
BEYOND THE BOTTOM LINE:

*IDEAS FOR THE FUTURE OF
PUBLIC INVESTMENT IN MINNESOTA*

March 2011



Index

| | |
|--|----------------|
| Letter from Partners | Page 1 |
| Executive Summary | Page 2 |
| Buying Health, Not Sickness | Page 8 |
| Delivering Integrated Health Services: Multi-County Shared Services | Page 16 |
| Tax Expenditures: Minnesota’s Hidden Spending | Page 21 |
| Fundamentally Different Medical Assistance: Improve Public Health and Lower Public Cost | Page 26 |
| Special Education | Page 29 |
| Freeing Counties to Focus on Results | Page 33 |
| Staying Safe; Shifting Resources from Prisons to Community Interventions | Page 35 |
| System Redesign | Page 38 |

Minnesota is a great place. Home to 10,000 lakes, the nation's highest per capita number of Fortune 500 companies and an unparalleled civic spirit, Minnesotans can accomplish almost anything with our unique mix of compassion, creativity and ingenuity. Just imagine what could happen if we applied this same spirit to the state's structural budget challenges. As six Foundations committed to the future of our state, we have come together to explore this very idea.

Our challenge to Minnesota's decision makers, businesses and citizens is simple: *Imagine Another Way*. Imagine a budgeting conversation that moves beyond the polarized battles of raising taxes versus cutting services. Imagine a thoughtful approach to designing our public services that focuses every tax dollar invested to generate the best possible outcomes for Minnesotans, rather than maintaining processes designed by past generations for a passed world.

The following report, *Beyond the Bottom Line*, offers 16 ideas that could help our state's leaders do just that. We commissioned Public Strategies Group to draft these recommendations, which build upon a report of nine redesign ideas suggested in the 2009 report *Minnesota's Bottom Line*. Each idea offers a starting-point for discussing new ways to think about Minnesota's budget problems that can offer real, immediate cost savings while preserving the state's most essential services.

We have commissioned these ideas because we recognize that we cannot solve our state's structural budget problems unless leaders of all politics and persuasions are ready to consider new approaches – and no one can do this alone. But we hope that they are a starting point for conversations in Minnesota's legislatures, civic clubs and communities across the state.

Whether leaders embrace one or all of *Beyond the Bottom Line's* ideas, we hope that they will serve as a clear illustration of the three key principles we hope will guide our state's budget conversations:

- **Make Strategic Choices.** *Prioritization is a critical element of government redesign, from assessing the highest public needs to evaluating the best way of providing services.*
- **Innovate.** *Governments need to think long-term with their budget challenges, and to be willing to toss out the old rules and try new program structures and delivery systems.*
- **Deliver Better Outcomes.** *Paying for processes and continuing with the current results won't be enough. Minnesotans want their government to understand the possible outcomes for the tax dollars they spend.*

From these principles, we believe Minnesota's leaders can find a common ground to address our budget challenges with an eye toward the goal we all share: creating the best possible future for all Minnesotans.



Blandin Foundation™
STRENGTHENING RURAL MINNESOTA



Program Redesign

Minnesota could realize better outcomes from its state government while spending less money if we take advantage of the opportunities to redesign both:

- I. the programs we use to deliver service; and
- II. the administrative systems of government.

It is time to look at the bureaucratic maze that government programs have become over time and create new ways to deliver service with a focus on outcomes for Minnesotans. The following are seven clear opportunities to redesign our service delivery that create more value and are much more efficient.

1 Buying Health Not Sickness

What if Minnesota used the recent shifts in federal policy to convert the entire Minnesota market to one driven by incentives for providers to improve the health status of their clients and, just as critical, serious incentives for each individual to take responsibility for better health? What if the state could save two billion dollars per biennium while seeing health outcomes get better?

Minnesota has the opportunity to **spend \$2 billion less per biennium and get better health outcomes** by focusing on payment reform using a total cost of care approach rather than pay for episodes of illness on a fee-for-service basis. Minnesota's exchange design should focus on better outcomes for Minnesotans through access, quality and price of care. Minnesota should also prioritize Medicaid reform. A serious "incentive," capping or eliminating the tax-free treatment of employer-provided health insurance would help Minnesotans realize the per capita "bite" that result from their health care decisions.

2 Delivering Integrated Human Services

Minnesota's human services system is a tangled intergovernmental puzzle in which responsibility is fragmented and results are elusive. Would the state knock down the silos and give counties real flexibility as well as responsibility, if the state could get better results while saving between \$350-360 million less per biennium?

Minnesota can **spend \$350-360 million less per biennium and get better human services results** for Minnesotans by seeking maximum flexibility through a global Medicaid waiver and through the creation of an innovation fund to invest in promising projects. Minnesota already has several flexible redesign projects underway, including a 12-county project in southeast Minnesota and a Lutheran Social Service project.

3 Tax Expenditures are Minnesota's Hidden Spending

When the budget goes through the grinder every biennium and debates break out over priorities, why does the first \$22.8 billion of revenue slide right by, untouched, not even examined for costs and benefits?

Minnesota has a big **opportunity to get better outcomes while spending up to \$22.8 billion less per biennium** by targeting tax expenditures to those things that get the best results/\$. Examples of large tax expenditures that produce few results include the mortgage interest deduction and the tax-free treatment of employer-provided health insurance. Minnesota could get better housing results and better balance the budget through an approach different than the mortgage interest deduction.

4 Dramatically Different Medical Assistance

Medicaid, designed to protect low-income Minnesotans, gets more expensive every year without delivering better health to those it's supposed to protect. Should Minnesota seek a federal "global waiver" so it can redesign the system to get better results and spend \$500 million less?

Minnesota has a significant opportunity to **spend \$500 million less in FY 2014-15 and get better results** by pursuing a whole-cloth Medicaid waiver to provide maximum flexibility and innovation possibilities for designing Medicaid delivery. Rhode Island has already secured a global waiver. This is a key enabling initiative to drive innovation in other redesign areas.

5 Special Education

Will Minnesota invest in a proven program that reduces the need for special education, avoiding costs ranging up to \$300 million per biennium within eight years, while improving the education prospects for thousands of Minnesota children in their earliest years of school?

Prevention Improves Outcomes and Lowers Costs. Minnesota can **get better special education outcomes and spend \$300 million less per biennium**, by lowering the price of mis-identifying youth as needing special education instruction by initiating a response to intervention prevention model rather than waiting for students to fail before providing assistance. Minnesota can also adopt the federal definition of "students with disabilities" and lower the price of the adversarial system through vouchers.

f Freeing Counties to Focus on Results

Might the state get better results on every front by replacing mandates with real flexibility, focusing just on measurable results? What if these governments could, as some pilots now promise, be even more accountable for results than they are today while yielding savings for the state reaching \$540 million per biennium?

Minnesota could **spend up to \$540 million less per biennium in local aids and get better local government results** by creating a new state-county relationship that holds counties accountable for results (rather than mandated levels of service) in exchange for increased flexibility.

7 Staying Safe by Shifting Resources from Prisons to Community Interventions

Is there evidence that by shifting more criminal proceedings to community-based interventions, Minnesota could actually have safer communities, stop the growth in prisons, and save \$300 million a biennium within eight years?

Minnesota could **reduce recidivism and spend \$15 million less in the next biennium and up to \$300 million less per biennium within eight years** by avoiding building new prisons and reduce recidivism by shifting resources from prisons to community and local corrections and investing in substance abuse programs. Recent studies show these interventions result in significant reductions in rearrest (37%), reconviction for new crimes (43%) and reduced risk of reincarceration for a new felony (57%).

System Redesign

The systems and culture of our state government are basically barren ground for the seedlings of redesign. It can be done; but it takes a lot of leadership and effort pushing back against an existing system that is strongly stacked in favor of the status quo. Therefore, it will support redesign and generally help our state government become an engine of innovation if we begin to make some basic changes in state government's systems and culture. What follows are a series of interventions — ways to change the system and culture — that have proven successful in other jurisdictions. Where we know of measurable short-term benefits to the bottom line, we have so noted. Others have longer term, less individually discernible benefits.

1 Budgeting for Outcomes

Minnesota can **get better value for the limited funds available** if the Governor and the legislature engage in a dramatically different budget process. By asking the question “*what’s the best way to produce the most value with the dollars we have?*” new possibilities for redesign emerge. The way we currently deliver services does not have to be the starting point for the next biennial budget. Rather, the state’s priorities should be the starting point. This approach has demonstrated significant savings and better results in other states.

2 Performance Contracting

Minnesota can **save 10-20% on its service contracts and obtain better results** by engaging in performance contracting. Performance contracting involves paying for results rather than activity and giving providers as much freedom as possible in how they provide those results.

3 Civil Service Reform

Minnesota’s state government has the opportunity to be more **adaptive, innovative and results-oriented** if we begin modernizing our civil service system, which was designed in the early 1900s. This opportunity includes moving toward a system giving managers more freedom while holding them accountable for results, broader job classifications and pay bands to allow more flexibility and mobility in the work force, and linking compensation to team performance.

4 Charter Agencies

Minnesota has a great opportunity to pilot, with select agencies, a results-based approach to producing measurable results (and improvements in those results) in exchange for increased flexibility in the form of waivers from bureaucratic red tape (e.g. needing to seek approval from other agencies before taking action).

5 Performance Management

Minnesota has an **opportunity to make results matter** by regularly reporting on outcomes. Minnesota can establish a set of data measures that matter to Minnesotans to measure, track and publish over time and contract with the Wilder Foundation and its Compass project to provide the information publicly.

6 Innovation Fund

All of the redesign and other changes proposed here require investments that may be capitalized from an innovation fund requiring a **disciplined investment approach** demanding **measurable returns and outcomes for investors** and for Minnesotans. Failure to invest in change is a sure way to keep the status quo.

7 Entrepreneurial Management

Minnesota can **save from 10-20% of everything it spends on internal support services** by using a set of practices called entrepreneurial management. Minnesota can organize its internal support services into oversight services, marketplace services and utility services, and create a small group of deputy commissioners to provide stronger accountability for cost and service quality across these areas.

8 Winning Compliance

Minnesota can **spend from 10-20% less on all of its internal and external regulatory activities, increase compliance and reduce complier burden** by adopting proven modern compliance practices. Minnesota has the opportunity to adopt more creative and less expensive means of ensuring compliance rather than defaulting to the most expensive method (promulgate a rule and enforce it through penalization). Environmental permitting is one example of a policy area that could benefit from this type of systems redesign, where we could improve compliance with environmental standards and achieve an added benefit of improved economic development.

9 Service Sharing

Minnesota has **opportunities other than consolidation** to achieve efficiencies while delivering the same or better outcomes for its citizens. Minnesota could significantly increase choice and competition in local governments by either forbidding local governments from providing services directly but allowing them to contract with whomever they want or limiting suppliers to a reasonable number and have local governments compete to be among that number. Minnesota is particularly likely to see savings and improved outcomes where there are currently duplicative backroom services being provided in the metro area's 170 cities and 347 school districts.

Buying Health, Not Sickness

1

What if Minnesota used the recent shifts in federal policy on healthcare insurance to convert the entire Minnesota market to one driven by incentives for providers to improve the health status of their clients and, just as critical, serious incentives for each individual to take responsibility for better health? What if the state could save a billion dollars a year while seeing health outcomes get better?

How could Minnesotans be healthier — without continuing to devour state and personal resources?

