IDEAS

Finding Our Way Forward

Minnesota is a great place. Our business, governmental and non-profit organizations regularly respond when our state and its communities are challenged. This is just such a time requiring our very best ideas.

In our homes, where we work and across our communities, it feels like the economy has turned against us. Our state and local governments are facing unprecedented challenges. The gap between revenues and spending has never been greater. The prospects for closing that gap are daunting. Many of us hope the situation will go away and, if not, that the pain will be borne by others, not by us. Our faith in the status quo – the way we've been doing things for a long time – has been shattered. We are frightened and discouraged. We hear the words that "there is an opportunity in every challenge," but it is hard to see that opportunity when the threat seems so imminent.

We will be able to embrace the opportunities when we are again hopeful. In the face of this daunting challenge, both the Governor and the leaders of the legislature from all parties have called on Minnesotans to offer our best ideas. Our five foundations came together believing that a search should be launched for ideas that could offer hope that out of this fiscal challenge could come better ways to meet the needs of our state; ways that would better prepare us to succeed in an uncertain future. We contracted with the Public Strategies Group to lead this search. PSG is a Minnesota company with a long history of finding and developing creative solutions to public problems. We gave PSG a tough challenge: *Find practical ways to improve public services and that cost less*. Then we made the challenge unreasonable: do it in six weeks. PSG has come back from that search with a collection of ideas.

We are grateful to PSG for what they have done. These ideas offer hope. But they also challenge us to consider new approaches. We are not advocates for any of the ideas individually. We believe there is an urgent need to search for practical options for delivering high quality services at affordable cost to the people of Minnesota. Through that search and the discussion of these and many other possibilities Minnesotans will discover directions to help us create a way forward. It is from that way forward that we will create our future.

Bush Foundation

The Minneapolis Foundation

Northwest Area Foundation
Helping communities reduce poverty

Minnesota Community Foundation

The Saint Paul Foundation

the Public Strategies Group
Architects of Results-Based Government

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Fellow Minnesotans,

I hope. In these tough times, one can't have enough hope. My wish for Minnesota is that the potential solutions we are putting forth will germinate hope in others; that hope will grow into possibility, then to action, and ultimately all this will lead to better outcomes for Minnesotans at a price we can afford.

Einstein said, "We cannot solve our problems with the same thinking we used when we created them." The options we put forth here come from a different kind of thinking, so you may find them uncomfortable, impractical or even impossible. That is a normal starting point for any change of thinking.

My colleagues and I know to expect strong resistance to these ideas. And we know that the resistance is there to teach all of us how to morph these ideas into a reality that works for Minnesota. Our experience with this kind of work in places all over the country is that the resistance will focus on these things in this order:

1. First, the prospective savings will be challenged.
2. Then, the data and analysis we present will be disputed.
3. Next, the credibility of PSG will be questioned.
4. Then, the ideas themselves will be tested.
5. Finally, the foundations that sponsored this project will be confronted.

These ideas are developed, not as finished proposals, but rather, as the beginning of a new dialogue. I have a challenge for everyone interested in pursuing a better future for Minnesota. Focus resistance on the ideas themselves. But first, entertain the notion of "*what if?*" Make the dialogue about possibility. Where the ideas are weak, modify or strengthen them. Where they are incomplete, broaden them. Where they are wrong, pose a better alternative.

Sincerely,

Babak Armajani
Chairman

Bridges to a Better Bottom Line

An Outside Look at Minnesota's Budget Dilemma

By now everyone is tuned into the economic downturn. Its effects stretch out over all the state's regions, invade every sector of the economy, and touch individual lives in ways rarely seen. And one immediately clear and cruel consequence is the impact on the state's budget for the next biennium and beyond: demand for public service is up and revenues are down.

In response to this situation, several Minnesota foundations see the need – and the opportunity – to promote a fuller public discussion of the options that could be considered for moving our state forward. They gave the Public Strategies Group (PSG) a tough challenge: Don't just come up with ways to balance the budget, come up with ways that will improve Minnesota's bottom line now and in the future.

Doing so means improving the results Minnesotans get in important services at costs the state can afford – the bottom line of Minnesota government. There is a better bottom line if we can find the bridges to get there. And that was the purpose for which PSG was engaged – to find those bridges to a better bottom line, supported by sound data and analysis.

"We are all faced with a series of great opportunities brilliantly disguised as impossible situations." – Charles Swindoll

An Overview of the State Budget

There are two high-level differences between our look at the budget and the ways one normally sees it portrayed:

1. **We look at the whole general fund budget**, not just the part that is appropriated. More than 40% of the general fund revenue capacity is spent in the form of tax expenditures rather than direct appropriations. These merit the same kind of review and scrutiny as appropriated expenditures. These 222 expenditures are rarely discussed, rarely evaluated against any policy purpose. They add up to a projected $11.4 billion in 2009. And because they do not have to be reauthorized and do not take the journey through legislative committees that other state expenditures do, they are essentially off the table in the biennial budget and policy process. This may be worth challenging.

2. **We look not only at costs, but at the results associated with that cost – a ratio of results/$.** It's easy to find or claim "savings" if one ignores the results produced by government and just reduces the expenditure. Yet, people care about results as well as cost. Minnesotans want a better ratio of results to cost – a better bottom line.

The table below shows the whole proposed general fund budget for the next biennium. This holistic view is important. Most of the money we spend on housing, for example, is in the form of tax expenditures rather than direct appropriations.

BIENNIAL SPENDING: THE WHOLE PICTURE[1]

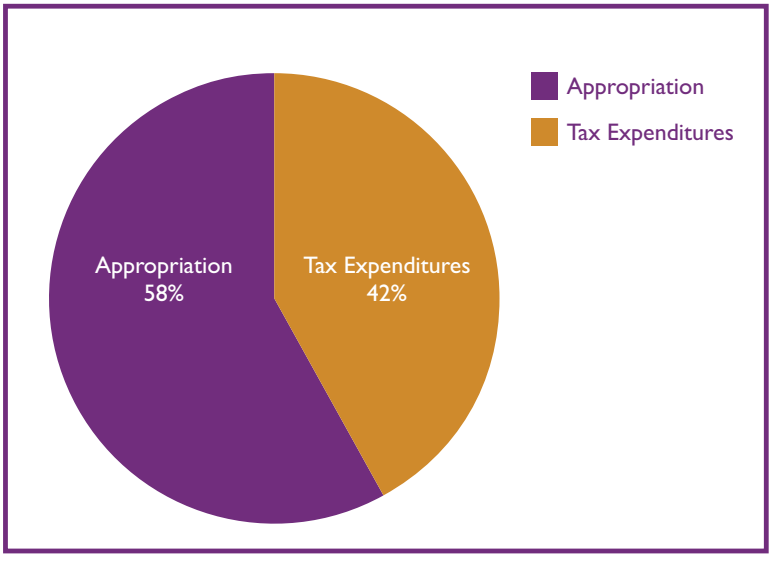
($ in millions)

EXPENDITURE AREA	TOTAL SPENDING	APPROPRIATION	TAX EXPENDITURE
Health and Human Services	$18,901.7	$11,326.9	$7,574.8
K–12 Education	12,880.3	12,772.2	108.1
Other *	8,953.7	0	8,953.7
Economic Development **	4,144.6	235.3	3,909.3
Property Taxes Aids and Credits	3,304.4	2,890.5	413.9
Higher Education	2,920.9	2,856.9	64.0
Transportation	1,989.9	369.7	1,620.2
Agriculture & Veterans	1,927.6	268.9	1,658.7
Public Safety	1,683.7	1,680.6	3.1
State Government	639.4	638.6	0.8
Environment, Energy & Natural Resources	344.5	336.1	8.4
Debt Service and Other	235.3	235.3	0
TOTAL	**$57,926.0**	**$33,611.0**	**$24,315.0**

* Includes Sales Tax on Selected Services, Charitable Contributions, and other items.
** Economic Development includes Housing and Economic Development related expenditures.

This chart shows the portion of the budget that is appropriated relative to tax expenditures.

2010–2011 SPENDING



"Every organization must be prepared to abandon eveything it does to survive in the future." – Peter Drucker

"I can't understand why people are frightened of new ideas. I'm frightened of the old ones." - John Cage

An Overview of Alternative Approaches

Think of the content that follows as a collection of ideas, not an integrated proposal. Some of these alternative approaches will strike people as provocative, perhaps radical, shifts; others will seem just straightforward, even simple ways to improve results at affordable levels of investment. The key objective here, and the reason that foundation leaders proposed this work, is to make the Minnesota budget conversation more public, better informed, and furnished with policy designs and analyses aimed at the largest financial commitments the state makes.

Here are some bottom line possibilities, with estimated dollar savings over the next two biennia:

1. **Improve the health of citizens while spending $3.7 billion less.** The Alternative entitled *Buying Health, Not Sickness* suggests that by spending state money on health outcomes rather than fees for services, we can improve Minnesota's health bottom line.
2. **Meet the needs of vulnerable children and families at costs $455 million less.** The Alternative entitled *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.
3. **Improve housing outcomes while spending $2.1 billion less.** The Alternative entitled *Better Value for Housing Subsidies* asks how we can invest state resources more wisely to improve Minnesota's housing bottom line.
4. **Deliver better county services while reducing state aids by $984 million.** The Alternative entitled *Freeing Counties to Focus on Results* suggests how holding counties accountable for results in return for flexibility in how to achieve those results can improve Minnesota's bottom line on county services.
5. **Preserve or improve the health of the elderly and low-income populations with $497 million fewer dollars.** The Alternative entitled *Fundamentally Different Medical Assistance: Improve Public Health and Lower Public Costs* suggests that with a federal waiver a redesigned Medicaid system can improve the Minnesota bottom line.
6. **Preserve public safety and reduce recidivism at $54 million lower cost and avoid building a prison.** The Alternative entitled *Staying Safe: Shifting Resources from Prisons to Community Interventions* suggests how we can use evidenced-based approaches to improving Minnesota's corrections bottom line.
7. **Improve educational outcomes for those with disabilities while trimming $645 million in state and local spending.** The Alternative entitled *Special Education: Modest Changes, Better Education, Major Savings* suggests how improving special education screening and reducing red tape can significantly improve Minnesota's special education bottom line.

8. and 9. are alternative approaches for reviewing tax expenditures and for service sharing at the local level are offered as additional ways to improve Minnesota's bottom line.

"Only those who will risk going too far can possibly find out how far one can go." – T. S. Eliot

Many other areas were analyzed and alternatives explored. This is by no means the "end" of the list of good opportunities to improve Minnesota's bottom line. In fact, we found promise that future study and dialogue in the following areas are likely to produce similar breakthroughs:

- **Higher education:** How much learning does Minnesota's investment actually produce per dollar of general funding spent? By increasing student financial aid and having colleges "earn" their dollars, could Minnesota produce greater numbers of high-quality post-secondary graduates for the same or lower General Fund investment?
- **A new deal for cities:** How could the state-city relationship be redesigned to exchange local aid and additional flexibility for better results that Minnesotans want as well as improve accountability?
- **Pension plan contributions:** What other mechanisms could be used besides tax expenditures to increase savings for retirement that result in a greater proportion of the population saving for retirement while costing the state less?

And, there are surely many others.

"A great wind is blowing, and that gives you either imagination or a headache."

- Peter Drucker

Project Parameters

These Alternative Approaches were developed under these parameters, created in consultation with our sponsors:

The Revenue/Spending Debate. There is already ample dialogue around the question of how much revenue Minnesota should raise and spend. This work remains silent on that important question. Rather, whatever Minnesota's elected officials decide to spend, we looked for new opportunities to get the best results for those dollars.

Focus on Major Opportunities. The time track for this work was rapid, making it impossible to cover every corner of the budget, every potential idea for improvement. So the search was targeted to the big-ticket areas of spending, where the scale of potential policy and budget change would register a high impact. Analysts used a minimum threshold of $250 million in biennial savings as a working standard.

The Value-for-Dollars Lens. The value proposition turned on a ratio – the results delivered per dollar spent. This is a fundamentally different way of struggling with the dilemma facing policy makers. Both the tax-raising answer and the budget cutting answer tend to reduce the value-to-dollar ratio.

Sustainability of Policy Changes. The philanthropic investment in this analysis was aimed, not just at the exigencies of balancing the next budget, important as that is, but at the kinds of changes that would position the state for long-term success with policies and spending patterns designed for stable and sustainable service and economic competitiveness.

Project Principles

The first thing any group of analysts and policy designers do in this kind of situation is to ask what has already been learned from things tried here and elsewhere, what practices improve the value ratio, and what principles seem to drive success in getting more value for money?

