense. Finally, in addition to regulating market structure, governments must develop additional policies to address the general lack of PMSC accountability in the private defense industry. These policies include: making past performance an integral component of the screening process, penalizing companies that underperform even when it means incurring the transition costs of contracting with alternate firms, and slowing down the revolving door of employment between governments and PMSCs.

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