Opportunity

Two years ago, **Buying Health, Not Sickness** suggested that Minnesota could fundamentally change the marketplace to buy “a year’s worth of health,” rather than for paying for episodes of illness.¹

In other words, Minnesota could move from the piecemeal system of paying for every eligible test and treatment to a system of competing providers and plans taking responsibility for the total cost of care. A major business group — Buyers Health Care Action Group — showed in the 1990s that the approach saves substantial sums. Unfortunately, as just one collection of companies, it could not bring about fundamental system change in the market. The governor’s special task force recommended this approach in early 2008.² The Rand Corporation conducted an experiment showing that this realignment of incentives to improve individual health leads to spending that is 25 to 30% less than sticking with the fees for every service model.³

“When doctors work on a fee-for-service basis, there’s not much incentive for them to take time to promote healthy living or strong doctor-patient relationships; the payment system rewards high turnover and pits doctors against the clock.”⁴

Minnesota could choose to interrupt this addiction to volume — more technology, more tests, more surgeries, more drugs, more churn. Instead, payment could reward staying healthy and *better* care, not more care. Using a total cost of care financing model, the original Governor’s Transformation Task Force estimated that the **public and private** savings could reach \$2.1 billion annually (an overall reduction of 10%).⁵ Going to competitive total cost of care purchasing would likely save little in FY 2012-2013 as the system changes over. Thereafter, Minnesota would spend over \$53 million less from the general fund *for each percentage* of savings realized in FY 2014⁶ (or \$532 million if the whole 10% was realized).

Second, Minnesota could stop excluding the value of employer-provided health insurance premiums from employee income, achieving parity with those, mostly low-income, workers who do not have employer-provided coverage. It also would help Minnesotans face more of the true costs of their medical decisions. Removing this exemption entirely would cause **one billion dollars each year**⁷ to remain in Minnesota's revenue stream, some of which could be used to help finance the transition costs for Minnesota and other employers, as well as for insurance companies and providers.

External Context

A Payment Reform — “Total Cost of Care”

Federal Health Reform — The new Affordable Care Act (ACA) *can help*. *It begins to change the rules of the marketplace*, so insurance companies cannot deny coverage to people with pre-existing illnesses, and subsidizes health coverage for people up to 400% of poverty. It promises \$1-2 billion/year for state and local prevention and wellness programs, to attack underlying causes of illness.

However, while the ACA does much to improve coverage and quality, *it does not fundamentally attack cost*. It does require new insurance exchanges to be in place by 2014, and these exchanges could be used as a mechanism for the kind of buying power envisioned in the design. As of December 2010, Minnesota has been discouraged (by former Governor Pawlenty's office) from participating in planning with the Federal government around the potential of the ACA. Planning grant funds for each state were made available inside the Act. Minnesota was one of two states that had not applied for this money.

The economy and escalating health care costs. In August 2010, Minnesota Health Commissioner Dr. Sanne Magnan repeated dire projections about the future impact of health care costs on Minnesota's budget: *“between 2008 and 2033, the average annual growth of Minnesota's state revenue will be 3.0%, while the average annual growth of health care costs will be 8.5%.”*⁸ Also in 2010, the Minnesota Department of Health projected that *“the percentage of Minnesota's economy (the gross state product) that is spent on health care is projected to increase...(from 13.4% of the state's economy in 2008... (to) an estimated 21.1% of Minnesota's gross state product in 2018.”*⁹

According to the President's 2011 budget, the tax exemption for employment-based health insurance is projected to cost the federal government \$1.05 trillion from 2011 through 2015.¹⁰ The recent deficit reduction commission report, [The Moment of Truth: Report of the National Commission on Fiscal Responsibility and Reform](#), and the Rivlin-Domenici Bipartisan Policy

Medicare has been active in payment reform.

Medicare has launched demonstration projects to develop alternatives to fee-for-service reimbursement, and offers financial support for states to experiment with new payment solutions. (Further research is needed to capture what has been learned.) Medicare-certified “health care homes” are to be on a “total cost of care” basis; Medicare is still determining what they will be willing to pay. That is, they are not envisioning a bidding process as [Minnesota Bottom Line](#) suggested.

Second, Minnesota could stop excluding the value of employer-provided health insurance premiums from employee income, achieving parity with those, mostly low-income, workers who do not have employer-provided coverage. It also would help Minnesotans face more of the true costs of their medical decisions. Removing this exemption entirely would cause **one billion dollars each year** to remain in Minnesota's revenue stream, some of which could be used to help finance the transition costs for Minnesota and other employers, as well as for insurance companies and providers.

Federal Urging — Stop Exempting the Value of Employer Sponsored Health Coverage

According to the President's 2011 budget, the tax exemption for employment-based health insurance is projected to cost the federal government \$1.05 trillion from 2011 through 2015.¹⁰ The recent deficit reduction commission report, The Moment of Truth: Report of the National Commission on Fiscal Responsibility and Reform, and the Rivlin-Domenici Bipartisan Policy Center, both urge shrinking or eliminating the exemption. The first report states succinctly, *"the Commission's recommendations regarding reducing and potentially eliminating the exclusion for employer-provided health insurance will help decrease growth in health care spending, according to virtually all health economists."* Newly enacted Federal law will tax *high-cost* health insurance plans, beginning in 2018. Beginning in 2011, employers will be required to report the value of health insurance coverage they provide to employees on the employee's Form W-2 (but the value remains tax-exempt). *This eliminates one potential counter-argument: that employers would have to update their W-2 system if Minnesota enacted this change.*

Minnesota Impacts

Further design work on buying health has occurred. Sponsored by the Minneapolis Foundation's *Fund for Charting Minnesota's Future*, three design challenges were scoped for purposes of deepening the original 2009 design. One was completed in September 2009, entitled *"Fee for wellness: Making it work."*

Health payment reform is a chosen focus of both the Minnesota Chamber of Commerce and the Minnesota Business Partnership. As a result of the original MBL, and other influences, the Chamber chose *"More Government Value"* as a longer-term strategic initiative. One of their top focus points is health care affordability. The Minnesota Business Partnership's *Blueprint for Health Care Reform*¹¹ aligns nicely with MBL: *"Our system rewards quantity of services over quality of services with economic disincentives to improve care and no accountability for results."* Specifically, they recommend more transparent, packaged-care pricing; enhanced quality measures and reporting; and provider contracts that pay for superior results, not on the basis of discounts.

Openness to payment reform has grown the last two years. The November 30th Minneapolis Star Tribune reported that Minnesota's three largest health insurers — Blue Cross & Blue Shield, Health Partners, and Medica - have each crafted new contracts with health systems in Minnesota — e.g. Health Care East, Fairview, and Allina — that *"shift the emphasis away from piecemeal payments, which have made the system resistant to change, to so-called "total cost of care" payments"* that have as their intention keeping people well and cutting cost. The Star Tribune article quotes Medica spokesman Larry Bussey as saying, *"We believe the overall market will function best when these types of agreements become common across all payers."*

BEYOND THE BOTTOM LINE

Private and public sectors in Minnesota have worked hard to implement the 2008 enacted health reforms, making considerable progress on *market transparency* — whereby Minnesotans can compare providers on quality and cost of episodes of care — and *shared savings* models. One interviewee actively engaged in supporting overall implementation said the “*appetite and acceptance levels*” for payment reform has moved markedly the last two years, from “*fear of episode-based payments to a willingness and appreciation for how it might work.*” Jim Eppel from Blue Cross/ Blue Shield says that in his 30 years in this field, he has never seen a time like this. “*Providers, plans and government are working on the same side of the table - all working to align incentive models that reward improvement in quality and reduction in cost.*”

Minnesota was recently one of eight states chosen by Medicare to pilot *health care homes* that agree to coordinate all care and services for a (often chronically ill) person and her family. As of August 2010, thirty-nine provider systems have signed up. The 2010 legislative session added a requirement that the Minnesota Department of Human Services develop a demonstration project to test alternative health care delivery systems, including *accountable care organizations* that provide services to a specified patient population for an agreed total cost of care or risk-sharing payment agreement.

It can be done! — Learn from Hennepin County’s experience inside payment reform. Hennepin County was one of four hospitals this year that agreed to provide a narrow set of “essential medical services” for a fixed block grant. They went from receiving \$100 million under fees for service the previous year for approximately 10,000 people, to receiving \$30 million for approximately 8000¹² single adults (formerly covered under GAMC). Hennepin had to radically change their approaches when operating under this (under-funded) “complete risk” model. Three of the strategies they devised made the most difference: 1) comprehensive multi-disciplinary team management for high users — e.g. individuals with three or more hospitalizations in 12 months; 2) increased hospital transition management to drive down re-hospitalizations; and 3) more effective connection of people to ongoing primary care. “*Without these things, we’re convinced use of emergency rooms would have skyrocketed.*” Drs. Johnson and Harristhal encourage Minnesota to use the learnings from this year’s experience to help guide an expected early expansion of Medical Assistance to this same population. They found it “liberating” to operate beyond fee-for-service, saying that it caused them to look for opportunities to “*beat our historic costs.*” It caused them to “*turn our thinking on its head*” — and a new set of clinician leaders, principally from primary care and hospital administrators, rose to the challenge.”

They see global payments as inevitable, and welcome the challenge, but worry about payments based on how much the state has available rather than ones that are actuarially sound with adjustment that reflects the social complexity of high risk, safety net care. To better position for payment reform in general, they suggest that Minnesota develop accurate population-based spending baselines. Then, Minnesota could set minimal sets of expected outcomes covering clinical outcomes, the quality of patient experience, and global spending targets that adequately compensate — and squeeze — providers who accept.

Significant energy is focused on the Exchanges. Much attention in Minnesota is currently on the *insurance exchanges* that are required to be in place by 2014. The exchange work is critical if Minnesota wants to create its own exchange rather than the Federal government. There are many, many current discussions occurring about its purpose — which states can define.

Taking Action

1

Minnesota Could Keep Building on its leadership of performance and payment reform:

Encourage the Governor to issue a challenge: Design the insurance exchange(s) with an eye toward improving the value ratio: results (access and quality) and price. This builds where energy is already focused. It represents an opportunity to *design* rather than *redo* an existing system. While 2014 can seem far away, Minnesota needs to position itself now.

One key is to *make the health exchange(s)' purpose*, and underlying principles, *explicit*. At the onset, it is important to openly state — and debate — the choices on the table.

Purpose A: Consumer Access/ Small Businesses. With this purpose, simplicity and ease of access is key, as is understandability of offerings. The exchange would need to be “magnetic” enough to attract most individual and small business purchasers. A Federally-defined basic benefit set is common — and health plans and insurers compete to be shown in the best light inside the exchange. Consumers can shop for the best deal on health in a common marketplace. For health providers, visibility of price and quality measures, along with “features” such as offering a health care home, may be key ways to distinguish one’s offerings inside the exchange.¹³

Purpose B: Purchaser Pooling/ Large Groups. With this purpose for the exchange, purchasers coalesce to exert additional buying pressure — or cost leveraging — on the marketplace. Acting separately or together, they buy certain “outcomes” or “standards” inside the exchange. Once a purchaser block reaches a tipping point of 30% of the market, it can influence the whole marketplace.¹⁴

The date certainty of 2014 makes the debate urgent. Wherever possible, the exchanges should be designed with an eye towards a future where the state, with its own portfolio of publicly paid health care, teams up with other sectors to form a large enough consumer base to “tip” the Minnesota health care market over to payments for outcomes and results, not processes. Governor Dayton could be encouraged to issue a challenge — “By July 1, 2011, the Governor challenges the Commissioners of Human Services, Health and Commerce Departments — working with the private market — to bring him *a full strategy for Minnesota’s approach to the new Federal Health exchanges, including purpose, high level architecture, and enabling legislative language.*”

2

Prioritize reform of Medical Assistance — Position our Medicaid system to be ready to enter the exchange as a major purchaser. After 2014, health care will be subsidized up to the middle incomes. It is simply too complex currently, and the populations served represent unique conditions. There will need to be some sense made of the different benefits and wavers. Seek a global waiver now to redesign medical assistance to improve the results received (improved population health outcomes) for the money invested.