Here is a core set of such principles; developed with our sponsors, they became the building blocks for designing a set of prospects for policy changes that might improve outcomes while lowering cost:

- Promoting collaboration, sharing, across levels and types of government
- Funding consumers of services rather than suppliers of service
- Offering flexibility in how things are done while strengthening accountability for results
- Integrating funding sources around the needs of citizens rather than the convenience of the government system
- Distinguishing between the "deciding" function of government and the "doing"
- Strengthening accountability through greater transparency of actions and reporting
- Having a preference for results-inducing incentives over coercive forms of compliance

Investing in Change

Bringing about real change requires investment. Leadership attention, time from Minnesota's best thinkers and most capable doers, political capital, and cash are all necessary to making effective change. So, with each of the options, we have made a rough estimate of the cash part of the investment. This would come from the reduced spending. We show the "savings" net of this investment.

Going Forward

What follows, then, are some different ways of thinking about old problems. They are offered to give Minnesotans hope that there are choices that can help both resolve our immediate financial crisis and set our state on a sustainable path to future success. And, these ideas are put forth, not as a final recommendation, but rather, as the beginning of a dialogue about how we can change things for the better in Minnesota.

Each of the options put forward could be acted on immediately. And, each holds the potential for longer-term reform as well.

"Courage is being scared to death, but saddling up anyway."
- John Wayne

Limitations

These are ideas offered for dialogue. Different ways to think about important issues facing Minnesota. They are not recommendations, nor are they finished work. The sponsors of this project asked PSG not to broadly engage stakeholders in developing the ideas or in doing the analytical work. So, in most cases, the perspectives are those of PSG. The sponsors met weekly with PSG, reviewed the status of the ideas and offered guidance to PSG. The data presented here is readily available public data. No original research was conducted.

Financial figures are taken from the November 2008 forecast, not the more recent March 2009 forecast that came out after most of the work was completed. This is a collection of ideas, not a package. Each idea stands alone. However, some ideas overlap; the savings are not additive. Investment estimates are just that; they are based on experience not an aggregation of specific actual costs.

Notes

[1] *Source: State of Minnesota Tax Expenditure Budget Fiscal Years 2008 - 2011*. Minnesota Revenue Tax Research Division. February 2008 and Minnesota Governor's Proposed FY10-11 Budget.

Buying Health, Not Sickness

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The Bottom Line: Healthier Minnesotans

The people of Minnesota could be healthier without devouring state and personal resources. How could the state, with its own portfolio of publicly paid health care, team up with other sectors to form a large and dominant consumer base, and from that position, fundamentally change the payment system in the Minnesota health care provider market? Is there a way Minnesotans could pay for "a year's worth of health" rather than for episodes of illness?

Background

The American health care system is a classic misnomer: it's mostly not about health but about medical repair. The system largely runs on tests and treatments delivered when people show up injured or ill, a service-by-service, case-by-case approach. Most doctors and clinics get paid similarly - by unit of service. The more services they provide, 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.

So it is no surprise to find that a sixth of the entire economy is spent on health care, more per person than any other nation pays.[1] If all this spending resulted in a healthier population, it might be honored as a worthy investment. But the most respected studies over time show the effect is almost the opposite; it seems the more we spend, the sicker we are.[2] Our national dividend: health status and life expectancy that is the same as Slovenia.

Of course Minnesota is better than the national average? Think again. If Minnesota's children are a good barometer, their health status is barely better than the national mean – 23rd among states. Our ranking on overall health has dropped. Meanwhile spending rises relentlessly. Minnesota's 2004 health care spending per capita – at $5795 – was exceeded by only 12 other states.[3] Costs to the state's businesses attributed to health care outpaced inflation in all but four of the past 18 years, with enough businesses dropping coverage to see the percentage drop from 70% to 63% from 2001-2004. Forty percent of personal bankruptcies cite health care costs as the prime reason.

Current practices are simply not sustainable. State spending alone on health care is rising at eight percent per year, putting the general fund on course to see two-thirds of all dollars consumed by

medical services within 25 years.

The good news: the state could be a leader in assembling the market power to change the payment incentive system. Minnesota could move from the piecemeal system of paying for every eligible test and treatment to a system of competing providers taking responsibility for the total cost of care. A major business group – Buyers Health Care Action Group – showed in the 1990's 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.[4] The Rand Corporation conducted an experiment showing that this realignment of incentives to improve individual health leads to spending that is 25 to 30 percent less than sticking with the fees for every service model.[5]

"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."[6]

A local example: in Minnesota we have 50 percent more back surgeries than the national average with no evidence for greater need or better outcomes. This may be due in part to having more back surgeons who advise surgery over physical therapy or other courses of treatment. 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, Minnesotans could realize annual General Fund savings of over $350 million each year. System-wide, the public and private savings could reach $2.1 billion annually.[7]

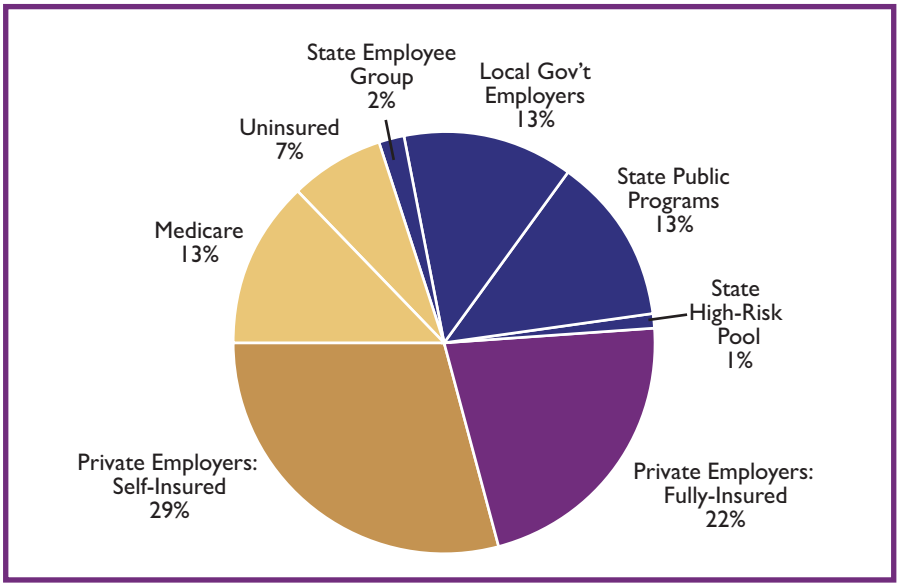
3 Another Approach to Healthier Minnesotans

There's a well thought out model available in Minnesota that interrupts today's incentives that drive more health procedures and treatments. The model replaces old incentives with ones that help Minnesotans stay healthy and receive preventive and comprehensive care. The result is better health outcomes and lower costs.

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). Given the attractiveness of this new payment method to purchasers, the TTF projected 50 percent initial market penetration. 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;[8] the rest will be influenced to change until everyone's operating in the new way.

ACHIEVING THE "CRITICAL MASS" NEEDED



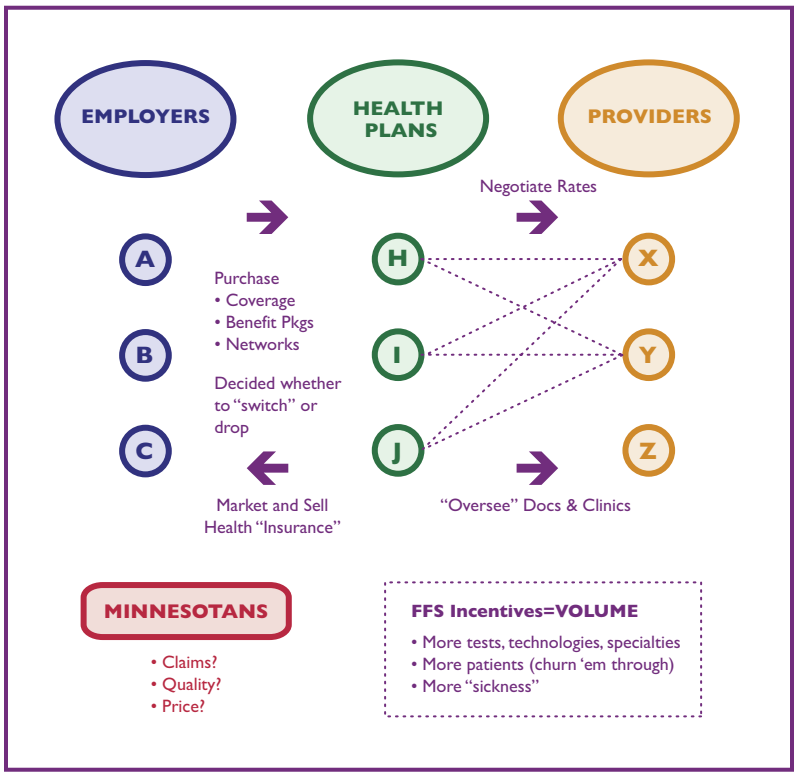
2. Have this critical mass of purchasers determine a shared essential benefit set and request a single "total cost of care" price from each provider care system. That "bid" would be the care system's price to cover all essential care that a standardized (i.e., risk-adjusted) population will require in 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.

While this description may sound familiar to some, it is a profound departure from present-day experience and represents a rapid advancement of the "baskets of care" payment reform now underway in Minnesota. It changes roles, recasts the incentives, and it clarifies accountability.

- **Providers** would set their own "total cost of care" price if they wished to be considered by 30-50% percent of the marketplace purchasers. There are no further negotiations with multiple health plans; providers would be directly accountable to the customer market. Being accountable for total cost and care outcomes, they would soon put a premium on healthy living, preventive and primary care. Profitability under a total cost of care price would require that providers shift from late-stage, high-end, profitable 'procedures' to early and integrated care.
- **Health Plans** would, for these populations, cease negotiating rates with providers and cease trying to "manage" care from afar. They would focus primarily on contributing *value-added services* to care providers and consumers (e.g., risk adjustment/reinsurance pooling, population health measures such as smoking cessation, member enrollment, dissemination of evidence-based medical research, etc.). This builds on health plans current work in managing insurance risk, assuring access and providing comparative data to the public about provider effectiveness.
- **Minnesotans** (consumers, patients) would choose their care provider system based on visible cost and quality, paying more if they chose a higher priced system. They would experience health and *financial* rewards for engaging in optimal health behaviors.
- **Purchasers** (employers, individuals) would go from piecemeal purchase of services to contracting for comprehensive services to keep individuals healthy. They would go from a sea of inexplicable bills and endless health plan negotiations to simply paying their share of the price for a "year's worth of health."

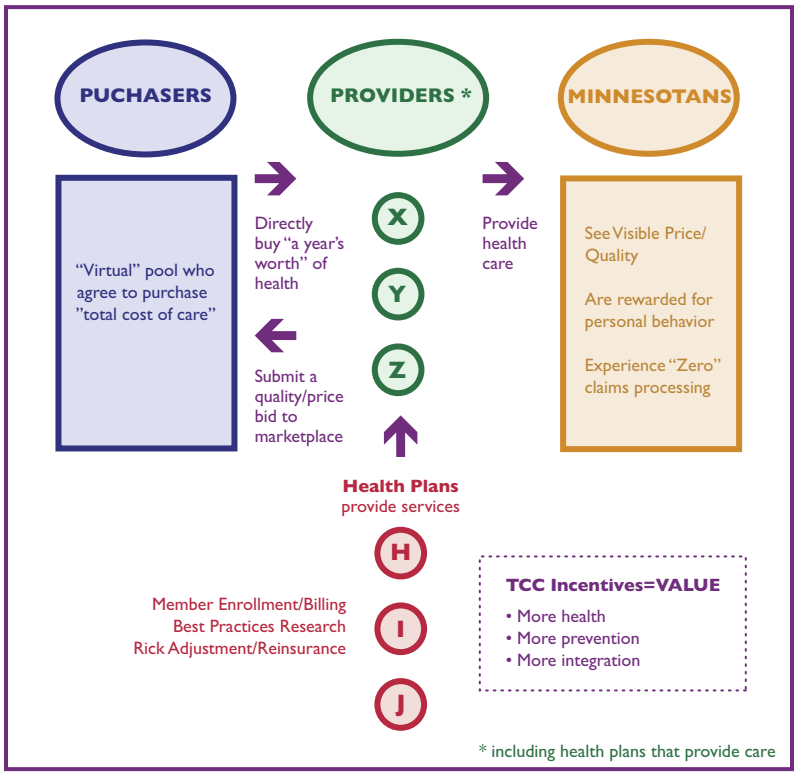
The following two graphics contrast *fee for service* (FFS) with *total cost of care* (TCC).