3

Minnesota is pressing on payment reform. Don't shift attention — Accelerate! Cost containment is key, and the exchanges are not the only way to get there. Given the momentum of the last few years, Minnesota can continue to *shift from paying for services to paying for results*.

- A. Capture and utilize learnings** from: 1) Hennepin County and others who provided services under last year's Coordinated Care Delivery System block grants; 2) Minnesota's work with health care homes and accountable care organizations; and 3) payment reforms being piloted elsewhere under sponsorship of Medicare and the ACA Innovations Center. Continue to measure and reward improvement in "*total cost of care per patient*."
- B. Develop accurate population-based "bottom lines" of outcomes and costs.** (Population subsets should consider age, level of functioning, and complexity of care.) Minnesota can develop more transparent, accurate population-based *baselines* that measure health outcomes received (such as improvements in life expectancy, social functioning, and health status), as well as historical trend lines of payments made. The two will afford Minnesota new information regarding our "Health Bottom Line."
- C. Encourage more competition.** One aspect of the original *Minnesota Bottom Line* work that has not advanced is *open bidding* by insurance plans and provider networks to provide health status improvement for risk-adjusted populations (and replace negotiations of performance contracts or rates). Governing recently convened a "Summit on the Cost of Government." Over 90 experts attended. Their third key strategy for health care affordability is to *encourage more competition*. According to Joe Minarick, executive director for the Center for Economic Development, "*it takes a minimum of 100,000 people in order to have active competition among five plans.*"⁵ Minnesota buys coverage for many more than 100,000 lives.

4

Cap or eliminate the health insurance exemption. At a minimum, Minnesota could immediately conform to any changes as they occur at the Federal level. Minnesota *could also lead the way* by placing a cap on the amount that is tax exempt in Minnesota, or eliminating the exemption entirely. In addition to buyer and provider systems change, consumer behavior also has to change — especially moving beyond wanting access to any doctor, any test, at any time, for any reason. Removing this exemption would help Minnesotans understand the full per capita "bite" that health care takes.

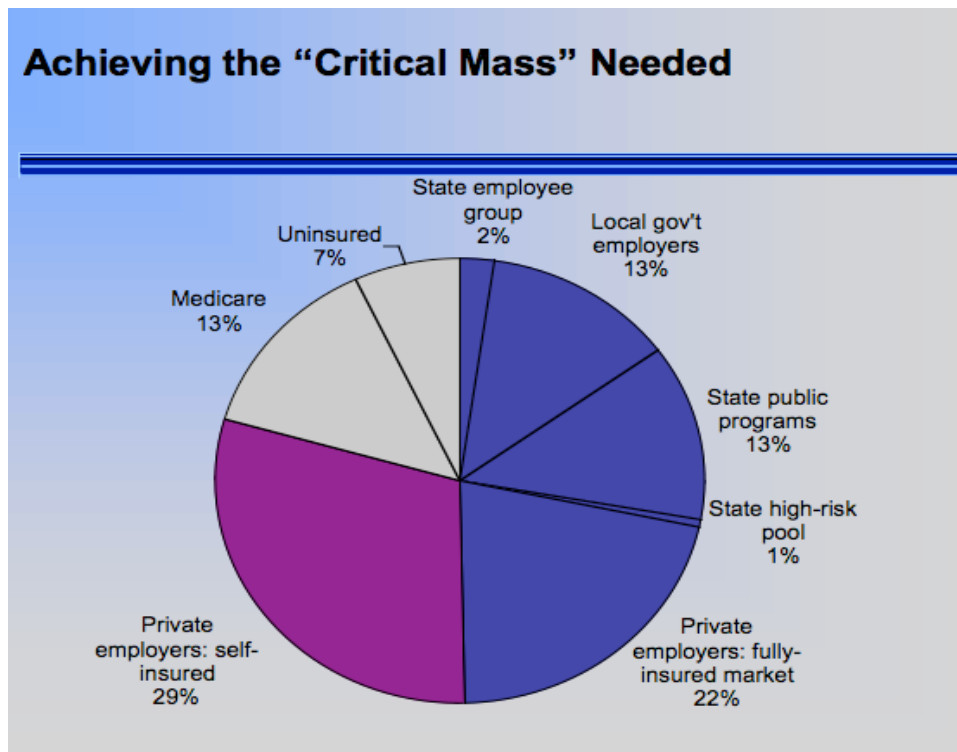
5

Create and fund a transformation fund. At least \$50 million of the revenue generated from removing the exemption of health care premiums could be used to capitalize a Transformation Fund that helps position Minnesota for accelerated payment reform. It could be made available to support buyers, providers and plans as they change their business models (especially in areas of analyzing cost, setting competitive prices, and crafting new ways to deliver outcomes with that price). The fund could be used to invest *now* in ways that bend the cost curve permanently.

Appendix: Background

In January 2008, the Governor's Health Care Transformation Task Force (TTF) recommended the replacement of fee-for-service payments with annual per-person cost-of-care bids. Getting there has three basic parts:

1. Create a critical mass of purchasers who all agree to use a new "total cost of care" payment method (described below). This critical mass would include required participation by all public purchasers (on behalf of all state and local employees, recipients of public programs, and the current state high-risk pool) with voluntary participation by private fully insured employers. Many private self-insured employers would likely sign up as well. Once that share of the marketplace changes, a "tipping point" will be reached; the rest will be influenced to change until everyone's operating in the new way.



2. Have this critical mass of purchasers determine a shared essential benefit set and request a single "total cost of care" price from each provider care system. That "bid" would be the care system's price to cover all essential care that a standardized (i.e., risk-adjusted) population will require in a given year. Accompanying that price would be the delivery system's outcome data, a trend line of data on the risk-adjusted health status of its enrolled population.
3. Make these price and quality "bids" visible to all, a form of comparative and transparent accountability.

BEYOND THE BOTTOM LINE

Endnotes:

- 1 The American health care system is a classic misnomer: the system largely runs on tests and treatments delivered when people show up injured or ill, a service-by-service, case-by-case approach. The more services provided, the greater the revenue. Study after study shows that the amount of services performed tracks closely with the supply of providers — that more hospitals and specialists result in more special services delivered, regardless of cost. The system turns on incentives, and the way payments flow is the largest single force affecting industry behavior. Minnesota Bottom Line, 2009
- 2 *Governor's Health Care Transformation Task Force*, Jan 2008.
- 3 J.P. Newhouse and the Insurance Experiment Group, *Free for All? Lessons from the RAND Health Insurance Experiment* (Cambridge, Ma.: Harvard University Press, 1994).
- 4 Chen, "Getting Off the Patient Treadmill", *New York Times*, Feb 20, 2009.
- 5 *Governor's Health Care Transformation Task Force*, Jan 2008.
- 6 This savings projection is derived from applying the 10% savings expected system-wide from payment reform, as estimated by the Governor's Health Care Task Force, to these state spending categories – \$346 million for state employer health premiums, and \$4,977 million from the General Fund for projected medical care for public recipients in FY 2014.
- 7 The Tax Expenditure Budget: Fiscal Years 2010-2013 states that the exemption of employer-provided health and long-term care insurances has existed since 1933. It is valued at \$986 million in FY 2011, \$1,044 million in FY 2012, and \$1,110.7 million in FY 2013.
- 8 Source: "*Commissioner's Perspective: Next Steps in Health Reform in Minnesota*", Commissioner of Health Dr. Sanne Magnan, August 2010.
- 9 Source: "*Minnesota Health Care Spending and Projections*," Minnesota Department of Health, June 2010.
- 10 Tax Action Bulletin, Thompson Reuters, 2010. found at: <http://www.hw-cpa.com/wp-content/uploads/2010/05/Health-Care-Law2.pdf>
- 11 The Minnesota Business Partnership's "*Business Plan for Health Care Reform*" can be found at: <http://www.mnbp.com/article.cfm?aid=3&atid=88&cid=1>. Soon, an update, "The Blueprint," is expected.
- 12 This group of people has high risk factors, with multiple diagnoses, chemical dependency and mental health issues.
- 13 A new public or private employer's option - utilizing a consumer purchase exchange - is participating inside the new exchange using a *defined benefit* approach – "*Here's an amount of money I will provide. Go to the exchange and buy your choice of coverage offered there.*" See "Health Care Strategies: Opportunities and Affordability", Governing, December 2010.
- 14 A known tipping point is 30% of the market. Competition for a market share that reached 30% in Dane County, Wisconsin reshaped the whole market, and drove costs for individual and family plans 14 % below the statewide average and 30 % below the most expensive regions.
- 15 See "Health Care Strategies: Opportunities and Affordability", Governing, December 2010.

Delivering Integrated Human Services: Multi-County Shared Services

2

Minnesota's human services system is a tangled intergovernmental puzzle in which responsibility is fragmented and results are elusive. Would the state knock down the silos and give counties real flexibility, as well as responsibility, if the state could get better results while saving between \$100-\$180 million a year?

Opportunity

Delivering Integrated Human Services: Multi-County Shared Services suggests that taking a regional approach to integrate services around the needs of individuals and families can improve Minnesota's human service bottom line. This idea builds on a form of Human Service regionalization — an idea previously advanced by the Minnesota Association of Counties, the Legislative Auditor, and Governor Pawlenty. It suggests Minnesota use existing state law to form Regional Human Service Boards. These Boards become “steerers,” or purchasers, of outcomes for the area's individuals in need. Funds from human service, housing, corrections, and health would be un-mandated, giving these Boards additional flexibility to integrate child or family-centric services. The Boards would not provide services directly, but could purchase from existing county delivery systems, from non-profits, or from consortia of both — looking for the best results for children and families.

External Context

On March 23, 2010, President Obama signed comprehensive health reform, the Patient Protection and Affordable Care act (PL 111-148), into law. The federal health care legislation has fundamentally changed the landscape of health care nationally and in Minnesota, as providers and health care innovators come to terms with the new constraints and opportunities available under the law. The 2010 election season also included numerous campaign pledges promising repeal of the law; that ongoing dialogue will continue to serve as the backdrop for this issue, though it does not have a direct impact

Minnesota Impacts

Legislative discussion but no action. The 2010 legislative session contained several proposals related to regionalization that neither fully embraced the 2009 *Minnesota's Bottom Line* redesign nor passed, including:

- **Governor Pawlenty's** proposal, contained in his budget submission, to impose a regional framework, which did not pass.
- **Representative Downy** introduced HF 3754 after committee deadlines that would have formed ten regional human service centers, administered by the state, but that legislation did not pass.
- **The Commission on Service Innovation** was established by the 2010 Legislature. Chaired by Gopal Khanna, state chief information officer, the group has met monthly since July. (Khanna recently announced his December departure from the State Office of Enterprise Technology, but has stated his intent to continue chairing the commission.) The commission co-chair is Mike Kirst, senior director of information systems at General Mills and representative of the Minnesota Business Partnership. The commission is to provide a strategic plan to reengineer the delivery of state and local government services, including the realignment of service delivery by region and proximity, the use of new or centralized technologies, shared facilities, and other means. The commission includes representatives of local government associations as well as representatives of non-profits, unions, business, and higher education institutions. Its first report, with proposed legislation, is due January 15, 2011.¹ The Commission has heard presentations from the Association of Minnesota Counties on its REDESIGN efforts, but has not embraced those efforts as its priority.

Southeast Minnesota Redesign Project

Twelve southeast Minnesota Counties and the Department of Human Services (DHS) are pursuing the Human Services section (Section 2) of the *Minnesota Bottom Line*. With support from the Public Strategies Group and funded by a grant from the Bush Foundation, a joint County-DHS Steering Team is now working on a redesign for human services in Southeast Minnesota. This redesign has already been informed by two stakeholder sessions of more than 120 participants each, Steering Team deliberations, and a three-day PSG "Design Lab" in October.

The Steering Committee is still working on the "blueprint" for this redesign, but at this writing it appears that the new system will take advantage of all the region's resources, not just those of government. The system blurs the lines among traditional human services provided by government, services offered by community-based organizations, private sector participation, and informal support from family, friends, and colleagues. The first question clients hear when they seek help is "what are your strengths?" Each client identifies a small (three-to-seven) network of people specifically identified to support that person, a circle of support. In most cases these will be family members, close friends, caregivers, and professionals already touching their lives. Then a "navigator" helps the client and the client's circle of support identify strengths upon which they can build to meet their needs. The navigator then helps the client connect with resources to meet their needs. Eligibility for government programs is simplified and consistent across as many programs as possible. Intake information is taken once and eligibility for all programs is determined up-front.

Lutheran Social Service Redesign

PSG is also working with Lutheran Social Service of Minnesota, a large, statewide non-profit provider of services to people with disabilities. This design work looks at improving outcomes for people with disabilities via radical repositioning of the incentives in the system. The design minimizes duplicative oversight that is generated in part due to “fear” for people with developmental disabilities, and replaces it with “trust” in the abilities they do have. This design would directly give more bundled, un-mandated funds to people with disabilities — and their chosen trusted partners. It lets them use those funds to purchase from providers of their choice in a competitive marketplace. People who select this optional course would accept more responsibility and accountability — and a more limited budget — in exchange for more freedom in their expenditure use and the opportunity to keep a share of savings they realize. These changes will achieve more *personalized* outcomes at lower prices than can be imposed through the more limited means at government’s disposal today (i.e. rate reductions, capped programs, and lists of people who are left waiting for service.) It is a better way to get more value out of whatever dollars are appropriated, and could be applied to other populations with continuing needs for support, including the elderly.

Minnesota Health Care Homes Demonstration Waiver

Additional opportunities for providing person-centered, integrated human services are possible through Minnesota’s health care homes. Minnesota began innovating in health care homes (an approach to primary care in which primary care providers, families and patients work in partnership to improve health outcomes and quality of life for individuals with chronic health conditions and disabilities) in 2008, when Minnesota passed legislation authorizing the creation of health care homes. The homes are based in fee-for-service plus a “care coordination fee” that ranges from \$10-\$61 per person per month to cover the team of providers that coordinates the care for the individual (e.g., nurse, occupational therapist) under the certified coordination of a doctor. The patient is the focus of the plan (which focuses on preventive care and coordination) and is expected to see better health outcomes and reductions in the use of higher cost health settings. In November 2010, Minnesota was named one of eight states awarded a Medicaid demonstration to test this approach by the Centers for Medicare and Medicaid Services (CMS).

Taking Action

Continue to Build Momentum. The momentum on this issue is growing as multiple groups look for ways to integrate care around the individual and coordinate across resources. Given the stakeholders interested in the outcomes of existing design projects and demonstrations, this is worth continuing to promote.

After completing design work, the Southeast Minnesota-DHS Steering Team will begin to promote the redesign, seeking go-aheads from county boards, the new leadership at DHS, legislators, and others so that the design can move into the planning and implementation phases. Redesign advocates will encounter serious resistance. The proposed redesigned system is different, very different, and those invested in the status quo will engage to keep it. When people evaluate this blueprint, we need to focus on the comparison between this “package” against the status quo. It will be easy to criticize particulars of the blueprint, just as it is easy to criticize aspects of the way things are done now. The better question is which system can better serve Minnesotans? And which system will be more sustainable over time?

Action will be required of the federal government, the State of Minnesota, and the participating counties. The most important ask of the federal government will be a global waiver from CMS. Other waivers may also be needed to give state and local jurisdictions the ability to implement redesigns. Similarly, state government will also need to unbundle funding and grant flexibility. Counties will need to see that the benefits of redesigned systems and regional action and resources outweigh the loss of direct control over “their people” and “their dollars.” The change agents behind these initiatives will need access to an Innovation Fund, up to three-quarters of a million dollars that will be needed to ensure the capability to plan and implement projects like those outlined above. It will be important to emphasize measurable outcomes and return on investment in these waiver requests and to secure Innovation Fund monies.

BEYOND THE BOTTOM LINE

Action steps needed include:

1. Continue to raise broad awareness of the unsustainability of the status quo. There will not be adequate funding to make it work and simply cutting the budget will only make things worse.
2. Build support for these or other proposed redesigns — directly and indirectly — with the people who will be making the next, critical round of decisions: Boards of Commissioners in the 12 counties, the new DHS leadership and incoming Governor and his team, and the key legislators whose support will also be needed, including legislative leadership, key committee chairs, and other legislators whose opinions will matter most.
3. Build support for these or other redesigns or minimize resistance to redesigns among human services advocates and providers, public sector unions, media, and other opinion leaders.
4. Establish an Innovation Fund of up to \$750,000 to support these or other redesigns.
5. Let redesign leaders know that you strongly support them and back them with the funding and other support needed to take the redesign into the planning and implementation phases.

Note also the potential of synergy in “back office” operation efficiencies — whether achieved through competitive or centralized provision — across K-12 and local governments, including human services.

Sources

Tom Moss
John Selstad

¹ 2010 Session Laws: Chapter 392 (SF 3134)

Tax Expenditures: Minnesota's Hidden Spending

3

Opportunity

Examine All State Spending — Rather than just appropriated funds, tax expenditures should be evaluated based on their intended outcomes. More than 40% of general fund revenue capacity is not appropriated – that is 222 tax expenditures that add up to \$11.4 billion each year. This idea suggests tax expenditures be evaluated in terms of the results they are intended to achieve, and reauthorized biennially in an open and transparent process.

Eliminate the Mortgage Interest Tax Expenditure — The ability to deduct mortgage interest is a tax expenditure equaling \$1 billion in FY 2010-2011. Yet research shows that it has little or no effect in promoting home ownership, an original intent of the law. Less than one-third of Minnesotans use it, as most don't itemize their deductions or own their home outright. If eliminated, the state could target these dollars to housing subsidies for those in greatest need, redirect them to other home ownership appropriations, such as foreclosure prevention or down payment assistance, or use them to address budgetary needs.

| Tax Expenditures and Tax Receipts in Minnesota ⁴ | | | |
|---|---------------------------------|-------------------|--------------------|
| Report Tax Category | Projected Tax Expenditures 2009 | Tax receipts 2008 | Estimated Tax Base |
| \$ in Millions | | | |
| General Sales and Use Tax | \$5,426.8 | \$4,493.0 | \$9,919.8 |
| Individual Income Tax | 4,682.5 | 7,830.0 | 12,512.5 |
| Corporate Franchise Tax | 792.8 | 1,020.0 | 1,812.8 |
| Motor Vehicle Sales Tax | 183.6 | 512.0 | 695.6 |
| Estate Tax | 156.8 | 115.0 | 271.8 |
| Insurance Premiums Taxes | 104.4 | 356.0 | 460.4 |
| Cigarette and Tobacco Taxes | 13.3 | 424.1 | 437.4 |
| Motor Vehicle Registration Tax | 8.9 | 478.0 | 486.9 |
| Deed Transfer Tax | 7.4 | 84.3 | 91.7 |
| Highway Fuels Excise Taxes | 3.9 | 652.0 | 655.9 |
| Mortgage Registry Tax | 1.9 | 114.0 | 115.9 |
| Lawful Gambling Taxes | 1.4 | 43.0 | 44.4 |
| Alcoholic Beverage Taxes | 0.7 | 73.0 | 73.7 |
| Airflight Property Tax | 0.4 | 8.0 | 8.4 |
| Other | | 1,530.6 | 1,530.6 |
| Grand Total | \$11,384.8 | \$17,733.0 | \$29,117.8 |

External Context

Sacred Cows under review! The elimination of tax expenditures is becoming part of the national conversation as part of President Obama's National Commission on Fiscal Responsibility and Reform¹, which released its first proposal in mid-November. The chairmen of President Obama's bipartisan deficit commission have proposed a blueprint that includes "slaying a herd of sacred cows," including the tax deduction for mortgage interest claimed by many homeowners as well as the tax-free treatment of employer-provided health insurance.²

The bipartisan commission's proposal shows that the main beneficiaries of tax expenditures are in the top quintile and top 1% of the population.³ In the area of individual tax reform, the chairs of the bipartisan commission recommend limiting the mortgage deduction to exclude second residences, home equity loans and mortgages over \$500,000, in addition to various other tax expenditure eliminations.

The commission's report was released on December 1. It does recommend eliminating major tax expenditures. The report obtained 11 votes in the 18-member commission, falling short of the 14 votes needed to move the report to Congress for a vote, but achieving what would have amounted to a 60-member filibuster-proof supermajority in the Senate had the report moved out of the Commission.⁴

Minnesota Impacts

HF 1782 – proposal to eliminate the mortgage interest deduction and replace it with a mortgage credit.

In March 2009, Representatives Lenczewski and Marquart authored and introduced HF 1782, which proposed the elimination of multiple tax expenditures and created new tax credits. In HF 1782, Rep. Lenczewski proposed the elimination of the mortgage interest deduction as a way to raise revenue and make benefits more accessible to lower income individuals and families. A limited provision passed the house in HF 2323, but failed in conference committee after facing significant opposition from the real estate lobby, skepticism from Democrats concerned it was "political suicide" and no supporters in the Republican Party. The bill did not pass.

HF 3785 / SF 3413 – Tax Expenditure Review Act

In the 2010 session, Representative Liebling (DFL - Rochester) and Senator Bakk (DFL - Cook) sponsored the Tax Expenditure Review Act in the 2010 session (HF 3785, SF 3413). The bill set out a schedule for all tax expenditures to be subjected to review and expiration at ten-year intervals. If the legislation had passed, the mortgage interest deduction and other tax expenditures would have been set to expire and would have required reauthorization, if recommended by the new Tax Expenditure Commission that would have been established by the bill (12 members: 6 legislative, 6 public). The bill only received a hearing in the House Tax Committee and did not move forward as introduced.

BEYOND THE BOTTOM LINE

HF 3729 – statement of intent for new tax expenditures and report on process to review all tax expenditures

Ultimately, the only action enacted into law on tax expenditures was in the omnibus tax bill, HF 3729. The law requires that a “statement of intent” be included in the tax expenditure report. This reflects a partial victory of the MBL recommendations, as the provision only applies to new tax expenditures enacted after July 1, 2010. Any new tax expenditures passed by the legislature must include a statement of intent as well as a standard for measuring whether that intent is met. No new tax expenditure laws have been passed since this legislation passed. The commissioner of revenue is instructed to complete a study of all of Minnesota’s tax expenditures, by February 15, 2011. The Department of Revenue is preparing a report to the legislature by February 15, 2011 on a process for periodic review and sunset or extension of tax expenditures. That report is being prepared by a team of staff from the Department of Revenue, academics and consultants. The House and Senate tax committees have publicly noted that Minnesota spends \$11 billion on tax expenditures, and those committees anticipate reviewing some or all tax expenditures.⁵

Additional discussion occurring. In addition to the multiple legislative processes above, the *Minnesota’s Bottom Line* (MBL) work was raised in a report by Joel Michael, Research Department, Minnesota House of Representatives, in his September 15, 2009 report entitled “Assessing the Effectiveness of Tax Expenditures: Lessons from Minnesota.” This presentation was made to the Federation of Tax Administrators Revenue Estimating Conference. The report called out, among other things, the lack of ability to measure effectiveness of expenditures, especially for long-standing tax expenditures. The presentation refers to the MBL work as follows: “Independent group (funded by several large foundations) simultaneously prepared a similar analysis of a smaller subset of tax expenditures. Their findings were policy prescriptive and more controversial, deflecting some potential heat from us.”⁶

The Chamber of Commerce is not supporting review of tax expenditures until the state service delivery and administrative systems are redesigned. Their position may change given the depth of the FY 2012-13 budget problem and the fact that redesign generally cannot achieve major results quickly enough to solve the problem.