FEE FOR SERVICES (FFS)



Source: The Public Strategies Group, 2009

TOTAL COST OF CARE (TCC)



Source: The Public Strategies Group, 2009

For 30-50% of the marketplace that adopts TCC, notice that plans are no longer stuck in the middle. They are no longer blamed for cost increases they can't control; nor are they policing how people use the system. Instead they're providing competitive services to providers (such as critical quality improvement research and risk pooling re-insurance arrangements) and valuable administrative services to enrollees.

So what if total cost of care payment reform does not occur? Clearly the state needs some sort of "or-else" option. The system we know has a future we fear and current costs we cannot bear.

If legislative authority is not given for TCC, or if 50% of purchasers do not adopt TCC by July 2010, the obvious alternative available is a state-imposed stipulation of price. The state could decide for its entire health care portfolio (and that of any collection of purchasers that joined the effort) to reduce what it pays by a flat percentage. Explain it as a blunt instrument to force out waste,[9] reduce administrative costs,[10] and generate pressure for more rational utilization of expensive diagnostic procedures and treatments. This option would be "a bitter pill," but under circumstances of nothing left to do but witness spending spirals, it becomes necessary medicine.

Minnesota could make those fee-for-service and managed care rate cuts more strategically. The Commissioners of Health and Human Services could be given the authority (or use their current authority) to reduce rates equivalent to the savings that are estimated to occur under TCC. The Commissioners would hold harmless, or even pay higher rates for primary care, preventive care, and care integration. They would reduce rates for hospitalizations, procedures, tests, and high-end specialties. They would not pay for errors, repeat procedures,[11] care outside the essential benefit set, or brand-name drugs where effective generics are available. Last, Minnesota could impose an across-the-board reduction of state payments for health plan administrative services. A 25% reduction alone would result in over $50 million in GF savings, and up to $250 million/year across the whole state (public and private).

PAYMENT REFORM OPTIONS

	PROS	CONS
OPTION ONE: ***TOTAL COST OF CARE***	• Fundamentally resolves the adverse incentives of FFS • Has been used successfully before in Minnesota • Some necessary foundational elements are already under development • Providers themselves decide their competitive price for *a year's worth of health*; rates are not imposed • Doctors/clinics are not held responsible for the underlying health risks of their patients	• Some hospitals and specialty care providers will see this as impairing their main revenue stream • Some small or free-standing groups may initially see themselves at a disadvantage (over integrated delivery groups) until they take advantage of their greater agility • All questions have not been answered. Additional strategies are needed to address risk, access and meaningful data for purchasers, consumers and providers. New strategies may be needed to avoid cost shifting to populations not enrolled in TCC.
OPTION TWO: ***BITTER PILL***	• Uses the current and familiar FFS infrastructure • More strategic than an across-the-board cut in rates as reductions are avoided in known cost-effective care areas • Predictable, book-able savings	• Rate reductions in fees for service don't result in overall cost reductions, as *volume* increases to compensate • If private purchasers were not included, providers could shift costs to them to compensate
OPTION THREE: ***STATUS QUO***	• Another year or five may give Minnesota more information about Federal health reform	• Thousands more Minnesotans may lose their private or public insurance • Minnesotans will spend $1.5 billion more in general fund spending alone

In any road taken, Minnesota could eliminate the employee exclusion from income tax for the value of employer-provided health insurance premiums. If intended to encourage employer-provided insurance, actual behavior has been in the opposite direction. Minnesota businesses have been dropping coverage, down to 63 percent in 2004. If the intended result was income parity, research shows that 88% of these tax-free employer contributions goes to households with incomes at or above the median.[12] Removal of the exclusion achieves parity for those individuals who do not have employer-provided insurance. This exemption removal could begin July 2010, to allow for individual tax planning purposes and for employer adjustment to their withholding systems. Elimination of this tax expenditure results in over one billion dollars for either the budget shortfall or for re-investment in these payment reforms.

Investments

Experience indicates that the number one reason changes fail is that they are undercapitalized. Therefore, for this design to succeed, a *one-time* investment will facilitate the transition to a new system. The funds for the investment will be taken from elimination of the tax expenditure and other savings. Investment will be needed for these things:

- *Public education.* Minnesotans want access to any doctor, any test, at any time, for any reason. Public information is needed to help Minnesotans realize that *more care, and more expensive care, is not better care,* as well as to help them understand what evidenced-based best care entails.
- *Fast track work.* The State Departments of Health and Human Services will need resources to fast track work on evidence-based care and an essential benefit set, cost and quality information for providers to use in pricing, and new payment or rate-adjustment methodologies. The $14 million appropriation received from 2008 legislation for health reform is available for these purposes. An additional $5-10 million may be required.
- *Provider and plan support.* Make fifteen percent of the projected savings from payment reform, or $55.5 million, available to support providers 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); help smaller provider systems assess their options; and help health plans change their systems and risk reinsurance methods.

These are not a calculation of actual costs. That is beyond the scope of this work. They are intended to give an order of magnitude of the investment needed.

4 Impact: Burdens and Benefits

Burdens

- Even though fundamental payment reform is widely accepted as necessary, there will be fear relative to the new rules of the game. Those entities whose revenue streams and business models are affected will fear and resist the changes. (See From and To Aspirations: Total Cost of Care Payment Reform in the Appendix for descriptions of some changes envisioned). As there will be less overall revenue in the system, providers and health plans will have to fundamentally change what they do to provide better outcomes for less money.
- Until the remaining share of the health care market – private self-insured employers, Medicare, and uninsured individuals – also choose this payment reform, health plans and providers would continue to act and be paid in current ways. This will cause dual systems for a period of time.
- Some individuals would pay higher individual income taxes when the value of their employer-provided health care premiums are reflected in their total compensation. However, Minnesotans don't always fully understand the per capita "bite" that health care takes, nor how dramatically health care costs have held down real wages over the last 20 years. Removal of this tax expenditure makes the per capita cost more visible, while redirection of its use hopes to increase the value received/$.

- There are risks inherent in this approach. Policy makers, health care plans, and providers will need to play a strategic role in resolving population, geographic, or information gaps that exist now (and continue) or appear when the outcomes/price bids are first offered.

Benefits

- Health improvement. Thirty years of Dartmouth research shows that primary care and prevention show better outcomes/price than specialty care, drugs, and surgeries. This payment reform will influence provider networks to place a higher value on wellness, on influencing patient behavior change and preventive health care, and on chronic care management than today.
- Transparency. A visible price and quality for each provider system will give health consumers information that is currently not available.
- Virtual elimination of confusing bills and claims processing.
- Reduced health care costs or increased savings through:
    - Redirection of a tax expenditure to payment reform with greater results/$ and toward closing the state's budget gap. This elimination contributes to the General Fund $1,009 million in FY 2011, and each year thereafter.
    - Competitive price/quality purchasing. While this saves little in FY 2010-2011 as the system changes over, Minnesota would spend $74 million a biennium less from the general fund for each percentage of savings realized thereafter.

This savings projection is derived from applying the 10% savings expected system-wide from payment reform,[13] as estimated by the Governor's Health Care Task Force, to these state spending categories totaling $7.4 billion a biennium –

- $685 million for state employer health premiums, and
- $6,720 million for medical care for public recipients. [14]

During the FY 2012-2013 biennium, a full ten percent savings from this forecast $7.4 billion would generate $740 million. Local government health care purchasers would realize additional savings. A biennial estimate of local government savings on their employer health premiums exceeds $270 million.[15] Minnesota could decide to capture all or some of these savings by reducing local and school aids, on the premise that locals could not have realized these savings acting alone (adding to the savings shown in the table below).

The Task Force report cautions that this 10% savings three years out is not guaranteed, but a best estimate. However, their savings estimates are sound. Their bases are as follows:

- Past evidence shows that consumers do switch to lower-cost, quality-equal providers.
- Providers will lower prices in order to be competitive for 30-50 percent of the market. (Fifty percent of Minnesota's market represents over 2.8 million lives.)
- Additional savings are expected as health care systems shift away from a system that rewards *volume* of services toward a system that rewards providers for keeping people healthy and managing needed care well. The TTF states, *"The largest impact is expected to result from transforming the payment system in ways that establish accountability for the total cost of care."*

If total cost of care does not proceed, this same level of savings – averaging a 10% reduction – could be extracted using the rate reduction (i.e., "bitter pill") starting immediately in FY2011. This contributes an additional $357 million in General Fund savings in FY 2011 (adding to the savings shown in the table below).

MINNESOTA'S BOTTOM LINE

($ in millions)

FISCAL YEAR	2010	2011	2012	2013
Savings		1,008.8	1,366.3	1,391.4
Transition Investment	(5)	(55.5)		
NET SAVINGS	(5)	953.3	1,366.3	1,391.4

Questions for Public Dialogue

1. We currently pay for every separate health care service that is delivered, regardless of whether it was well done or needed. How does this current payment method affect individuals?

2. What do you think about "total cost of care" payment reform? What ideas do you have for improving on this?

3. What are the likely barriers to shifting to a total cost of care model? What can be done to mitigate these barriers?

4. This idea has a large purchaser set determining a standard benefit set for its covered members, as informed by evidence-based research. What might be the benefits, and unintended consequences, of that approach?

5. Who should determine the kinds of outcome data that accompanies the price (purchasers, providers, plans, policymakers)? What information would you like to see?

Appendix: *From and To Implications: Total Cost of Care Payment Reform*

Health Care Providers – Today	Health Care Providers – Tomorrow
Lose $ when they keep patients healthy	Are rewarded for keeping patients healthy
"Waste" $ when they coordinate care of complex patients (non-billable time)	Are rewarded for integrating care
Are paid for the # of services provided, regardless of their effectiveness/efficiency	Are paid for the effectiveness (outcomes) and efficiency (cost) of services provided
Have incentives to refer patients to providers *inside their own group* or system	Refer patients to providers that have the best outcomes and lowest cost
Spend time negotiating payment rates for multiple discrete services with multiple health plans	Annually analyze the cost of the services they provide and set a single price for these services
Treat patient contacts as isolated disease events	Take responsibility for individual patients and their population of patients
React when their patient experiences health problems	*Act* to prevent disease and treat chronic diseases early
Invest in technology that improves the bottom line	Invest in technology that provides better outcomes at a lower cost
Are confused by multiple health plan decisions about which services are or are not covered by insurance	Deal with a more simplified "essential benefit set"
Cost-shift to other insurers if one insurer is paying less	Have no ability to cost shift within the purchasing pool
Have no responsibility for the isolated or overall cost of care they provide	Assume responsibility for the total cost of care of patients, or partner with other providers who do

Health Care Plans – Today	Health Care Plans – Tomorrow
Spend vast amounts of time negotiating payment rates for multiple services with multiple providers	Play a strategic role in addressing risk, access, sufficiency of competition, and understandability of outcome data
Create selective "provider networks" based primarily on negotiated rates	Support provider networks with value-add services (risk pooling)
Are penalized for enrolling sick or high cost patients	Enroll all patients regardless of disease; monthly billings of annual rates
Act as if the plan can significantly influence cost and quality	Hand over cost and quality responsibility to the entities that actually control it (providers)

Purchasers – Today	Purchasers – Tomorrow
Have little idea of the cost or quality of the health care services they are purchasing	Know explicitly the cost and quality of those services
See their health insurance costs rise faster than revenue, than any other expense in their budget	See their health insurance costs trimmed
Annually ask themselves whether to quit offering health insurance to their employees	Avoid the annual heartburn
Decide whether to absorb the increasing cost of health care or to expand their business	Expand their business
Decide whether to relocate their business in another country with lower health care costs	Stay in Minnesota
Spend hours trying to understand health insurance	Attend to their own business
Spend hours negotiating with one or more health insurers about the price of various products	Attend to their own business

Consumers – Today	Consumers – Tomorrow
Have no idea of the cost or quality of the health care services they are seeking	Know explicitly the cost and quality of those services
Experience no financial advantage for healthy behaviors	Pay lower premiums if they don't smoke and are at a healthy weight
Know that they are disadvantaged by the poor health behaviors of other people in their pool	Know that their own health behaviors will affect the price of their own insurance
Have inadequate incentives to manage their chronic illnesses	Have financial incentives, but not requirements if they manage their chronic illnesses
Stay in a job they hate because they can't risk losing health insurance	Move to a job they prefer and retain their health insurance
Worry that their information will be lost upon referral to another clinic	Know that their provider is assuring coordination of their care
Are confused about which services are or are not covered by their insurance	Deal with a more simplified essential benefit set

Notes

[1] Dr. Risa Lavisso-Moury, CEO, Robert Wood Johnson Foundation.