Taking Action

Declare partial victory for advancing the dialogue and a new law requiring a statement of intent. This is an opportunity to applaud and encourage Minnesota's leadership about the action taken to ensure that outcomes are attached to future tax expenditures and to create a process for reviewing existing tax expenditures. In this area, there is much more to be done, and the time is now to engage on this issue and do more. As a matter of redesign, the February report is an opportunity to highlight a process and timeline for reviewing the outcomes associated with tax expenditures that demand public attention, especially as the federal conversation appears to be shifting in that direction.

Selectively promote lowering rates and broadening the base through expenditure reform. Tax expenditures remain an important potential source of revenue and an attractive compromise in a likely split partisan environment in which the expected Governor wants to raise taxes on the wealthy and the legislature does not want to be perceived as raising taxes.

“Snap the tail this year.” Because of all the discussion at the federal level, one could conjecture that we are on the road to federal action on the mortgage deduction. An opportunity is to “ride the coattail” of federal deficit commission recommendation but to “snap the tail”, so to speak, by taking action in Minnesota for our portion of the deduction a year before the federal action.

Make a Deal on Revenue and Housing. Although groups like the Chamber are not interested at this time, we believe the elimination or partial elimination of the mortgage interest deduction could be part of a potential deal on taxes between the Governor and the Legislature. Instead of a tax increase this could be presented as a change in subsidy away from the people upon whom the Governor-elect wants to increase income taxes. In the end there would be more revenue coming to the state primarily from the people Governor wants to tax but not through an income tax increase that the legislative leaders want to avoid.

BEYOND THE BOTTOM LINE

- ¹ <http://www.fiscalcommission.gov/about>
- ² Obama Gets a Deficit Cure – And It Would Hurt, Pioneer Press reprint of Washington Post, http://www.twincities.com/ci_16580215?IADID=Search-www.twincities.com-www.twincities.com&nclick_check=1 (November 10, 2010).
- ³ Co-Chair’s Proposal, November 2010, 11.10.10 Document draft available at http://www.fiscalcommission.gov/sites/fiscalcommission.gov/files/documents/CoChair_Draft.pdf, pages 25-26.
- ⁴ Bipartisan Deficit Commission Puts Politicians on Notice, Washington Post, available at http://www.washingtonpost.com/wp-dyn/content/article/2010/12/03/AR2010120303778_pf.html (December 3, 2010).
- ⁵ AMC Legislative Session Summary: 2010. Found at: http://www.mncounties.org/Intergovernmental_Services/Session%20Summary%202010.pdf
- ⁶ Assessing the Effectiveness of Tax Expenditures: Lessons from Minnesota, http://www.taxadmin.org/fta/meet/09rev_est/pres/michael.pdf (September 15, 2009).

External Context

The Great Recession: More Minnesotans in poverty. The economic recession has pushed record numbers of Minnesotans into our state-subsidized health programs. The monthly number of Minnesotans eligible for Medical Assistance (MA) averaged 600,000 in 2010, up from 550,000 in 2009. This is the *largest one-year increase* in the past decade, and represents more than 1 in 10 Minnesotans. The December 2nd forecast shows Minnesota's share of Medical Assistance growing from a price of \$5.9 billion in FY 2010-11 to \$8.7 billion in FY 2012-13 to \$10.5 billion in FY 2014-2015.

With record costs and few known outcomes, the value ratio of dollars-to-outcomes is unknown at best, and likely to be dramatically worsening.

Federal Health Reform. Inside the recently passed Affordable Care Act, the CMS Center for Medicare & Medicaid Innovation was created. The CMS' Innovation Center is looking for proposals from States that bundle payment streams, and cross the acute care and long term care "lines." On a smaller scale, the Affordable Care Act also allows for specific new waivers to be sought after 2014, but there is no legislative directive in place at this time for Minnesota to seek these waivers.

Rhode Island — 2008 application for Global Waiver successful! For those who said it was not possible or would take too long, Rhode Island successfully asked CMS for a "global waiver" of Medicaid rules/regs under Section 1115(a). They were directed by the 2008 Legislature to do so. Rhode Island's 5-year waiver period started January 16, 2009. We have copies of the original House and Senate bills, as well as the approval letter — to serve as "actionable" examples.

Federal Deficit Commission. The recent deficit reduction commission report, The Moment of Truth: Report on the Fiscal Responsibility and Reform, endorses and recommends expedited applications for Medicaid waivers. They specifically reference Rhode Island's waiver. They go on to say that waivers, when successful, should be authorized to expand without further congressional action.

Minnesota Impacts

To our knowledge, no action relative to Minnesota seeking a global waiver has occurred inside DHS or the Legislature. However, with local energy focused on the Health Exchanges required under Federal Health reform, some insiders are saying that the Medical Assistance program is nowhere near ready to bring into an exchange, due to its complexity and unwieldy waivers — and needs a fresh look.

The idea of a global waiver is included in a new design for one subset of Medicaid customers — producing a likely ally. Lutheran Social Service of Minnesota commissioned a redesign of the system of supports and oversight for Minnesotans with disabilities. One major lever to increase value is to give money directly to people with disabilities, letting them purchase what's most needed for their individualized situation. This design work will recommend a global waiver for this clientele, replacing five separate CAC, EW, DD, TBI, and CADI waivers that apply to this population alone.

On January 5th, 2011, Governor Dayton signed his first executive order which expanded enrollment for childless adults up to 133% of poverty into the Medical Assistance program (as agreed by legislative compromise in the 2010 legislative session). Over 95,000 more Minnesotans (tens of thousands are adults with chronic conditions, including chemical dependency, mental illness and diabetes) can now be enrolled in Medical Assistance, which draws on both state and federal funds. *Authority to redesign Medical Assistance and its payments* could be sought on behalf of this expanded population, and is especially timely to take advantage of learnings from the last two years whereby four hospital systems accepted "global" Coordinated Care Delivery Systems (CCDS) payments for these same populations. Their realizations regarding quality of care, quality of patient experience, and lowering costs should be captured and utilized. While this expansion is considered by the DHS to be revenue neutral to Minnesota, payment reform within it could showcase new ways to slow rates of growth.

Taking Action

Now more than ever! Minnesota could seek a new Medical Assistance accountability compact with CMS. The exchange: Minnesota will serve more people and get better outcomes in exchange for fewer, bundled funds and reduced regulations.

Second, a fresh look could help position Medical Assistance as a major purchaser of value (i.e. an improving dollars-to-outcomes ratio) prior to utilization of Minnesota's health exchanges after 2014. Longer term, with the interest in *integration of Medicare and Medicaid payments streams*, the Foundations could up the ante and suggest an even broader look. *Actionable?* — Yes. We have the Rhode Island legislation as "*model language*," that could be revised for Minnesota.

Special Education

5

Will Minnesota invest in a proven program that reduces the need for special education, avoiding costs of up to \$160 million a year, while improving the education prospects for thousands of Minnesota children in their earliest years of school?

Opportunity

Prevention in Special Education Improves Outcomes and Lowers Costs:

- Lower the price of mis-identifying youth as needing special education instruction by initiating a “Response to Intervention (RtI)” prevention model that has demonstrated up to a 43% reduction in students classified as “learning disabled” in a few innovative Minnesota districts. Current Minnesota law provides options for districts in terms of the processes used to identify special education students. Ironically, most continue to use out-dated and expensive models which require that “students fail” before they can be helped. Providing a financial incentive for districts to utilize the “RtI” model would be better for student learning and also saves a significant amount of professional staff time doing evaluations, attending meetings and preparing “paperwork” for which special education is famous.
- Adopt the federal definition of “students with disabilities.” The most significant impact would be to remove “behavior problems” from Minnesota’s definition of “emotional disability.” Minnesota would continue its “seriously emotionally disturbed” category Minnesota students no longer classified as “disabled” because of this change would be served in alternative school models rather than special education classes. In many cases, this would likely result in a better education for them but at significantly reduced cost.
- Lower the “price” of an adversarial system where disagreements between parents of students with disabilities and districts are too often not resolved. Rather than continue with the adversarial model, parents could choose to accept a voucher which they could then use to purchase special education assistance from a portfolio of privately provided services ranging from after school tutoring to a full time private school.

External Context

Prevention pursued in other states and encouraged by the Feds.

- States such as Iowa, Colorado and Kansas have begun to implement an Rtl model as their sole process for serving students with academic needs. These states are beginning to see the same impact as have the St. Croix River Education Districts (SCRED) in Pine and Chisago Counties as well as the Minneapolis district — better results at lower costs.
- Most students are receiving special education services in the form of assistance with their speech or reading, math and writing tutoring. Parents ought to be given options as to how these services are provided including through the use of vouchers. Four states — Florida, Georgia, Ohio and Utah — currently utilize special education voucher programs that serve more than 22,000 in these states. The vouchers can be used by the parent or adult student to purchase services of their choice. Some studies considered this approach better for four reasons:
 1. They give parents who do not agree with the services proposed by the district a timely non-litigious means of recourse;
 2. Schools are responding to the increased possibility that children with disabilities might leave the school entirely and receive better services in the process. A Florida study found that educational gains made by disabled students increased more as voucher options became available;
 3. For the school year 2005-06, public schools in close proximity to an average number of voucher-accepting private schools were 15% less likely to diagnose a student with a learning disability in the first place;
 4. Students with disabilities currently attending private schools are being transported to district schools for tutoring which significantly disrupts their learning day. The voucher provides parents another option.

Minnesota Impacts

Minnesota roots but will need law changes in Minnesota.

- Federal Individuals with Disabilities Education Act (IDEA) law was reauthorized in 2002 to specifically encourage Rtl models. Although the Rtl model has its roots in Minnesota, led by the SCRED and Minneapolis districts, most other Minnesota districts have yet to fully embrace this option. Most districts elect to use the more expensive and less effective options available under Minnesota law. While some argue that districts ought to have varying options available to them based on their mission and instructional models, it does not follow, however, that the state should be required to pay for options that are more costly and less effective. Implementation of the Rtl model on a large scale will need to be phased in over a period of three to five years with a “Minnesota Rtl Assistance Center,” funded with current federal education revenue paying for the Rtl Center.
- The Minnesota law will need to be changed so that districts who choose not to use the Rtl model will receive less state special education reimbursement and those who use the model will receive greater level of state aid. (Note: the longer term result is that less aid will be needed because students will not need assistance from costly special education programs.)

BEYOND THE BOTTOM LINE

- By removing “*behavior problem*” from “*seriously emotionally disturbed*”, this growing area of “disability” will be curtailed while providing districts new options for serving students facing behavioral problems in alternative programs.
- The Rtl model is “whole school reform” so it provides a common systematic framework for identifying students who are not on target and immediately providing them assistance. It brings together the disjointed services of classroom, No Child Left Behind (NCLB) (Title I), special education and ELL as well as other “*remedial*” programs. The result will be a reduction of over 10,000 students needing “*special education learning disability*” assistance, a savings of millions of dollars of state aid and improved learning for students.
- The change in definition of “*Emotionally Disturbed and Behavior Problem*” will impact every district and likely most sites. Added alternative school models will emerge and classrooms will not be as disrupted because of behavior issues. The result is not labeling children as “*disabled*,” providing them more options in alternative environments resulting in improved learning. Cost is reduced because of the less expensive service model.
- Parents, especially those with children attending non-public schools, will use the special education voucher for remedial services rather than have their child bused to a public school for tutoring. Some parents of public school students will do likewise.