[2] Mahar, "The State of the Nation's Health," *Dartmouth Medicine*, Spring 2007, pp. 27-35

[3] Shea, Davis, & Schor, *U.S. Variations in Child Health System Performance: A State Scorecard,* The Commonwealth Fund, May 2008.

[4] *Governor's Health Care Transformation Task Force*, Jan 2008. This work describes total cost of care in more detail, including needed legislation and waivers.

[5] J. P. Newhouse and the Insurance Experiment Group, *Free for All? Lessons from the RAND Health Insurance Experiment* (Cambridge, Ma.: Harvard University Press, 1994).

[6] Chen, "Getting Off the Patient Treadmill", *New York Times,* Feb 20, 2009.

[7] *Governor's Health Care Transformation Task Force,* Jan 2008.

[8] 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.

[9] Several researchers (including Mark McClellan, head of CMS) estimate that up to 30% of current spending is wasted, due to unnecessary care, duplicative care, or care not delivered when it could do the most good. Source: Dartmouth Atlas Project Study, web-exclusive FAQ, Nov 2005.

[10] US health care administrative costs are roughly twice that of any other country. This results primarily from multiple health plans in the marketplace that each advertise, market, and negotiate, and from fee-for-service payments where every service generates a claim.

[11] For example, cease to pay for any hospital re-admissions within 90 days of elective surgery.

[12] 1983 Congressional Budget Office study

[13] *Governor's Health Care Transformation Task Force*, Jan 2008, p. 184

[14] This $6.7 billion is combines the Nov 08 forecast estimates for MA – Family and Child Basic Care, MA – Elderly and Disabled Care, and General Assistance Medical Care. We did not include forecast amounts for Medical Assistance to LTC facilities or under LTC waivers, nor payments made through the state's Medical Education and Research Costs (MERC) Fund. Providers with medical education programs would continue to receive payments through MERC and do not need to increase prices to cover the costs of medical education.

[15] Annual school district, county, and city health insurance premium costs were estimated at $2.7 billion by multiplying the total number of school and local government employees by the average cost of insurance for school district employees.

Delivering Integrated Human Services: Multi-County Shared Services

2

1 The Bottom Line: Better Results for Vulnerable Children & Families

Is there a way to spend less on human services and create better results for vulnerable children and families? How could creating multi-county regions increase service integration, reduce state and local administrative costs, combine funding streams, and support investments in prevention?

2 Background

"Minnesota's human service system has challenges and performance problems that are not being adequately addressed by the state or counties."

- Office of the Legislative Auditor (January 2007)

Funding

In FY2005, total human services expenditures (all funds) were $8 billion including funds for economic support, social services, and health care. Spending by the state for human services accounts for 25 percent of state operating expenditures. In 2004, 38 percent of Minnesota counties' operating expenditures were for human services. Health care accounted for half of that amount.

Funding structures are not generally set up to encourage prevention. For instance, many counties in Minnesota do not provide early intervention and prevention services absent a finding of need for child protective services.

Human services access, cost, and outcomes vary significantly. Spending varies from $661 per resident in Scott County to nearly $3,232 per resident in Mahnomen County. County property tax funding is a key factor in the variation of services offered because each county has a different tax base and allocates varying amounts to human services.

According to the 2007 Legislative Auditor's report, for FY2005 the percentages for local, state, and federal funds were:

	Expenditure	Federal Share	State Share	County Share	Others' Share
Economic Support	$784 million	65%	16%	11%	9%
Health Care	$4.9 billlion	46%	52%	1%	1%
Social Services	$2.7 billion	40%	40%	18%	2%
TOTAL		**46%**	**45%**	**7%**	**2%**

Current Delivery System

Eighty-four local human services agencies cover Minnesota's 87 counties. Only nine states rely primarily on counties to provide human services. Research did not identify any states that were pursuing a multi-county service delivery strategy.

County cost per client varies substantially from county to county. For instance, the county cost per client for income support varied from $99 to $263. Sparsely populated counties have difficulty providing adequate services due to lack of providers and higher costs associated with unique cases.

Counties currently join with other counties to provide services but county partners differ from service to service, spinning a fragmented and uncoordinated web of relationships across the map.

Eighty-five percent of human services administrators stated in a Legislative Auditor survey that cash, food, and healthcare eligibility requirements could be simplified without harming program integrity. In the same survey, 46 percent of county commissioners said that their local human services agency has rarely provided them with comparative information on human services performance in other counties.

Existing Statutory Authority to Form Regions

A statutory framework has existed since 1973 to create regional entities to coordinate human services, corrections, and health services. Chapter 402 of the Minnesota state statutes allows counties to form Human Services Boards. This Chapter outlines the composition of these Human Service Boards and accompanying Advisory Committees. It also provides that the Commissioners of Corrections, Health, and Human Services "may delegate any duty, authority or responsibility vested in their departments relative to programs or services provided by the state."

The statute is currently used in only two regions. Faribault and Martin Counties jointly provide human services, as well as community health services. In Southwest Minnesota, Lincoln, Lyon, and Murray Counties partner to offer human services and will soon be partnering to provide health services.

3 Another Approach to Supporting Vulnerable Children & Families

Two recent reports support a regional approach to human service delivery:

- The Association of Minnesota Counties *Minnesota Redesign: Governance, Flexibility, Transparency* (February 2009). This report proposes that there "be voluntary multi-county collaboration in public health and human services".
- The Office of the Legislative Auditor, *Evaluation Report: Human Services Administration* (January 2007). The Auditor found that "more use of multi-county human services agencies could improve cost-effectiveness and consistency".

In this alternative approach to achieving better results for vulnerable children and families, counties would be required to create human service regions to oversee delivery of human services and community corrections, health services, housing, and/or other related services or funds as desired. The approach that follows outlines how this value proposition could be implemented over the next two biennia, taking advantage of federal stimulus funds, to the extent possible, to make the one-time investments needed to support the transition and smooth the changes.

The 1973 legislation assigned counties to regions but demographics have changed since then. Counties could be assigned to regions or counties could be required to form regions with whichever other counties they desired, as long as the region covered a minimum population.

Each region would have a Human Service Board (HSB) to govern and purchase services. Representation on the HSBs would include county commissioners and citizens. Human Service Boards would primarily play a guiding role: negotiating outcomes, selecting providers, and mobilizing partners and communities. HSBs would not typically provide services themselves but would "steer" the effort by articulating the outcomes, including some tailored to specific regional needs, setting policies, selecting and contracting with service providers, and holding providers accountable for the outcomes and value sought.

Advisory Boards would be created to assure that consumers and their advocates can influence decisions. HSBs would agree to a formula for financial contributions by the counties in their region. County property tax funds and county program aid (CPA) would be subject to the formula. State funds would also be allocated directly to the regions using an existing or new formula. The goal would be to provide more equitable funding across the state for human services.

In regions with few potential service providers, the HSBs would be responsible for increasing capacity in the region by creating new organizations, attracting current organizations that provide services nearby, and/or helping build the ability of a county or counties to provide services to the region. Over time the HSBs and providers could work together to mobilize community resources and volunteers and build community partnerships with schools, housing and workforce development organizations, local businesses, civic organizations, and faith communities to support necessary service provision.

HSBs would issue performance-oriented Requests for Proposals (RFPs) to choose service providers. The RFPs would:

- Target potential service providers, including non-profits, for-profits, counties, schools, or other local jurisdictions.

- Specify what outcomes are desired and propose a payment system aligned with producing those outcomes.
- Include incentives to reduce the use of high-end services, to integrate services for families, and to address generational poverty.
- Require the use of evidence-based practices.
- Require the use of evidence-based, culturally competent service delivery strategies to address disparities in outcomes for racial and ethnic minorities.
- Ensure the provision of basic core benefits, and also encourage innovative approaches and customized services for local conditions.
- Require that providers provide information about their service outcomes to the HSBs and to the public.

State departments supervising the relevant funds would contribute to the success of the regions by eliminating unnecessary restrictions on use of funds, including de-categorizing funds, combining funding streams, seeking federal waivers, eliminating mandates, and streamlining reporting and other requirements. Departments would eliminate requirements for submitting *individual* plans for each service area or funding source and instead would expect integrated plans. They would also eliminate the requirements for the formation of specific advisory councils for each service; instead allowing the HSBs to create other mechanisms for advice from advocates, consumers, and the community.

State departments would be accountable for the use of state funds and assure quality by negotiating with HSBs for the outcomes they want for citizens and taxpayers and the metrics to measure success. If a region fails to produce the expected outcomes, and cannot remedy that failure, the state would have the authority to step in and assist the HSBs and/or require certain changes. In extreme cases the state could take over regional services. Reasons for state take over or other intervention would need to be spelled out specifically ahead of time as counties and the state negotiate their agreements to produce outcomes.

The state Department of Human Services recently created a Shared Master Index (SMI) to integrate client information across service systems. This system provides an excellent basis for integrating services to clients on a regional basis.

Some human services may be most appropriately provided on a statewide basis. The Legislative Auditor surveyed county human service directors for its 2007 report. More than 50% of the directors indicated either "yes" or "maybe" about transferring the following services to the state: adoption services, child care licensing, and child support enforcement. The reasons cited included "consistency," "better able to provide specialized services," and the "lack of control over highly regulated services."

The availability of federal stimulus money, including $2 billion in Medicaid funds, creates a potential opportunity to fund the transition to regions. If allowable, an "Innovations Fund" could be created at the state level with this "one time" stimulus money to provide the regions with upfront strategic planning, infrastructure, and innovative system designs needed to leverage funds and provide excellent service.

Based on the examples below and others, Minnesota can conservatively expect to improve human service outcomes and simultaneously save at least 5 percent of the cost. Reducing the state portion (45%) of $16 billion per biennium spent on human services by 5 percent would save $360 million per biennium.

- San Mateo County (CA) has adopted an integrated approach such as this. Though they don't report "captured" savings, their system integration has resulted in reduced wait times, cross program information sharing, and a seamless client-centered delivery system.

- Mesa and El Paso Counties (CO) have implemented human services programs that deliver client-centered results. Mesa County saved approximately 40 percent in operating and administrative expenses with the integration of human services into a one-stop agency.

- Racine and Kenosha Counties (WI) have developed an integrated agency in a single location. The Workforce Development Center in Racine County has dramatically changed the service delivery programs of the county. The Job Center in Kenosha County has integrated services and improved efficiency.

For Minnesota, value can be maintained with fewer dollars by:

- Reducing the cost of administration.
- Reducing the use of high-cost services by creating incentives for early intervention and prevention.
- Integrating services to get the most effective mix of services for a client.
- Paying for outcomes, not service units.
- Combining funding streams and creating as much flexibility as possible in the use of funds.
- Reducing unnecessary rules, regulations, reports, and advisory groups.

Implementing this plan and reductions could be staged as follows:

- In the Fiscal Years 2010–2011 biennium, use federal stimulus money, if allowable, to reduce the short-term impact on clients who are impacted by the worsening economy and to invest in the creation of the regions and their service models. During this period regions would be formed, Human Service Boards established, negotiations with the state initiated, and integrated service plans developed.
- In the next biennium, Fiscal Years 2012-2013, implement an equitable way of reducing state funds for human services by 5 percent ($360 million/biennium). The funding formula would need to assure equity across the state for families and children.

4 Impact: Burdens and Benefits

Burdens

- Creating regions requires changes in culture and disrupts current practices and staff at the state and county levels.
- The counties' role in human services would change under this proposition. Counties could choose to get out of the human service delivery business or could compete to provide a service or services for the region. At least some may see this change as an opportunity.
- Although services would no longer be provided by an individual county, consumers and citizens would have input through the advisory committees. At least some may experience the changes as a weakening of local control and local accountability.

Benefits

Vulnerable children and families in Minnesota will benefit from better coordination of their services and access to services that are as tailored as much as possible to their needs, not the requirements of funding sources. Having 84 of 87 counties deliver service diverts valuable resources from direct service to administration, does not allow for the diversity and integration of services that families require, and does not encourage investments in prevention. This approach assumes that a more coordinated, flexible,

regional delivery system can be created with fewer dollars. Additional benefits include:

- Contracts with providers based on achieving outcomes and aligning compensation improves outcomes and value.
- Incentives to use the least-cost service to produce the best value saves money.
- Early intervention and prevention reduces the use of high-cost services and can help children and families reduce or eliminate reliance on government programs.
- Integrating services and creating an integrated data system can lead to identifying those families that consume an extraordinary amount of resources (the "million dollar families") so their needs can be addressed in a coordinated, less expensive way.
- Families in need are often mobile. By creating regional service delivery, these families can continue to be served by the same case manager and providers throughout the region.
- Counties would benefit from forming regions. Benefits would include:
  - More efficient and effective services could be provided to county residents by reducing administrative costs, combining expertise, coordinating services, and having access to specialized services.
  - Federal stimulus money for Medicaid or other stimulus funds can hopefully be used to support creating regions and can make the transition less disruptive.
  - Counties can be relieved of the day-to-day obligation of administering or contracting for human service programs if they desire and can focus their energies on other county priorities.

Investment

Experience indicates that the number one reason attempted changes fail is that they are undercapitalized. Therefore, for this design to succeed, a modest *one-time* investment is suggested to facilitate the transition to a new system. The funds for the investment will be taken from the savings or from federal stimulus funds. At this point it is not clear how flexible the federal stimulus funds will be.

It is anticipated the investment will be needed for these things:

- Assistance in forming and organizing Human Services Boards, including training boards in their roles and assistance with start up activities;
- Developing new relationships among counties, regions, and state agencies;
- Changing practices in state departments to achieve flexibilities and combining of funding streams;
- Writing Requests for Proposals to solicit service providers and doing an initial selection and negotiation of contracts;
- Developing initial regional service integration plans for human services, corrections and health as appropriate; and
- Implementing integrated data and accountability systems building on the Shared Master Index recently developed by the MN DHS.

The investment is estimated to be approximately $500,000 - $1M for assisting the state in making the changes to support this new system depending on the number of departments involved. In addition an additional investment of approximately $250,000 - $750,000 per region formed may be needed, depending on the extent of current cooperation, the number of counties in each region, and which services will be delivered regionally. These are not a calculation of actual costs. That is beyond the scope of this work.

MINNESOTA'S BOTTOM LINE

($ in millions, based on FY2005 figures)

FISCAL YEAR	2010	2011	2012	2013
Savings	0[1]	$100[2]	$180	$180
Transition Investment	(Stimulus $)[3]	(Stimulus $)	($5)[4]	($0)
NET SAVINGS	0	$100	$175	$180

[1] Assumes that regions will be in formation during FY 2010.
[2] Assumes ramp up of savings as regions are implemented.
[3] See discussion in "Investment" section above for initial transition investments. It is not yet clear if stimulus money can be used for these investments.
[4] Assumes that some level of investment will be needed during this period to assist regions to be successful.

Questions for Public Dialogue

1. Can counties deal with the political issues associated with putting aside traditional ways of operating human services, corrections, and health programs and come together in regions to deliver integrated services with combined resources?

2. Can a more equitable way of funding human services be devised for the state?

3. What new models can be employed to reduce the need for human services in the long term with investments today in prevention?

Better Value for Housing Subsidies

3

1 The Bottom Line: Home Ownership

Is the tax expenditure of the Mortgage Interest Deduction a good value for the money in terms of promoting home ownership?

2 Background

The Tax Expenditure Budget for the State of Minnesota indicates that there will be approximately $1,039 million of implicit spending during the 2010-2011 biennium for the home mortgage interest deduction. [1] "Tax expenditures," as defined by the Minnesota Department of Revenue, are ". . . statutory provisions which reduce the amount of revenue that would otherwise be generated [assuming no reduction in general tax rates], including exemptions, deductions, credits, and lower tax rates. These provisions are called "expenditures" because they are similar to direct spending programs." [2]

Ostensibly the home mortgage interest deduction, a tax expenditure, is in place to assist in increasing home ownership rates in the United States.[3]

- Research shows that the home interest deduction **has little or no bearing on home ownership rates.**[4] Home ownership rates in the U.S. are about the same as in Canada, Australia and England, which do not have the deduction.[5]
- According to the National Association of Realtors, only about 27 percent of people nationally take advantage of the mortgage interest deduction.[6] In Minnesota approximately 29 percent of income tax returns included this deduction in 2007.[7] Generally, there is a perception that many will benefit from the mortgage interest deduction. This is shown by information provided by the home builders and realtors professional associations' web sites as well as a home ownership analysis some realtors show clients. In many of these analyses there is a spot that explicitly lists the tax deduction. However, more than 70 percent of people find that they cannot benefit from using this deduction, because they don't itemize (many instead use the standard deduction) or possibly because the homeowner does not have a mortgage but owns the home outright.
- According to the Joint Committee on Taxation, a little over half of the benefit is taken by just 12 percent of taxpayers, those with incomes of $100,000 or more.[8]
- The legislative history is not immediately apparent indicating that the mortgage interest deduction was a deliberate policy set by Congress. Until 1986 all interest was deductible. In the Tax Reform Act of 1986 Congress eliminated the interest deduction on credit cards and consumer loans, but left the mortgage interest deduction.[9]

- Research suggests that without the deduction houses would cost a little less – some estimate 10 to 15 percent.[10] Others estimate the actual increase is less than 5 percent, but either way, in today's economy with home prices already considered depressed, any governmental action that further reduces wealth (i.e., the price or value of a home) could be seen as counter productive.
- The State of Minnesota collected approximately $7,759 million in income tax revenue in 2008. [11]

3 Another Approach to Home Ownership

Eliminating the mortgage interest deduction at the state level would provide additional revenue to the State. Correspondingly, eliminating the state level deduction would likely have no impact on housing purchasing habits since the value of federal government deduction is approximately three to four times that of the state level deduction.

4 Impact: Burdens and Benefits

Burdens

Those who benefit from the Home Mortgage Interest deduction may be concerned about the loss of the tax deduction. In addition, there are concerns that the loss of the deduction will depress housing prices (as noted above).

The state along with individual tax filers would also have some administrative cost in order to convert collection and payment systems to account for the difference between this change and the federal system.

Benefits

Eliminating the mortgage interest deduction at the state level would provide additional revenue to pay for alternative home ownership enhancing programs, such as:

- Foreclosure prevention
- Down payment assistance
- Credit enhancement

These types of programs directly target those in need of assistance and increase housing related policy outcomes. [12]

Depending on the amount of revenue redirected for housing assistance programs, there would likely be additional revenue available to the State. This additional revenue could provide for the overall income tax rates to be reduced for all Minnesotans.

It should be noted that in areas where people own their houses outright (e.g., many agricultural regions), they cannot take advantage of the Mortgage Interest Deduction.

MINNESOTA'S BOTTOM LINE

($ in millions)

FISCAL YEAR	2010	2011	2012	2013
Savings	495.3	543.9	543.9	543.9
Transition Investment	1.0			
NET SAVINGS	494.3	543.9	543.9	543.9

Experience indicates that the number one reason attempted changes fail is that they are undercapitalized. Therefore, for this approach to succeed, a *one-time* investment is suggested to facilitate the transition to a new system. The funds for the investment are taken from the projected savings.

The investments contained in the above tables are not a calculation of actual costs. That calculation is beyond the scope of this project.

Questions for Public Dialogue

1. Should state government be in the business of subsidizing housing?

2. If so, what is the best approach for this purpose – a tax expenditure? a refundable tax credit? some other direct expenditure?

Notes

[1] State of Minnesota Tax Expenditure Budget Fiscal Years 2008-2011. Minnesota Revenue Tax Research Division. February 2008. p. 59

[2] State of Minnesota Tax Expenditure Budget Fiscal Years 2008-2011. Minnesota Revenue Tax Research Division. February 2008. p. 1

[3] Edward L. Glaeser and Jesse M. Shapiro, "The Benefits of Home Mortgage Interest Deduction", Harvard Institute of Economic Research Oct. 2002: Discussion Paper 1979.

[4] Edward L. Glaeser and Jesse M. Shapiro 20.

[5] http://www.nationmaster.com/graph/peo_hom_own-people-home-ownership. Economist, 30 March, 2002. Euromonitor.

[6] www.realtor.org/press_room/public_affairs/tpmortgageinterestdeduction

[7] Tax Expenditure Budget, p. 59; Minnesota Tax Handbook: A profile of State and Local Taxes in Minnesota. Minnesota Revenue Tax Research Division, January 2009. p. 3

[8] United States, Joint Committee on Taxation, Selected Data Related to the Federal Tax System Mar. 2007: 11

[9] United States, President's Advisory Panel on Federal Tax Reform. Final Report: Simple, Fair, and Pro-Growth: Proposals to Fix America's Tax System, November 2005: 14.

[10] Roger Brimer, Mark Lasky, and David Wyss, "The Real Estate Market Impacts of a Flat Tax," Data Resources Incorporated, May 1995.

[11] Minnesota Tax Handbook: A profile of State and Local Taxes in Minnesota. Minnesota Revenue Tax Research Division, January 2009. p. 2

[12] Most researchers credit the availability of credit enhancement through Fannie Mae (Federal National Mortgage Association established in 1938) as being the impetus for facilitating the rise in home ownership in the U.S. by making credit available.

Freeing Counties to Focus on Results

4

1 The Bottom Line: Local Accountability for Local Results

Can counties provide better results to residents with fewer state dollars?

The keys to affirmatively answering this question are:

1. Changing a state-county relationship that is now based on controlling inputs to one focused on producing outcomes, and
2. Increasing counties' direct accountability to their citizens for results.

2 Background

"In the spring of 2003, the AMC Board of Directors came to the conclusion that as county officials, it was vital that they look at county government and reexamine its traditional roles."

-- Redesign Project Document, Association of Minnesota Counties, January 2009[1]

Minnesota's fiscal system raises a higher percentage of revenue at the state, rather than local, level yet returns a higher percentage to the local level than many other states. Some argue that this system works well because the state can raise money more efficiently. While this system worked for many years, it now seems unstable.

Despite the state's substantial role in raising revenue for local government, there are only ineffective state mechanisms for managing this investment or for creating accountability. No office in the executive branch can enforce real accountability and the legislature commits a minimum of time and energy to this accountability.

While the state relationship with cities is in a similar condition, this inquiry is focused only on the state-county relationship because, in addition to providing for local needs, the counties act as an administrative arm of the state.

The state's forecast provides $466 million in county program aid (CPA) and approximately $250 million in market value homestead credit (MVHC) funds to counties in the next biennium. The state also funds counties for human services and specific other programs. These dollars have no specific outcome expectations attached to them. However, the state has mandated how counties should operate,

requiring "maintenance of effort" in certain functions, as well as cost-sharing requirements. The Association of Minnesota Counties (AMC) has produced long lists of these mandates and estimates that the federal and state governments mandate 80 to 85 percent of county services.

Minnesota is comprised of 87 counties, almost half of which have populations less than 20,000. Each of these, plus 855 cities and 1500 towns, exists to respond to local needs and to add a local perspective to services. To adapt services to fit local circumstances, local governments need to ***provide*** for services– that is, to decide *whether* to provide. Unfortunately, most units of government concluded that to provide for the service they also had to **produce** it, i.e., "do" that service themselves. This unnecessary conclusion has led to a situation where many different units of local government are producing the same service on an inefficient scale. One need only look to the seven-county metropolitan area to find 77 police departments and 102 fire departments in the business of producing local services. Similar issues exist at the county level of government.

Three consequences of this status quo are

1. A significant amount of mistrust,
2. Many governments, each with a narrow, local focus; and,
3. Weaker accountability for local government services.

"The fundamental underpinnings of levy limits come from a legislative belief that the public blames legislators for property tax increases and a common legislative belief that local government officials are wild spenders and cannot be trusted to contain local spending." -- Redesign, AMC

Levy limits, the long lists of mandates, maintenance of effort requirements, reports, and prescriptions placed on counties not only handcuff counties but also curb innovation. Can Minnesota continue to bear this cost of mistrust?

Finally, the current arrangements provide only weak accountability for county services' bottom line. Who is really accountable for the county portion of property tax levies, the county or the state? Who is really accountable for the outcomes a county produces, the county or the state? Minnesota's system of mandates and levy limits, and state prescriptions for how local governments do things muddles accountability. Research shows that when accountability is strong, one usually gets better results for the dollar.

3 Another Approach: Stronger Accountability for Local Taxes and Results

Counties will likely incur a reduction in state aid as a part of this year's budget, no matter what happens. Another approach is needed to reduce the cost of mistrust and increase accountability to Minnesotans at the local level. With respect to transforming the current state-county relationship to achieve those ends, the following five elements of a "new deal" are suggested:

1. Reduce state funding[2]
2. Eliminate state control of inputs
3. Focus the state and county together on outcomes[3]
4. Give counties flexibility in how they produce results
5. Increase accountability of county government to its residents

It is assumed here that, absent another approach, county aids will be reduced 50%, with no change in mandates and maintenance of effort (MOE) expectations. What if counties would phase out county aids altogether in exchange for freedom from most state restrictions, and an emphasis on outcomes rather than effort?