Taking Action

Support the preventative approach now:

1. Under the Rtl model children are provided assistance as soon as they need it rather than requiring that they fail first. As a result fewer children need costly special education services later. This redesign also saves huge resources and reduces paperwork which special education teachers have complained about for decades. And student learning is enhanced. Savings through prevention is exemplified with this effort.
2. The Minnesota Rtl Assistance Center is crucial. Rather, the Center should be housed in the St. Croix River Education District due to their expertise. This approach also redefines the notion of state leadership. “*State Leadership*” is not something that is necessarily provided by a state agency. Rather it is leadership that is provided to the state by whoever is most competent at doing so.
3. The notion of financial incentives and rewards for results-oriented practices is a strength of this proposal but one that will be met with resistance from the status quo.
4. Each part of this “*three-part*” package can stand on its own, but Minnesota law will need to be changed in each case beginning with the 2011 session. It is likely that the law will need to phase in these changes over a three to five year period.

BEYOND THE BOTTOM LINE

Specific Action Steps:

1. Minnesota's special education laws and agency rules need to be changed to both enable and facilitate the implementation of the recommendations.
2. Center at the St. Croix River Education District (SCRED) needs to be established using federal IDEA and NCLB funding, state funding or foundation funding.

Freeing Counties to Focus on Results

6

Might the state get better results on every front by replacing mandates with real flexibility, focusing just on measurable results? What if these governments could, as some pilots now promise, be even more accountable for results than they are today while yielding savings for the state ranging between \$180 and \$270 million?

Opportunity

New State-County Deal — Minnesota could build a new state-county relationship around results rather than mandates that require levels of service. This idea suggested that holding counties accountable for results in return for increased flexibility would improve the efficiency and effectiveness of county services.

External Context

Greater Pressure on County Government — The economy is improving very slowly, and the local levels of government will be among the last to feel any substantial recovery. Thus, there is likely even greater pressure now on counties to provide both cost savings and effective services.

Minnesota Impacts

Reductions without accountability or flexibility.

- **Aid reductions, but no freedoms.** Gubernatorial un-allotment and legislation reduced LGA by 19% in FY 2010-11 biennium, and 10% in FY 2012-13, with no commensurate exchange in freedoms/flexibilities.
- **Levy limitations lifted temporarily.** Special authority was granted to allow cities and counties to levy, outside of limits, for aid and credit reimbursement losses due to un-allotments or reductions that occurred legislatively.
- **The Commission on Service Innovation.** The Commission was established by the 2010 Legislature. Chaired by Gopal Khanna, former state chief information officer, the group met monthly from July through January. The commission co-chair is Mike Kirst, senior director of information systems at General Mills and representative of the Minnesota Business Partnership.

The commission is to provide a strategic plan to reengineer the delivery of state and local government services, including the realignment of service delivery by region and proximity, the use of new or centralized technologies, shared facilities, and other means. The commission includes representatives of local government associations as well as representatives of non-profits, unions, business, and higher education institutions. Its first report, with proposed legislation, was released on January 15, 2011.

- A new Council on Local Results and Innovation was created by 2010 legislation. The purpose of the group is to develop standard performance measures of effectiveness and efficiency for cities and counties to be ready for the 2011 legislative session. The council is also mandated to develop minimum standards for comprehensive measurement systems by February 2011.

The McKnight Foundation has funded a project at the Humphrey Institute to produce a "performance management guide" for local units of government. This report was completed in December 2010.

Taking Action

Pursuing this is problematic. Since there is no particular locus for taking the initiative in improving state/local relations (especially on the state side), it is difficult to see how it might be pursued. However, there are places in state agencies where relations between state and local entities are lodged (for example, the old Information Policy Office had a division devoted to these issues around technology).

Create a home in state government for state-county relations. We recommend that action be taken by the Governor to create a small council made up of the various local government liaisons from the various state agencies, staffed by Minnesota's Office of Management and Budget, tasked with creating a regular forum for discussion and resolution of state/local relationship issues. The specific task for this council would be to recommend specific flexibilities for local units of government when they adopt a viable performance measurement/management system.

Staying Safe: Shifting Resources From Prisons to Community Interventions

7

Is there evidence that by shifting more criminal proceedings to community-based interventions, Minnesota could actually have safer communities, stop the growth in prisons, and save \$300 million a biennium within eight years?

Opportunity

Shift Resources to Community Interventions — Minnesota could avoid building a new prison and decrease recidivism, while spending less by putting resources into strategies that data shows works. By shifting resources from incarcerating individuals in prisons to community and local corrections, and increasing the investment in substance abuse programs that work, Minnesota would reduce the level of recidivism, which is one of the main drivers of the growth in the prison population.

External Context

States are reducing prisons and increasing community efforts around the country. Trends in states are focused on reducing prison populations and increasing resources in the community, supporting the key aspect of the design. Of course it is important to keep in mind that Minnesota has a significantly lower prison population in comparison to almost every other state.

Significant changes are occurring in states across the country. A total of 40 states cut programming in corrections during 2009 and 2010. Colorado, Connecticut, Michigan, Nevada, New York, and Washington have recommended prison closures. In addition, states have implemented other strategies from sentencing reform to implementing good time or increased good time credit to reduce sentences based on good behavior.

States are increasingly realizing the value of community-based interventions for criminal offenders. A significant incentive has been focused on moving non-violent offenders out of prison and into the community. Beginning in 2009, Kansas started shifting to have its probation officers start helping offenders find work, health care, housing, counseling, transportation, and child care. In 2010, California adopted the concept in our design where counties were paid to reduce the number of individuals having their probation revoked. Arizona had enacted a similar change in 2008 and Illinois followed in 2009.

Minnesota Impacts

Minnesota has had lower incarceration rates than other states, but its prison population is on the rise. The prison population in January 2009 was 9,217, but increased to 9,650 as of July 2010.

Minnesota's support for community services has headed in opposite direction. The overall budget for prisons has increased from \$656.5M in FY2008-09 biennium to \$667.0M in the FY2010-11 biennium, while state support for community services has trended down over that same time period from \$236.3M to \$222.0M.

This opportunity promoted the focus on incarceration and treatment in the community over incarceration in prison, and promoting substance dependence treatment to support successful reentry. However, the trend is going in the opposite direction. Minnesota eliminated one program which paid local counties to incarcerate offenders locally, instead of in prison, during the final six months of an inmate's term. The counties were happy to do away with this program, since the state only paid a fraction of the cost. However, the evidence suggests that offenders are more successful at community reentry when they "step down" by serving the end of their sentence in the community.

Evidence based interventions in the community work. Since the release of the MBL report, the Minnesota Department of Corrections (DOC) released two studies that demonstrate that evidence based services and effective community reentry initiatives significantly reduce recidivism.

In March 2010, the DOC released a study on treatment for chemical dependency that showed:

1. Similar to most prior evaluations of prison-based substance abuse treatment, this study showed that CD treatment provided by the DOC significantly reduces offender recidivism.
2. It also showed promise for shorter duration programs combined with psycho-educational programs, which is significant, since longer term programming has previously offered the best reduction of recidivism.
3. Inmates that either completed or were still in programs at the time of release had the most success.

In February of 2010, the DOC released a study that showed the pilot project designed to increase community support for offenders transitioning into the community had significant success. The following is an excerpt from the report:

Prison-Based Chemical Dependency Treatment in Minnesota: An Outcome Evaluation, Minnesota Department of Corrections, March 2010.

- The results indicate that participation in MCORP significantly reduced reoffending.
- MCORP lowered the risk of rearrest for a new offense by 37%.
- MCORP decreased the risk of reconviction for a new crime by 43%.
- MCORP reduced the risk of reincarceration for a new felony offense by 57%.
- MCORP did not have a statistically significant impact on supervision revocations for technical violations.

BEYOND THE BOTTOM LINE

Perhaps noteworthy is that the report found that "(p)articipation in both prison- and community-based treatment significantly lowered the risk of rearrest, reducing it by 62%." This suggests the importance of ensuring a community-based component to treatment for offenders to maximize the reduction of recidivism.

The proposal from 2009 sparked discussion at both the legislative level and at the county level. Legislation was discussed during the 2009 session to expand MCORP program partially in response to the MBL report.

The Association of Minnesota Counties utilized the design to organize their May 13th and 14th Futures discussion, where they utilized an I-Wheel process to develop strategies for the counties.

Proposed policy to be adopted at the AMC annual meeting on December 7th, 2010 is a change in policy which states "AMC supports use of the chemical dependency treatment fund for prevention and treatment strategies supported by evidence-based practice." The design highlighted the fact that chemical dependency dollars were mainly funding programs that did not appear to be evidence-based or have data that indicated the programs successfully reduced recidivism.

A key design idea, to provide an incentive to counties to reduce the number of offenders having probation or parole revoked, has been implemented in Arizona, California and Illinois. This continues to be an excellent mechanism to achieve the objectives of the design.

Taking Action

Redirect resources to community corrections. This design is worth pursuing in the upcoming session. The discussion should occur to emphasize increased resources in the community over increasing expenditures for prison incarceration. Minnesota can achieve better results for its current budget by redirecting resources to community corrections rather than building additional prisons, which it cannot afford to do. Furthermore, the long-term benefits from reduced recidivism offer significant benefits in terms of safety outcomes for Minnesotans and dollars saved in the criminal justice system.

System Redesign

State Government Systems Out of Date

The systems and culture of our state and local governments are basically barren ground to the seedlings of redesign and innovation. It can be done; but it takes a lot of leadership and effort pushing back against a system that is strongly stacked in favor of the status quo.

- Most of our delivery systems were designed around the realities of the industrial age. Technology, demographics, and other important conditions have dramatically changed. We need to begin to redesign our delivery systems around the realities of the 21st century.
- The way governments budget strongly favors funding the status quo: what we did last year. Anything new gets much more scrutiny and is much more vulnerable to being cut. We need budget systems that challenge the old way of doing things and that encourage innovation.
- Our political systems and values suggest that, when resources are scarce, we should “spread the pain.” We can no longer afford to thin the soup. We need to invest in our priorities, not in everything. We need systems that support and encourage making choices, not spreading pain.
- Our accounting systems do a great job of measuring *inputs* but they tell us very little about the outcomes we are getting for our tax dollars. We need simple systems that measure and report on outcomes important to Minnesotans.
- The accountability structures of state and local governments are strongly oriented around following correct procedure. Doing so can be important around certain core values, yet procedurally correct government is no longer sufficient. We need accountability structures that focus on results as well. Not just how we do things but what gets done.
- Our budgeting, personnel and management systems promote turf protection and the maintenance of silos. We need systems that encourage focus on outcomes, encourage collaboration and sharing, and reward achievement of results.

Having a budget deficit of this magnitude provides a catalytic opportunity for positive and dramatic change to occur.”

– State Senator Terri Bonoff (DFL)

“We no longer can afford to be reactive in responding to problems we face. Though difficult, our current problems have presented us with a golden opportunity to fundamentally rethink how we structure operations and deliver service to citizens.”

– Gopal Khanna, State Chief Information Officer under Former Governor Pawlenty (R)
Lead Co-Chair, Commission on Service Innovation

“Change is not a destination, just as hope is not a strategy.”

– Rudolph Giuliani,
Former Mayor of New York City

“If there is dissatisfaction with the status quo, good. If there is ferment, so much the better. If there is restlessness, I am pleased. Then let there be ideas, and hard thought, and hard work. If man feels small, let man make himself bigger.”

– Former Vice President
Hubert H. Humphrey

“Well, you have the public not wanting any new spending, you have the Republicans not wanting any new taxes, you have the Democrats not wanting any new spending cuts, you have the markets not wanting any new borrowing, and you have the economists wanting all of the above. And that leads to paralysis.”

– Michael Bloomberg,
Mayor of New York City

BEYOND THE BOTTOM LINE

Changes along these lines are being made in federal, state and local governments around the country and in industrialized democracies throughout the world. Minnesota Bottom Line initiative came from this emerging model of **results-based** government.

There is opportunity in every crisis, and this is no exception. Minnesota is well positioned for its leaders to step up, collaborate, focus on results and value for the dollar, and advance a new culture and new systems that encourage such innovation.