The state would allow all counties to be *performance counties*, giving them freedom from most state restrictions and flexibility to focus on outcomes in exchange for an elimination of state aid over a two-year period. *Performance counties* accepting this "deal" would gain these benefits:

- Levy limits and other property tax restrictions are lifted for these counties. Counties can develop some stability of funding by use of their own levy and are accountable to their citizens for the money they spend and the results it produces locally.
- All maintenance of effort and cost sharing requirements are reviewed and turned into outcomes with performance measures.
- State and county agree on a performance contract between them that identifies outcomes and associated dollars for any state services administered and delivered by the counties. The state should provide a framework for – and the results expected from – the property tax system.

County officials taking the opportunity would gain flexibility to produce results in the manner that they think best. Currently maintenance of effort (MOE) requirements and mandates limit how counties can operate. Innovation is limited as MOE ties counties into old ways of doing things by restricting new thinking and designs. Old patterns of spending are not only encouraged, but also mandated.

Levy limits and funding from outside limit the ability for county government to be accountable to their citizens. This alternative approach will increase accountability of county government to its residents for the price they pay for county government and for outcomes that are achieved.

Counties would also have the option to *not* take this deal. In that case, they would have 50% of their aids reduced (as will likely happen anyway) but not participate in the new freedoms and flexibilities.

REDUCED AID TABLE

IN MILLIONS OF DOLLARS *

AID or CREDIT	FY 2010	FY 2011	FY 2012	FY2013
CPA Forecast	233	233	240	240
CPA Alternative	(233)	(233)	(240)	(240)
County Opt-outs	117	58	60	60
CPA SAVINGS	**(116)**	**(175)**	**(180)**	**(180)**
MVHC Forecast (county portion)	125	125	120	120
MVHC Alternative	(125)	(125)	(120)	(120)
MVHC Opt-outs	62	31	30	30
MVHC SAVINGS	**(63)**	**(94)**	**(90)**	**(90)**
TOTAL SAVINGS	**(179)**	**(269)**	**(270)**	**(270)**

* Assumptions include: aid and credit eliminated totally, but half the counties choose to opt out of flexibility and take only a 50% reduction.

* Dollars in categorical outcome agreements between the state and counties that participate are not included in these numbers.

This alternative approach will require an investment by the state in transitioning from input control to a focus on outcomes. Experience indicates that the number one reason transformational changes fail is that they are undercapitalized. Therefore, for this opportunity to succeed, the state should make a one-time investment to facilitate the transition to a new system. The funds for the investment will be taken from the savings.

The funds will be used for an investment in:

- Development of a set of county outcome measures and a system to collect monthly data on these measures. This could be accomplished through a grant to the Wilder Foundation, which has already made a good start on this work with its *Minnesota Compass* efforts. [4]
- Outcome reporting system; and
- Developing performance contracts between the state and counties.

Based on experience, this investment is estimated to be $3.5 million. This number is not a calculation of actual costs. That is beyond the scope of this project.

4 Impact: Burdens and Benefits

Burdens

- This design could lead to two types of Minnesota county governments – the haves and the have-nots. Areas of the state have varying ability to raise funds through the property tax.
- County governments would need to raise more money locally, and some will raise taxes rather than work to take advantage of flexibilities.
- County governments will be more dependent on the regressive property tax for local needs.
- Moving from the current finance system to a new one will require investment.

Benefits

- Citizens get better results for their money. Outcomes will be reported in services that citizens care about such as safety, education, mobility and environment. [5]
- Citizens get better transparency in the prices they pay for local services.
- Citizens get better transparency on the results they receive.
- County officials have more flexibility as they are freed from state mandates, reporting requirements, and maintenance of effort requirements that they feel now tie their hands.
- The state reduces spending.
- Buying results improves outcomes and reduces expensive red tape.

MINNESOTA'S BOTTOM LINE

($ in millions)

FISCAL YEAR	2010	2011	2012	2013
Savings	179	269	270	270
Transition Investment	(2)	(1.5)		
NET SAVINGS	177	267.5	270	270

Questions for Public Dialogue

1. Is there a way to improve outcomes and accountability for the bottom line to citizens of cities too?

2. This opportunity does not address the issue of too many fragmented local governments trying to produce services rather than provide them. The only incentive in the opportunity for sharing services is to decrease state funds thereby creating more limited resources. What is the best way to encourage shared services across all local units of government and regional offices of state agencies? How can we encourage development on the supply side of shared services?

3. To improve accountability, where in the executive branch of state government should the focus be for state-local relationship? Is the State Auditor the best option?

Notes

[1] The Association of Minnesota Counties has some excellent work in its Minnesota Redesign Project. This work is based on the same principles that they employ – governance, transparency, and flexibility.

[2] "A flypaper effect is found when there is evidence that an increase in aid to a jurisdiction is more stimulative on government expenditures than an equivalent increase in voters' incomes (Fisher, 1982). Hence, if a state government handed out income directly to voters rather than as grants to the local jurisdiction, the voters would support a lower level of government spending than the government of the jurisdiction would choose." "Spending Lesson Regarding Local Government Competition, Budgetary Complexity, and Fiscal Structure." Urban and Regional Analysis Group. Andrew Young School of Policy Studies Georgia State University. Research Notes, Sept. 2004: Number 2.

[3] Based on the best practices below -- and others -- Minnesota can expect a dividend of at least a 13 percent improvement in service quality and a 15 percent reduction in cost. Some best practices using this strategy include:

- The Federal government converted 26 contracts totaling $585 million to be "performance based." For instance, the Air Force found that it saved 50 percent on maintenance by specifying floors must be clean, free of scuff marks, etc. as opposed to requiring contractor to strip and re-wax floors weekly. The Navy, NASA, and the Departments of the Treasury and Energy undertook similar revisions. Collectively, these federal agencies achieved an 18 percent improvement in customer satisfaction with the contract services and a 15 percent reduction in contract costs. A better bottom line.
- Several states have instituted similar programs. Virginia, for instance, captured savings of 15 percent, Florida 17 percent.
- In the early 1990's the Australian federal government invested heavily in outcomes-based contracting. Overall, they experienced a 13 percent improvement in quality and 16 percent cost savings.
- Some jurisdictions have used this outcome-based approach to focus solely on improving performance, not reducing costs. For instance, in an initiative that eventually won Harvard's prestigious Innovations in Government Award, the State of Illinois dramatically improved outcomes for children under the protection of the state. Over a three-year period, they increased the adoption rate by 280 percent. Prior to the introduction of Performance-Based Contracting, Cook County's average permanency rate for agencies was just 6.7 percent, but by the end of state fiscal year 1998, the average jumped to nearly 20 percent. North Carolina and Iowa both achieved similar results in making their child protection systems outcome based.

[4] See the TC Compass site of the Wilder Foundation at www.tccompass.org. The metrics are currently being developed to turn this into a statewide measurement site. We believe it will be called MNCompass.

[5] See TC Compass examples.

Fundamentally Different Medical Assistance: Improve Public Health *and* Lower Public Costs

5

1 The Bottom Line: Better Health for Minnesota's Elderly & Poor

Is there a way Minnesota could improve the health of the lowest income Minnesotans, offer the elderly greater flexibility in care choices, extend health care to more people burdened with poverty – all while slowing the upward spiral in costs?

2 Background

Public health care programs already consume one in every five dollars spent through the state General Fund (GF). With present growth rates, that ratio is on track to be two out of every three dollars within 25 years – an obviously unsustainable situation. [1]

Medical Assistance (MA) in Minnesota has a projected bottom line in the FY 2010-2011 biennium of over $16 billion dollars. The State's share is fifty percent. In 2010-2011, that $8.2 billion share[2] includes $2.2 billion for families and children, $2.6 billion for elderly and disabled, and $3.4 billion for long-term residential care.

Large as these numbers are, they are slated to get larger – with the state's obligations increasing by at least $1.5 billion by the 2012-2013 biennium. In fact, MA is one of the fastest growing items in the state's budget.

Medicaid in Minnesota provides access to health services for certain categories of low-income citizens. To qualify for help, a person must be "poor, plus'" – poor and with children, or poor and disabled, or poor and elderly. (Single or married poor adults are not covered.) In 2007, over one-half million Minnesotans were covered, comprising 235,000 children, 121,000 parents, 99,000 disabled, and 55,000 elderly. Three-fourths of these lived below Federal poverty lines. Approximately 110,000 more people live below Federal poverty line, but do not currently receive assistance from Medical Assistance. [3]

There is a clear public interest in the state's efforts to raise the health status of the poor. A whole generation of research confirms that poverty is a killer, with heart disease at 50 percent higher rates, children more obese, and death rates that are right up there with chronic smokers. [4]

It's becoming equally clear that this public investment to intervene on behalf of the poor may not be designed for success. Using eight measures of quality chosen by the Minnesota Department of Human Services, a recent report suggests that, despite the high costs, the quality of health care available under

Minnesota's public health care programs, including MA, lags behind that provided to patients with private insurance.[5]

The likely truth is that no one knows. Medicaid programs have become so complex that they seem to defy analysis and evaluation. Studies often reach contradictory conclusions. Data about real outcomes are hard to come by.

Small changes will not help much. For policies and incentives to improve and protect the health status of Minnesota's most vulnerable citizens, the system begs for a major overhaul. To undertake this challenge, the state would need federal permission to design and try a fundamentally different Medical Assistance system. Minnesota could offer to design a results-based system that runs on lower costs.

3 Another Approach to Better Health for Minnesota's Elderly & Poor

Minnesota could propose to deliver better outcomes – and do that with fewer federal dollars – in exchange for the freedom to start over and design a Medical Assistance program that runs on results and is engineered to improve and protect the health of as many poor Minnesotans as possible. Specifically, Minnesota could request a Section 1115 waiver, whereby states can be authorized to waive compliance with many of the requirements of the Medicaid statutes. The intent of Section 1115 is to allow States to experiment. [6]

The specific terms of the waiver would need to be negotiated, but it could be requested as:

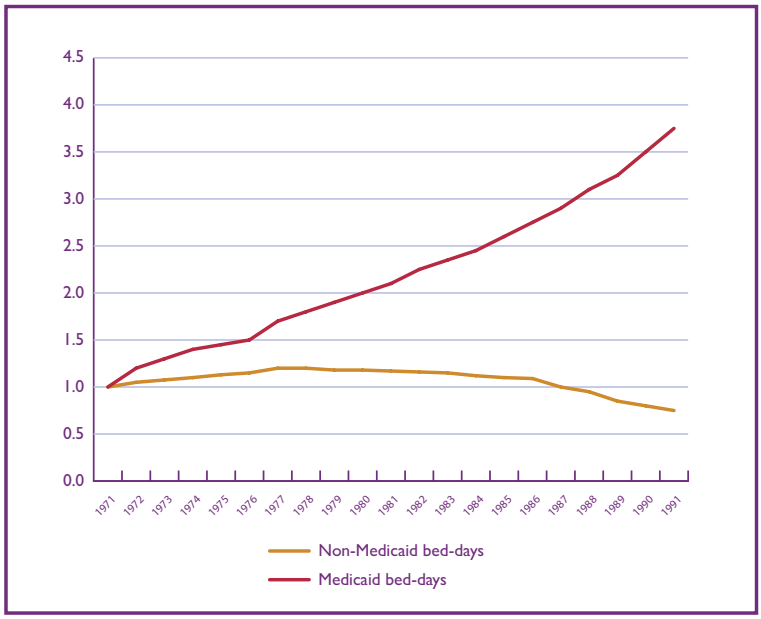
- A prospective share-in-savings arrangement. For every dollar Minnesota saves from projected federal MA costs for Minnesota, the state could receive a 50-cent rebate.
- An immediate five percent cut of projected FY 2011 spending. The design challenge starts with designing better outcomes within the amount available. Savings would be taken "off the top" – banked by both the state and federal governments.
- The state could also commit to a slower rate of MA cost growth. After the five percent reduction, MA dollars could be indexed to Consumer Price Index growth (not health-care inflation) - giving federal and state taxpayers additional savings, yet allowing for growth in access. [7]

If Minnesota policy makers decide to take this journey, they would need to ask for maximum flexibility, a global or *whole-cloth* waiver. Minnesota's past waiver requests have often been successful, but piecemeal. Each has its own target populations, purposes, and assessment protocols. Little summary information exists (although DHS is building a comprehensive data inventory of all collected waiver assessment data).

Designing the whole system, rather than tweaking by exception, could save everyone time. Currently, participants in a waivered process have to decide whether to opt in or opt out. It is time consuming both for them and the people who must explain the options.

A whole-cloth waiver would also allow the state to incorporate new data about MA and its impacts. Some data, suggesting that Medicaid has unintended consequences, beg to be better understood. For instance, one national study suggests that MA practices actually have the effect of reducing available substitutes for expensive nursing home care.[8]

GROWTH IN BED-DAYS FOR MEDICAID
AND NON-MEDICAID PAYERS, 1971–1991



Source: Rand Corporation

Medicaid redesign is *timely,* given that health reform in Minnesota is also picking up steam (from evidence-based care practices to what belongs in an essential benefit package).

Finally, the federal government would have a powerful incentive to say yes – Medicaid accounts for one of every five health care dollars spent across the US today, and the Baby Boomers are entering their senior years at the rate of one every eight seconds – and there are nearly 80 million of them.

To be effective, **the waiver request should be explicit about the outcomes to be achieved through** Minnesota's redesign:

- Maintain or improve the health of Minnesotans on Medicaid;
- Improve the choices for elderly Minnesotans in their living and health care arrangements;
- Increase access to Medical Assistance for those Minnesotans living below 100 percent of Federal poverty line who are not receiving MA; and,
- Save both state and federal taxpayers five percent of projected MA costs.

There are many paths leading to these outcomes. A whole cloth waiver would allow the state to find the points of greatest leverage. For example:

Medical Assistance could be redesigned to maintain or improve health status of Minnesotans, across the age continuum:

- *Kids and their Parents* – Minnesota recently was ranked 23rd in the nation on indicators of child health.[9] One factor where Minnesota ranked surprisingly low was annual preventive medical and dental visits. Designers could look both long-term and short-term to improve the health status of kids. When a leading indicator of health is a person's education level, designers could explore the return on investment (ROI) if MA dollars were spent to help kids succeed in school. Shorter term, the RAND Corporation estimates an ROI of $5.70 per dollar spent on Nurse-Family Partnerships, which provides home visits to first-time, low-income moms, beginning in pregnancy. [10]
- *Disabled Adults* – Designers could examine the good news that rates of disability among adults have been dropping. Between 1982 and 2002, the percent of the population 70 and older with

a disability has dropped from 23 percent to 15.5 percent nationwide. Designers could be challenged to analyze this trend and learn from its implications (i.e., can this trend be accelerated?). Proven and promising programs, such as the Minnesota Disabilities Health Option Program, could be widely and rapidly expanded to broadly infuse their improved care practices into the system – improving outcomes and saving cost. [11]

Better Outcomes for Disabled Adults

A broad waiver could help Minnesota achieve better outcomes for less cost by making MnDHO the preferred program for physically, mentally, and developmentally disabled adults with fragile medical conditions. Minnesota Disabilities Health Option Program (MnDHO) is a chronic care model that improves providers' capacity to deliver comprehensive and coordinated care. It has demonstrated consumer-oriented results, and could be expanded from the current 1200 participants to at least the 55,000 currently eligible. By allowing and encouraging chronic care providers (rather than health plans alone) to take the lead, MnDHO might offer even more effective approaches to treating disabilities. Somel elements of the program design could be: expansion into the developmentally disabled population, discounted payments to get savings, training and support for providers, risk insurance, and share-in-savings incentives for participants who sign up. Near term expansion of MnDHO would require an assessment of current acute and chronic care providers, support and training for them, and some back up for their risk.

- *Older Adults* - Nationwide, seven percent of Medicaid's long-term care users (LTC) use 52 percent of all Medicaid spending. [12] Designers could drill down into this high-cost use pattern and introduce Best Care alternatives for chronic and long-term care management. Medicaid funds might be used to target, assess, and provide early treatment and intervention to people with Alzheimer's in order to delay or completely prevent a nursing home placement. Medicaid might also be used to give additional incentives to nursing home providers when they move someone out of their facility and instead provide care in the community. [13]

Increasing Independence: Returning Nursing Home Residents to Community

Paying nursing homes for long-term care – *wherever they deliver it* – would provide incentives to return residents to the community sooner. Nursing homes are paid now for days of care in their facilities; after an initial few weeks, they don't have financial incentives to discharge residents back home or to the community. What if, for every resident they can start caring for in the community, nursing homes were offered a rate higher than today's community care rate (but less than the nursing home rate) for as long as the person did not return to the nursing home? It would be in the home's interest to help people move out and help people stay out. It would be in the State's interest to pay less for people who would have otherwise stayed in the institutions. The State could further support providers with increased licensing flexibility and conversion support, so providers can create less restrictive settings residents desire.

Using community care funds this way would require at least a waiver amendment. A one-time investment of 5% of the first year savings could be used to support homes in changing their business model, and for loans or grants to homes that want to convert more beds to other uses.

Medical Assistance could be redesigned given current knowledge of advances in technologies (monitors, sensors, cameras, shoes, electronic medical records, etc). Research points to an increased trend of using assistive devices as the sole form of assistance for older adults. However, disparities in use by race and socio-economic standing (SES) persist. Higher SES people are more likely to use assistive technologies and live in homes that facilitate aging in place. [14] Minnesota gets a lower rating in the use of technology than might be expected. [15]

Medical Assistance could be redesigned to expand the choices available for older adults to live at "home." Nursing home providers say that MA reimbursements are 20-25 percent below their costs – another apparently unsustainable situation, one reputedly driven by layers of complex regulations. So, if a waiver could eliminate all but the most necessary requirements, providers of housing and health services for older adults could convert time and energy spent today on pursuing rate increases needed to cover the cost of regulations into time spent understanding and developing products and services needed in the marketplace. Most elderly citizens could stay healthy at home. What might emerge are expanded or new models of housing and health-related care such as adult day health care centers or additional caregiver supports. [16]

Support for Family Care Giving: Prevention of Nursing Home Placement

Family and friends provide over sixty percent of long-term care. Early intervention with families is an effective way to prevent or delay institutional care – for elderly and other at-risk individuals. Using models successfully demonstrated in other states, Minnesota could aggressively identify and assess individuals and their care settings, in order to predict who is likely to need institutional care in the future. The State could intervene early with treatments and caregiver supports designed to delay institutionalization, if not prevent it altogether. Just one month of delayed nursing home admission for a potential Medicaid recipient saves Minnesota taxpayers an average of $1700. An expanded Federal Waiver might allow the state to use Medicaid funds for these preventive interventions before a person is actually eligible for Medicaid. Pending a waiver, there would be some front-end state investment necessary in advance of the savings.

Some may say this redesign waiver idea is too theoretical. However, given the forecast growth of MA costs, Minnesota has three options available –

1. *Continue the status quo.* This course is not financially sustainable.

2. *Seek rate adjustments "inside the box."* Have the Commissioners of Health and Human Services seek the authority to change rates under the managed care and fee for service portions of MA. Spend more time and energy on rates *to pay for the requirements.*

3. *Invest in an "outside the box" option to redesign the system anew.* For this design to succeed, a one-time *investment of at least $650,000*[17] *is needed* for:
   - A thorough understanding of this $16 billion delivery system, including gathering perspectives from current people served and other stakeholders;
   - The design process itself; and,
   - A communications effort to inform all actors of the purpose, the process to be used, and progress being made.

A one-time investment will also be needed to implement the design.[18] Negotiations with the federal Centers for Medicare and Medicaid Services - when the design shows how it will improve the health status of the lowest income Minnesotans, offer the elderly greater flexibility in care choices, extend health care to more people burdened with poverty, and spend less – should include the investments needed to successfully facilitate transition to the new system. Fifteen percent of the expected biennial savings, or $72 million, is not improbable. These are estimated investments, not calculation of actual costs.

4 Impact: Burdens and Benefits

Burdens

The burden of uncertainty. This idea contains a process of invention, rather than analysis. As such, it goes beyond what is currently known. This level and degree of uncertainty will cause concern across current recipients, providers, and policy makers.

For example:

- Minnesota has been successful in waiver requests with the federal Centers for Medicare and Medicaid Services (CMS), but they may be concerned with this waiver setting a precedent.
- State and local MA administrators and budgetary leaders will be concerned about financial risk – both inside MA, and on potential loss of federal stimulus money. The budget neutrality language of past waivers has sometimes locked in MA monies at a point in time or tied to a population level. And, maintenance of effort language in the federal stimulus bill could mean that certain things may be "off the table" for redesign. However, further information expected from CMS negotiations during the waiver request period could address the kinds of fiscal sharing options, as well as the overall boundaries of the redesign.
- Minnesota can seek a new waiver at any time. However, there is no guaranteed turn-around time expected of CMS.
- Some will fear that changes could be worse for the poor. Therefore, it would be critical to clearly and consistently tie all communications and work to the expected design outcomes – *reach more* of Minnesota's poor, *improve health* outcomes, *improve housing* choice, and *spend less*.

Benefits

However, realizing the design objectives would result in these benefits:

- Expanded access to medical support for more people burdened with poverty
- Greater flexibility for the elderly regarding care and aging *"at home"*
- Improved health outcomes for all ages. An emphasis on preventive care and making healthy choices for Minnesota's poor youth could result in literally a lifetime of benefit
- Less cost for federal and state taxpayers. Assuming that FY 2010 is utilized to design and obtain the MA waiver, savings would start accruing to the General Fund in FY 2011. A savings of two percent from projected spending generates more than $85.6 million. During the FY 2012-2013 biennium, a full five percent savings from the forecast $9.69 billion generates $485 million.

MINNESOTA'S BOTTOM LINE

($ in millions)

FISCAL YEAR	2010	2011	2012	2013
Savings		85.6	233.5	251.2
Transition Investment	(.65)	(72.0)		
NET SAVINGS (non-cumulative)	(.65)	13.6	233.5	251.2

Minnesota would spend even less if either option for fiscal sharing were accepted by the Federal government. For example, a 50-cent rebate to Minnesota of the federal-realized savings would result in an additional $81 million in FY 2011.

Questions for Public Dialogue

1. Taken alone, the initial investment of $650,000 for the redesign work looms large, especially during a budget crisis. Is a $650,000 investment to reconsider a $16 billion dollar program worth it to get the improved outcomes described?

2. What principles should guide a redesign of Minnesota's medical assistance program?

Notes

1 *Minnesota LT Budget Trends Study Commission,* Jan 2009, p. 16.
2 Expenditure projections used here, and in the savings estimates, result from these forecast items: MA – Families & Children Basic Care, MA - Elderly and Disabled Basic Care, MA - Long Term Care Facilities, and MA – Long Term Care Waivers. Source: *General Fund Balance Analysis*, MMB, January 27, 2009.
3 Minnesota Department of Human Services, Reports and Forecasts Department
4 America's Health, United Health Foundation, 2008 Edition, p. 3.
5 *2007 Health Care Disparities Report for Minnesota Health Care Programs*, Minnesota Community Measurement, June 2008.
6 Unsettling Scores: A Ranking of State Medicaid Programs, Public Citizen Health Research Group, 2007, p. 136.
7 To illustrate the difference, the consumer price index (CPI) for medical care grew more than 4% annually during 2000-2006. In contrast, the overall CPI grew between 1.6% and 3.6% per year during that same time period. (Source: *"U.S. Consumer Prices for Medical Care"*, IHS Global Insight, 2009.)
8 Rand Corporation and Minnesota Citizens League analysis.
9 Shea, Davis, and Schor, *U.S. Variations in Child Health System Performance: A State Scorecard,* The Commonwealth Fund, May 2008.
10 America's Health, United Health Foundation, p. 3
11 This idea is described in the sidebar entitled *Better Outcomes for Disabled Adults,* and is available as a separate work of analysis from PSG.
12 Kaiser Family Foundation, Medicaid's LT Care Beneficiaries: An Analysis of Spending Patterns
13 This idea is described in the sidebar entitled *Increasing Independence: Returning Nursing Home Residents to Community, a*nd is available as a separate work of analysis from PSG.
14 Trends in Old-Age Disability, as compiled by Citizens League.
15 Unsettling Scores: A Ranking of State Medicaid Programs, Public Citizen Health Research Group, 2007.
16 This idea is described in the sidebar entitled *Support for Family Care Giving*, and is available as a separate work of analysis from PSG.
17 A small portion of the two billion MA-FMAP federal stimulus monies could be earmarked for this design work, and position MA for long-term results/dollar improvement.
18 For one-time investments, such as retooling nursing home areas, purchase of technology necessary for home-monitoring of health, etc.

Staying Safe: Shifting Resources from Prisons to Community Interventions

6

1 The Bottom Line: Safe Communities

Could the state reduce the level of crime by focusing its resources on interventions for offenders that have proven to reduce recidivism, rather than on incarceration? Could the state avoid the future cost of a projected 30 percent increase in the prison population?

2 Background

Minnesota's prison population has increased from 5,500 inmates in 1998 to over 9,200 inmates as of July 2008. While one of the lowest incarceration rates in the country today, the rate is almost twice as high as Canada's. The prison population is projected to increase by 2,697 inmates, a 30 percent increase, by FY 2017.

Minnesota also has an unusually high number of individuals – over 142,000 – under supervision, a population 25 percent higher than the national average.