Therefore, the state, counties, cities and school districts need to begin a deliberate long-term effort to change the fundamental systems and culture of their organizations. We have written elsewhere about specific opportunities for redesigning some of the programmatic delivery systems of state and local government. What follows are a series of interventions — ways to change the administrative system and culture of government — that have proven successful in other jurisdictions. Where we know of measurable short-term benefits to the bottom line, we have so noted. Others have longer term, less individually discernible benefits.

| Administrative System Reform | Page Number |
|--|-------------|
| 1. <i>Budgeting for Outcomes</i> | 40 |
| 2. <i>Performance Contracting</i> | 42 |
| 3. <i>Civil Service Reform</i> | 43 |
| Creating a Culture of Innovation | |
| 4. <i>Charter Agencies</i> | 45 |
| 5. <i>Performance Management</i> | 46 |
| 6. <i>Innovation Fund</i> | 48 |
| 7. <i>Entrepreneurial Management</i> | 49 |
| 8. <i>Winning Compliance — Regulatory Reform</i> | 51 |
| 9. <i>Service Sharing</i> | 53 |

**Actionable, high priority now*

Administrative System Reform

What happens when elected and other leaders exhort state employees to save money, but the budget systems screams at them “*spend it or lose it?*” You get more spending, less saving.

What happens when leaders ask state and local government managers to find creative ways to get things done with fewer employees yet our classification system rewards “points” to managers based on the number of people they supervise? You get empire building.

What happens when managers are encouraged to produce results, but the state’s accounting system has no provision for measuring and reporting on results, only on inputs? Inputs (like FTEs, overtime, absenteeism costs) are carefully managed; results of the work are ignored.

What happens when internal support services are centralized in the name of efficiency while service quality and cost are ignored? Consolidation sounds great on a campaign brochure, but you get large, inefficient, centralized bureaucracies that often deliver poor service.

Administrative systems speak louder and with more authority than a whole roomful of bright visionary elected officials and other leaders. Below we list several opportunities for Minnesota to reform various administrative systems along results-based principles.

1 Budgeting for Outcomes

The budget is the single most powerful lever for focus and system change in government. But we rarely take advantage of that potential because budgeting usually starts with last year’s numbers. Last year’s numbers fund the status quo. Based on the status quo, minor incremental adjustments are made. There is no room for innovation. All the money goes to the status quo.

The budget process in Minnesota’s state and local governments can be yanked off autopilot — way off. We can generate measurable value from every dollar. We can jettison lower-value activities, regardless of how painful. We need a self-executing dynamic that rewards focus, effectiveness, redesign and innovation, not special interest pull or longevity. The budget’s primary criterion should be value — Minnesota’s bottom line.

Instead of asking, “How can we cut projected spending to meet revenues?” we ask “What’s the best way to produce the most value with the dollars we have without consideration of what we’re spending the money on now?”

Budgeting for Outcomes is a sophisticated process already being practiced in other states and local governments. It is dramatically different from conventional budgeting. Our state and local governments should begin adopting outcome based approaches to budgeting that proved successful in other places around North America.

The Benefits

While specific “savings” cannot be accurately identified with outcome budgeting in jurisdictions that are using this approach, elected officials are clearly finding that their priorities can better be reflected through outcome budgets. The process encourages and supports making choices. And, the process has clearly altered budget politics in such a way as to make tough choices politically palatable.

Taking Action

There are many forms outcome budgeting can assume; and various proven processes for those forms. Minnesota governments can design the specific structure that will work best for them. States such as Iowa, Michigan, and Washington, cities like Dallas, Baltimore, and Ft. Collins, counties like Polk County, FL, and Snohomish County, WA and school districts like Billings, MT and Jefferson County Schools in Colorado, are a few examples of success with outcome budgeting. They provide valuable lessons from which Minnesota jurisdictions can learn.

These are the basic principles of budgeting for outcomes:

- **Set the price of government.** Decide up front how much citizens are willing to spend. Get political agreement on a revenue forecast for the short and long term and any tax or fee changes, or just go with the revenue forecast.
- **Define the results Minnesotans seek.** Based on the state or local government’s vision and strategic plan, define the outcomes that matter most to citizens, with citizen input, and identify indicators to measure progress. Allocate the funds available among the priority outcomes.
- **Develop a purchasing plan for each priority.** Create a team for each priority to act as a purchasing agent for citizens and to advise elected officials on spending options. Ask each team to research and identify the strategies that evidence indicates will best produce the desired outcome over the short and long term.
- **Solicit “offers” to deliver the desired outcomes.** Have the teams issue “requests for outcomes” to all comers, public and potentially private: “tell us what outcomes you can deliver for what price.” Critique initial offers and negotiate better deals.
- **Prioritize the offers.** For each outcome, fund the best offers with the money allocated to each outcome — those that will provide the best results.
- **Negotiate performance agreements with the chosen providers.** Spell out the expected outputs and results, how they will be measured, the consequences for performance, and the flexibilities and support needed to maximize provider performance.

Performance Contracting

Performance contracts use state and local government money to buy results rather than paying for activity. The purpose of performance contracting is to align incentives in order to improve results. It is a method to focus contractors on supporting the strategy and goals of the contracting organization.

Performance contracts can be written for many relationships: between the state and local governments and their suppliers and grantees, between state government with local government and school districts. The basic win-win proposition is this: the contractor gets accountability for results and a better bottom line; the supplier gets more flexibility in how those results are created and cutting of unnecessary expensive red tape.

The Benefits

Jurisdictions employing performance contracting are experiencing savings ranging from 10%-25% **and** getting better outcomes through these contracts.

Taking Action

1. The Governor, city and county administrators and school superintendents should establish guidelines that capture the full benefits of performance contracting (some people paste measures in the contract and call it “performance contracting”).
2. Then, they should have people identify a specific target level of grants and contracts (for state government, at least \$100 million worth of contracts and grants) that should be converted along performance contracting principles.
3. In this process, the state or local government should aim for a 20% price reduction in each contract and be willing to settle for an overall average of 15% savings.
4. Then, a negotiation with the contractor or grantee can ensue. In the negotiation, three things are worked out:
 - a) how payments will be tied to results produced;
 - b) how the government can streamline its reporting and compliance procedures to help the contractor reduce cost; and
 - c) how the agreement can be a platform for a collaborative partnership around results rather than an adversarial relationship.
5. Learning from pilots can be shared widely throughout the state and local governments. Then more aggressive goals can be pursued.

3 Civil Service Reform

Due to antiquated and redundant systems today we have three layers of protection for employees and the result is often gridlock. Managers have trouble hiring the talent they need because the centralized hiring process is so bureaucratic and slow. Thousands of job classifications divide employees into narrow categories and pay grades, frustrating managers' attempts to move them or reward them with higher pay. Within each classification, pay is determined by longevity, not performance, and when good employees reach the top of their pay grade, further raises are impossible without a promotion. When layoffs occur, employees with seniority can usually “bump” those without, causing a massive game of musical chairs down the organization chart — leaving behind unhappy people in jobs they weren't trained for and don't want. Even firing those who can't perform seems almost impossible.

Good managers waste enormous amounts of time circumventing these rules and battling Human Resources offices in a frustrating attempt to get the right people with the right skills into the right jobs.

There are alternatives that preserve the benefits of a merit based employment system and the prerogatives of collective bargaining agreements. These more modern personnel systems are built around the employee rather than around the job, they provide fewer job classifications and broader pay bands, more objective approaches to performance reviews, new opportunities for employee mobility and professional growth, and Human Resources systems that focus on results.

The Benefits

Specific savings cannot be accurately attributed to civil service reform though some jurisdictions claim reduced administrative costs. There is, however, qualitative and quantitative evidence of higher levels of employee satisfaction and improved organizational performance in jurisdictions using more modern public Human Resources systems.

Taking Action

1. The Governor should form a small commission, not to “make recommendations” but to design state and local government civil service systems for the 21st century.
2. The commission should follow these principles in its work: Give managers freedom to manage their people. Decentralize authority for hiring, firing, and promotion. Take it away from Human Resources and give it to the agencies and departments themselves, along with accountability for performance. Make the Human Resources department primarily a consulting or support resource.

BEYOND THE BOTTOM LINE

Shift to broad job classifications and pay bands to give agencies flexibility in organizing work. Reduce the number of job classifications dramatically — down to a few dozen if possible. Couple this with a “broadband” pay system, with only three to five broad pay ranges within each job classification.

Link compensation to performance. Eliminate automatic pay increases based on longevity. Set salaries at levels required to recruit and keep the talent you need, in your labor market, and reward performance — based on objective performance measures, not subjective appraisals — with bonuses, awards, gain-sharing, and other tools.

3. The Governor should prepare legislation and submit it for action in the following legislative session and the designs should be made available to cities, counties and school districts for their consideration.

Creating a Culture of Innovation

We are facing great demands for change, yet any particular innovation is very difficult to execute. This is not for lack of good ideas, or good policy leaders, or good state employees to make the necessary changes. Rather, it is because the culture and the politics are designed to be highly counter-innovative.

Changing the Political Dialog

The politics of government delivery systems represent an equilibrium of the interests of all the stakeholders involved with the system. Often the interests of providers of a service have more political clout than the interests of consumers of the service. Provider and consumer interests may be congruent in many respects, but they are not identical. Consumers want to get results from the system. Providers want to produce results, but they **also** want to be the ones producing the results. It would not be in the provider’s interest for the consumer to get the results from a different source.

The political conversation is about how to balance interests; sometimes it is just about how to balance interests of competing providers — like state employees and business interests. Sometimes the results consumers get aren’t even part of the conversation. Minnesota’s Bottom Line is based on maximizing the results achieved for the dollar. In such cases, the politics are particularly difficult.

Yet, the situation is not hopeless. The political conversation can be changed, and in doing so, create the opportunity for a new equilibrium. One opportunity for changing the political conversation, for example, is to get people more focused on the results they are getting. Make the conversation a little more about how to get the best results rather who gets to produce the results. For example, a couple of decades ago, FBI crime statistics started to be publicized in the media. People came to understand that it is not just police who create those results; public works, parks and recreation, communities of faith, neighborhood organizations can all have a positive impact.

As imperfect as the measures are, we are seeing a similar morphing of the political conversation around K-12 education since measures of student achievement are being more widely reported and discussed. So one strategy many states are pursuing is to establish simple but credible systems to measure and regularly report to citizens on outcomes important they care about. With Minnesota Milestones, we were once a pioneer in this field. Today, we lag far behind many other states. This can be remedied quickly and inexpensively.

Changing the Organizational Culture

The culture of Minnesota's state and local governments is a close cousin to its politics. If you ask people what the unwritten rules of succeeding are they are going to tell you things like "be professional, do your job well, keep your head down, don't talk out of school, don't make waves, follow procedure and you will be ok, stay out of the newspapers," etc. They are much less likely to say things like "focus on results, experiment to find better ways to do things, challenge basic assumptions, come up with new ideas, take prudent risks," etc. In short, best to stay put, but if you are going to go someplace be sure to be a settler, not a pioneer.

Just like the political dialog, over time the culture can be changed. Culture is carried in language and symbols. We have found one of the best ways to change culture is to create small subcultures of innovation, then let them spread.

Below we provide several opportunities to change the culture and the political dialog so that innovation can flourish again in Minnesota state and local government.

4 Charter Agencies

A Charter Agency is an agency or department that has agreed to a unique deal. Agencies wishing to be chartered commit to producing measurable results — and improvements in those results — and lowering operating expenses. In return, the Charter Agencies are freed from red tape by being given waivers to certain rules, as well as being given special authorities.

Charter Agencies are designed to challenge years bureaucratic red tape have built up in governments, red tape that doesn't create value or fairness, is costly, and impedes the ability to produce results. They also demonstrate the significant gains that an organization focused on results can produce.

The Benefits

Iowa's original six Charter Agencies were expected to generate \$22 million in budget savings per year. They far exceeded that target in the first and subsequent years. Measureable results specified in each agency's charter also dramatically improved.

Taking Action

The Governor should seek state agencies to volunteer as Charter Agencies. Savings produced by the Charter Agencies could be captured on July 1, 2011. Mayors, county boards and school districts should also follow suit.

These principles should be followed.

- **Orientation and Communications Planning.** Charter Departments are a new concept and many questions will be raised about their benefits, how they will be implemented, how they will impact internal service managers and functions, how they will impact non-Charter Departments, and how they fit with other city initiatives.
- **Charter Departments Selected.** Departments are selected according to which are most likely to succeed. Selection is based on: the likelihood that they can achieve the extraordinary outcomes they promise, the impact achieving those outcomes will have on achieving the results and key focus areas, the types of flexibilities they want, and the level of contribution proposed.
- **Identify Flexibilities, Authorities, and Freedoms.** Charter Department leadership teams generate a list of desired authorities and flexibilities. This will be the starting point for identifying which flexibilities can be made legally available and how they will be exercised.
- **Negotiate Charters with Each Charter Department including Outcomes and Specific Authorities and Flexibilities.** Each Charter Department negotiates a deal with the Governor that defines the commitments and the measures for the extraordinary outcomes to be achieved, the specific and general flexibilities, authorities and freedoms that will be granted, and the amount of money to be contributed through a direct contribution or through revenue increases.

5 Performance Management

Performance Management is a strategy to identify, measure, and regularly report on results that matter to citizens. Minnesota, once a pioneer in this field, has fallen far behind.

Many states and hundreds of local governments around the country have established such accountability systems. They change the political dialog, focus employees on learning from measurement data, and open the door to innovation by providing a “yardstick” against which ideas can be tested.

The best systems have these features:

- They focus on *learning*, not reward and punishment.
- They take measurement at regular intervals; the more often the better the opportunity for learning and improvement.
- The data are public; most are web-based systems.
- They focus on a few, high level outcomes that matter to citizens, not hundreds or thousands of measures of what government organizations do.

The Benefits

One hundred years ago, reformers concentrated on greatly beefing up government accounting systems so that citizens knew *how the money was being spent*. Today, governments are beefing up performance measurement systems so that citizens know *what they get for their money*. This accountability infrastructure is essential to almost all of the other strategies outlined in this report.

Taking Action

1. Early in the 2011 legislative session the Governor should propose to the legislature a simple high-level set of outcomes Minnesotans value and a *few* measures for those outcomes.
2. The state should contract with the Minnesota Compass program at the Wilder Foundation to provide a high level measurement and reporting system for each of the key state's key outcomes agreed to by the Governor and the legislature.
3. Wilder should publish all the measures on a "Results Minnesota" web site and refresh the data on at least a quarterly basis.
4. Each quarter the Governor should review the data with relevant state and local government agencies, concerned Minnesotans and legislators. Together they should seek common ground on solutions to improve the state's performance.
5. The state's budget process, redesign initiatives, strategic plans, and other improvement efforts should be directly tied to this same set of outcomes.
6. Local governments and school districts should follow the lead of Minneapolis and other jurisdictions by undertaking similar initiatives, perhaps piggy backing on the state's measurement infrastructure.

Innovation Fund

For successful implementation of many of these redesign, administrative system reform and culture change initiatives, a small amount of capital is necessary. Not capitalizing change is a sure way to keep the status quo.

As states such as Iowa and Vermont have done, the investment fund can be created with savings “taken off the top” in establishing redesign initiatives. For instance, the redesign proposals in the Minnesota Bottom Line report totaled a net biennial savings of \$3 billion while requiring an estimated investment of \$163 million over that same time frame.

An Innovation Fund should be created for such one-time investments in the design process and for the technology, training, and other outside support needed to implement change. It should be run like an investment bank or social venture fund with full accountability for a measurable return in every nickel of investment. Return can be measured in dollar savings, improved outcomes, or both. The state and public investors (either as a group or philanthropic individuals who want to be actively involved in the development of the project above a certain threshold level of investment) can invest dollars in public projects at an expected rate of return and participate in the design and outcome accountability of the investment. The financial tools could be structured as bonds with performance targets and ongoing reporting to determine ROI to all investing parties or as a venture capital pool equity investment. The key design factors are public and non-public investor access to investment opportunities, measurable outcomes, and capitalization opportunities to develop redesign.

The Benefits

Rather than relying on only existing state general funds to finance new design and redesign projects, this fund will draw the attention of public and private investors interested in creating social impact and obtaining financial return on their investments in government redesign projects. This potentially opens up a significant pool of investment dollars for redesign efforts.

Taking Action

At the outset of the 2011 legislative session, the Governor should build on the growing momentum in the business and philanthropic foundation community behind this idea and propose simple fast track legislation to create such a fund and a mechanism to provide accountability for the use of such funds.

Entrepreneurial Management

Entrepreneurial management is a strategy, first created in Minnesota and since abandoned, to finance and manage internal support services like procurement, accounting, payroll, fleet management, building services, etc. in such a way as to provide much stronger accountability for both cost and service quality.

The approach, which is being used by states, cities, counties and school districts alike, organizes all administrative services into three distinct categories. Each category is funded and managed differently; but in such a way as to achieve strong accountability for cost, service quality and for compliance with rules and regulations.

1. **Oversight Services.** Separate all the functions that involve policy setting, compliance with internal rules and regulations, and *oversight* of other agencies from those that provide *services* to agencies. Canadian provincial governments, for example, centralize these oversight functions in Treasury Board. These should be funded with general funds. The services should be accountable to the chief executive.
2. **Marketplace Services.** Make all other service providing functions directly accountable to their customers. Set them up as publically owned business enterprise that live off the revenues they generate from sales of their services. Their customers have free choice; they can choose other public or private sources for these services. The power of competition keeps prices low and quality high. For example, federal agencies can purchase procurement or contract management services from any other federal agency. Providers of these services are strongly accountable to their customers.
3. **Utility Services.** There are some services for which a city may wish to charge agencies in order to moderate their consumption, but for which as a matter of policy it makes the most sense to have a single source of supply. For instance, many governments want to have a single email system, but they want consumer agencies to pay their fair share of the costs to maintain that system. Here, a monopoly makes sense.

However, monopolies have weak accountability systems on both cost and quality. So, under this entrepreneurial strategy, a board of their customers — like a cooperative — governs utilities. The board set the rates, determines what services will be provided and approves the budget on the utility. Oversight of a customer board is much stronger than could be provided by a budget department, for example. Providers of these services are accountable to their board.

The Benefits

Jurisdictions that have undertaken entrepreneurial management have experienced savings of 15% or more **and** have achieved better compliance and service quality results at the same time.

Taking Action

The Governor, city or county manager, or school district superintendent should initiate entrepreneurial management by forming a design team. The design team is challenged, in 60 days or less, to create the infrastructure for this system. It includes:

- A taxonomy of services into the three categories outlined above. Decisions about which services belong in which categories should **not** be made by the current providers of those services. Such decisions could be made by the chief executive, by a committee of “customer” agencies, or by an expert panel set up for that purpose.
- For marketplace and utility services revolving funds should be established (if they do not already exist). Each new revolving fund should be provided with seed capital that will be paid back to the jurisdiction over time.
- For marketplace services, managers of those services should be given the authority to set prices. They sink or swim on their own ability to compete for business. The market provides stronger accountability than any form of oversight could.
- For utilities, boards made up of customers are established to determine services, set rates to be charged for those services, and oversee the enterprise.

Simple business reporting tools — P & L statements and balance sheets — are used to inform elected officials of utility and marketplace service progress.



Winning Compliance — Regulatory Reform

Much of what government does involves trying to get citizens and organizations to pay their taxes, obey the speed limit, protect the environment, or maintain safe workplaces. To achieve compliance, most public organizations rely on enforcement: detecting and punishing violations in order to deter inappropriate behavior. Enforcement is very expensive, both in taxpayer dollars and in the public support for government we squander in doing it. Voluntary compliance is always less expensive than enforced compliance.

Enforcement is costly in part because it is based on a set of assumptions that don't apply in most cases. Enforcement agencies often assume the worst from people who are expected to comply. They assume we have to force people to do things they don't want to do. Yet most people want to comply with what is expected of them, and when they don't, it's usually because they didn't know they were supposed to or they don't know how to comply. Enforcement also relies on fear as the primary motivator. While this may be necessary in some cases, people are more often motivated by other factors, such as pride, peer pressure, rewards, and recognition.

Rather, than relying on enforcement alone, governments around the world are finding that they can increase the level of compliance while greatly decreasing costs by using a richer set of five strategies that includes but does not rely exclusively on enforcement. These strategies are:

1. Involve compliers in the rule-making process.
2. Educate compliers about the importance and mutual benefits of compliance.
3. Make compliance simpler by removing unnecessary obstacles.
4. Provide compliers feedback about the level of their compliance.
5. Make compliance consequential by rewarding those who comply and penalizing those who don't.

The Benefits

Organization utilizing these “win compliance” strategies are experiencing three kinds of benefits:

1. They produce significantly more voluntary compliance even though less money is being spent;
2. They save compliance organizations between 15% and 25%.
3. Because they reduce the burden on compliers, these approaches are popular with compliers.

Taking Action

The Governor should identify state government compliance systems for which total annual spending equals at least \$500 million.

Environmental Review and Permitting would be one of these compliance systems. In addition to winning compliance, streamlining bureaucratic processes could provide faster licensing and permitting without compromising quality standards. Experience has proven that generally people will comply with standards when the standards are clear and compelling. For example in some cases, the state could generate a checklist as clear guidance for compliance and self-certification. Then the state could audit compliance selectively based on past compliance data. This will improve service, compliance and cost less.

There are multiple approaches for streamlining processes and reducing costs. For example, one state used the Kaizen continuous improvement approach to reduce the time to approve air quality construction permits from 62 days to six days, landfill permits from 187 days to 30 days, clean water construction projects from 28 months to 4.5 months, and wastewater permits from 425 days to 15 days. Regulatory agencies could designate consumer advocates to guide consumers through the complicated permit application processes.

At a smaller scale, mayors, county boards and school districts should set similar targets.

Service Sharing

There is currently a great deal of demand for more service sharing — especially among local governments and school districts. And, we have in Minnesota, successful models for such sharing at all levels of government.

The tenets of twentieth century bureaucracy, however, give us one tool for capturing such efficiencies — consolidation. Consolidation is politically difficult. More importantly, it often does not help the “bottom line.” Yes, consolidation may produce savings, but service quality is often simultaneously degraded through the creation of large monopolistic bureaucracies.

So, here are some alternative models for service sharing:

1. Improve and expand opportunities for one jurisdiction to sell administrative or other services to another. We have many extant examples of this in Minnesota; we need many more.
2. Certify a small number of suppliers of a particular service. Require jurisdictions to purchase the service from one of these certified suppliers, *but allow them choice*. And allow them to change suppliers upon reasonable notice. Suppliers could be existing government organizations, private and non-profit organizations, or a mixture. Providers rely on their funding exclusively through the choice of jurisdictions that elect to purchase the service from that supplier.
3. Achieve sharing through consolidation or regionalization — but with very strong customer safeguards. Such safeguards could include a customer based governing board (like a rural co-op), challenging service standards with specific customer redress when the standards are not met, and/or service contracts that pay based on performance.

The Benefits

Jurisdictions that have undertaken service sharing have experienced savings of 10-15% or more and have achieved better outcomes at the same time.

Taking Action

1. The Governor has the opportunity to form regional councils of city and county service providers to identify key service areas ripe for pilot market test projects.
2. The Governor should form a quality standards boards to set measures for outcomes and accountability for shared service providers and certification services (where appropriate) to safeguard these new shared service markets, especially during initial testing phases.