Research shows that chemical dependency is a key driver of criminality. Sixty five percent of offenders in Minnesota's prisons have been assessed as chemically dependent , which is consistent with incidence studies in other states. According to a 2008 report, [1] thirty-seven percent of chemically dependent inmates will commit a serious crime within three years of release, yet proven interventions are applied for very few of these offenders in Minnesota.

A 2008 MN Department of Corrections (DOC) study, along with a variety of others, indicates that recidivism can be reduced among offenders by 50 percent or more with effective intervention for chemical dependency. [2] Such an intervention includes long-term treatment of at least six months in prison and continuing until release, followed by intense intervention and long-term aftercare in the community. National studies show that treatment in the community, which includes long-term management and support, also results a significant reduction in recidivism. Studies indicate that *extended incarceration by itself does not reduce recidivism* for the general offender population (except for the time spent incarcerated).

For high-risk violent offenders, extended prison terms provide the best protection for the public. However, studies indicate that for many lower-risk nonviolent offenders, shorter incarceration periods, combined with the right intervention at the right time, will reduce the risk to the public more significantly than a longer prison term.

3 Another Approach to Safe Communities

The combination of a growing prison population, high costs for incarceration, a large portion of inmates with chemical dependency problems, and proven ways to deal with chemical dependency outside of traditional prison settings creates an opportunity to both save substantial taxpayer dollars and improve public safety.

What if Minnesota reallocated a portion of the resources currently used for offender incarceration to evidence-based interventions (supervision, programming, and treatment) for offenders in the following ways?

1. Have the Minnesota DOC contract with community correction agencies, paying agencies from $6,000 to $16,000 for each offender diverted from prison for probation and supervision violations. Base the contract amount on current baseline numbers, with the contract value range dependent on the average length of stay averted. (Probation violators' prison stays average 15 months at a cost of approximately $40,000; supervision violators average 5.4 months at a cost of approximately $14,782.)

2. Ask the DOC to create capacity for a six-month substance abuse program, based on what has been most successful, that enables an additional two to four hundred individuals to participate. These individuals will be released six to 12 months early upon successful completion of the substance abuse program. A stipend of $6,000 to $12,000 would follow these individuals to pay for community interventions and long-term aftercare.

3. Have the DOC further contract with counties to accept inmates in their last six months of incarceration, providing $16,000 to place these individuals in county community facilities. The $16,000 would be needed by counties for intervention and placement alternatives for some of their current offenders who would likely be displaced by arriving state inmates.

These strategies could potentially reduce the population by 1,000 chemically dependent individuals and expand the capacity of communities to deliver evidence-based programs (EBP) for additional offenders on probation.

Counties could leverage additional dollars to divert existing community-based correction offenders from incarceration to EBP programming by:

- Reducing the number of individuals currently on probation by 30 to 50 percent, moving a large number to fine and community service-based sanctions.
- Ensuring all counties are diverting low-risk offenders from regular supervision, which research shows can actually *increase* recidivism for low-risk inmates. Larger Minnesota counties are currently doing this.
- Targeting existing treatment dollars (state and county programs) towards EBP interventions that have been proven to work. This does not appear to be happening in large numbers in Minnesota – although some great small projects exist.

Additional strategies to improve safety for the dollars spent could include:

1. Assigning designated non-profits a portion of offenders to case manage (with some community correction supervision). This strategy would help determine if a clinical approach to substance abuse can prove more successful than a correctional approach.
2. A recent Minnesota Department of Human Services (DHS) study indicates that counties, which manage substance abuse dollars, currently do not track outcomes from the various treatment

providers. DHS could coordinate with Corrections to track outcomes from substance abuse treatment to learn more about which treatment approaches and providers are most effective.

3. For participating counties, merge multiple streams of state grant dollars into a block grant that substitutes recidivism performance expectations for the current emphasis on rules and process.

4 Impact: Burdens and Benefits

Burdens

- Local corrections agencies would need to adjust their processes for interacting with offenders to reduce the number sent to prison.
- Local residence facilities are limited and local agencies may be reluctant to divert existing occupants to create space for inmates.
- Today's community corrections may have limited capacity to provide the full evidence-based interventions to successfully reduce recidivism. Local capacity may have to be significantly increased.
- It will be financially challenging to plan for reductions in prison beds while simultaneously forwarding a portion of the resulting savings to community corrections.

Benefits

- Reduction in Crime. A reduction of at least 1,200 serious crimes by the third year of implementation is predicted based on the following assumptions. This number does not include the number of lesser crimes that will be prevented.
    - A 2008 report indicates that 37 percent of chemically dependent inmates will commit a serious crime within three years of release absent successful intervention in their chemical dependency.
    - The right treatment, with the right supervision and extended aftercare can reduce recidivism by 50-75 percent.
    - For every 1,000 offenders under the new treatment, the number of convictions of serious crimes should be reduced by at least 185 over three years.
    - The initiative will enable more effective interventions for offenders beyond the 1,000 per year population reduction, so the actual number of convictions averted will be a multiple of 185.
    - The ratio of offenses to arrests for various serious crimes ranges from 2:1 to 10:1 (robberies). It is assumed conservatively here that for every three serious crimes there is only one conviction.

Potential General Fund Savings

The following assumptions were used to calculate how this alternative approach could produce savings to the state's general fund:

- Shift 650 inmates during year 1 and 1000 inmates by year 2 from prison to community-based interventions. Year 1 cost reduction assumed at 50% of total cost ($52/day, 2008 dollars). (Column A)
- Reduce projected prison population by 400 inmates in year 3 (600 by year 4) as a result of reduced recidivism at annual cost of $19,000/inmate. (Column B)
- Intensify use of evidence based practices for chemically dependant inmates while still incarcerated (Column C) and in community programs. (Column D)

POTENTIAL GENERAL FUND SAVINGS

($ in millions)

YEAR	FISCAL YEAR	A REDUCTION IN CURRENT POPULATION COSTS	B REDUCTION IN FUTURE INCREASE	C STATE EBP EXPENSE	D COMMUNITY INTERVENTION EXPENSE	E TOTAL GF SAVINGS
1	2010	$6		$.5	$5	$.5
2	2011	$19		$2	$10	$7
3	2012	$19	$8	$5	$15	$7
4	2013	$19	$11	$5	$15	$10
8	2017	$129		$5	$25	$99

Year Eight assumes a reduction of 3,697 inmates from current DOC projections. If such a reduction were achieved, the state could avoid the cost of building additional prisons, saving the full cost of $122/day (2008 dollars), and the marginal cost of the remaining 1,000 inmates of $52/day. If the projected increase of 2,697 inmates occurs, the state will be required to build two facilities. The operating costs for a prison of that size are approximately $43 million per year, plus an estimate of $75 million to build a 1200 bed medium security prison.

Additional State and Local Revenue and Cost Avoidance

Estimates for additional revenue and local cost avoidance are based on the following assumptions:

- Reduced prison population
- Reduced recidivism
- State and local taxes accrued based on wages of offenders who are working (annual income of $12,272 at 11.5% tax rate[3]

($ in millions)

YEAR	STATE AND LOCAL TAX REVENUE	COUNTY/CITY COST AVOIDANCE	NET STATE/ LOCAL TAX
1	$0	$0	$0
2	$1.4[1]	$6	$7
3	$1.8	$8	$10
4	$2.1[2]	$11	$13
8	$5[3]	$30	$35

[1] Assume increased income from 1,000 fewer inmates

[2] Assume increased income from 1.000 fewer inmates plus diverting the projected increase of 500 future inmates.

[3] Assumes increases income from 3,697 fewer inmates.

MINNESOTA'S BOTTOM LINE

($ in millions)

FISCAL YEAR	2010	2011	2012	2013
Cost Reduction	6	19	27	30
(Transition Investment)	(5.5)	(12)	(20)	(20)
Estimated Revenue	0	7	10	13
NET SAVINGS	.5	14	17	23

While the savings are modest in the first two biennia, by preventing the projected increase in population, this alternative would create net savings of $300 million for the 2017-18 biennium, after investing $70 million of the $370 total savings.

Experience indicates that the number one reason attempted changes fail is that they are undercapitalized. Therefore, for this alternative to succeed, investments are suggested to facilitate the transition to a new system. The funds for the investment are taken from the projected savings.

The investments contained in the above tables are not a calculation of actual costs. That calculation is beyond the scope of this project.

Questions for Public Dialogue

1. The key to avoiding future costs is to reduce recidivism. What must other areas of government (particularly human service agencies) and communities do to ensure adequate support and intervention for these offenders?

2. What additional steps do communities need to take to be better prepared to divert offenders from prison?

Notes

[1] Substance Abuse Treatment Evaluation Report, Office of the Legislative Auditor, State of Minnesota, February 2006, p. 101.

[2] Chemical Dependency Program Evaluation, Minnesota Department of Corrections, March 2008 p. 21.

[3] Crossroads: Choosing a New Direction Research Compendium, African American Men Project, Hennepin County Office of Planning and Development, p. 287. Indicates the lost wages for incarcerated individuals. Also, the 2009 Minnesota Tax Incidence Study, Minnesota Department of Revenue, March 2009 p. 15.

Special Education: Modest Changes, Better Education, Major Savings

7

1 The Bottom Line: Better Results for Special Needs Children at Lower Cost.

Could children in need of special educational assistance achieve more success in school at less cost? How could tensions between districts, schools and parents about special education services be mitigated in order to improve the degree of mutual agreement on how best to support these children? Isn't there something *that could be done to limit the paperwork and get more of that energy focused on kids?*

2 Background

The State of Minnesota, under both federal and state laws, is committed to provide an appropriate education for all children "in need of specially designed instruction and related services."

Long an extremely sensitive area of public policy, special education is complex in its multiple categories and sources of funding. It is often fraught with fears that disagreements over how a child is classified and what services are considered appropriate will not be resolved short of litigation.

Minnesota general fund expenditures for special education are projected to be $1.7 billion next biennium. Even with supplementary federal funding, school districts routinely find they have to subsidize special education from local funds. As stated in the 2010-11 biennial budget for the Department of Education, in FY 2007 for Special Education the State paid $700 million to Districts and allocated $172 million of federal funds. During the 2006-07 school year, the Department of Education reported that Districts spent $1.56 billion. Therefore, each dollar spent on special education translates to funding of approximately 45 percent from the State, 11 percent from the Federal Government, and 44 percent from local funds.

Economically distressed districts call upon the Excess Cost aid program to mitigate the losses from local resources. Not surprisingly, school districts are reluctant to see the rolls of special education expand; but the discretion afforded special education professionals by the eligibility criteria,[1] combined with pressure from understandably concerned parents (often supported by advocacy organizations) results in a relentless rise in the number of cases.

Student Identification

Minnesota has 14 categories of disability that qualify a person between birth and age 21 for special

education and related supportive services. Most of the categories are variations on mental disabilities such as retardation; neurological impairments such as autism; or forms of clear physical impairment. Three of the categories are widely seen as somewhat open to a range of professional judgment in the classification process: Emotional or Behavioral Disorders, Other Health Disabilities, and Specific Learning Disability. At the end of 2006 those three categories comprised 61,650 young people, or roughly half of the 122,112 total then classified as receiving special education services. Spending statewide across all these categories hit an average of $12,804 for the 2006-2007 year.

Special Education: Total Expenditures and Students in Minnesota School Districts, 2006-07

Type of Disability	Total Cost Per Disability type	# of Students	Costs per Student
Speech/Language Impaired (SLI)	$111,797,734	21,891	$5,107
Developmental Cognitive Disabilities: Mild-Moderate (DCDMM)	$115,817,226	6,772	$17,102
Developmental Cognitive Disabilities: Severe-Profound (DCDSP)	$103,574,902	2,217	$46,718
Physically Impaired (PI)	$43,793,569	1,693	$25,867
Deaf - Hard of Hearing (DHH)	$41,544,933	2,269	$18,310
Visually Impaired (VI)	$11,050,756	419	$26,374
Specific Learning Disabilities (SLD)	$237,021,172	31,039	$7,636
Emotional Behavioral Disorders (EBD)	$269,604,738	16,303	$16,537
Deaf-Blind (D/B)	$394,774	50	$7,895
Other Health Disabilities (OHI)	$33,295,301	14,308	$2,327
Autism Spectrum Disorder (ASD)	$102,291,361	11,273	$9,074
Developmental Delay (D/D)	$119,093,181	12,630	$9,429
Traumatic Brain Injury (TBI)	$1,467,443	456	$3,218
Severely Multiply Impaired (SMI)	$5,672,303	792	$7,162
Three or More Disabilities	$367,073,246	---	---
Total	**$1,563,492,640**	**122,112**	**$12,804**

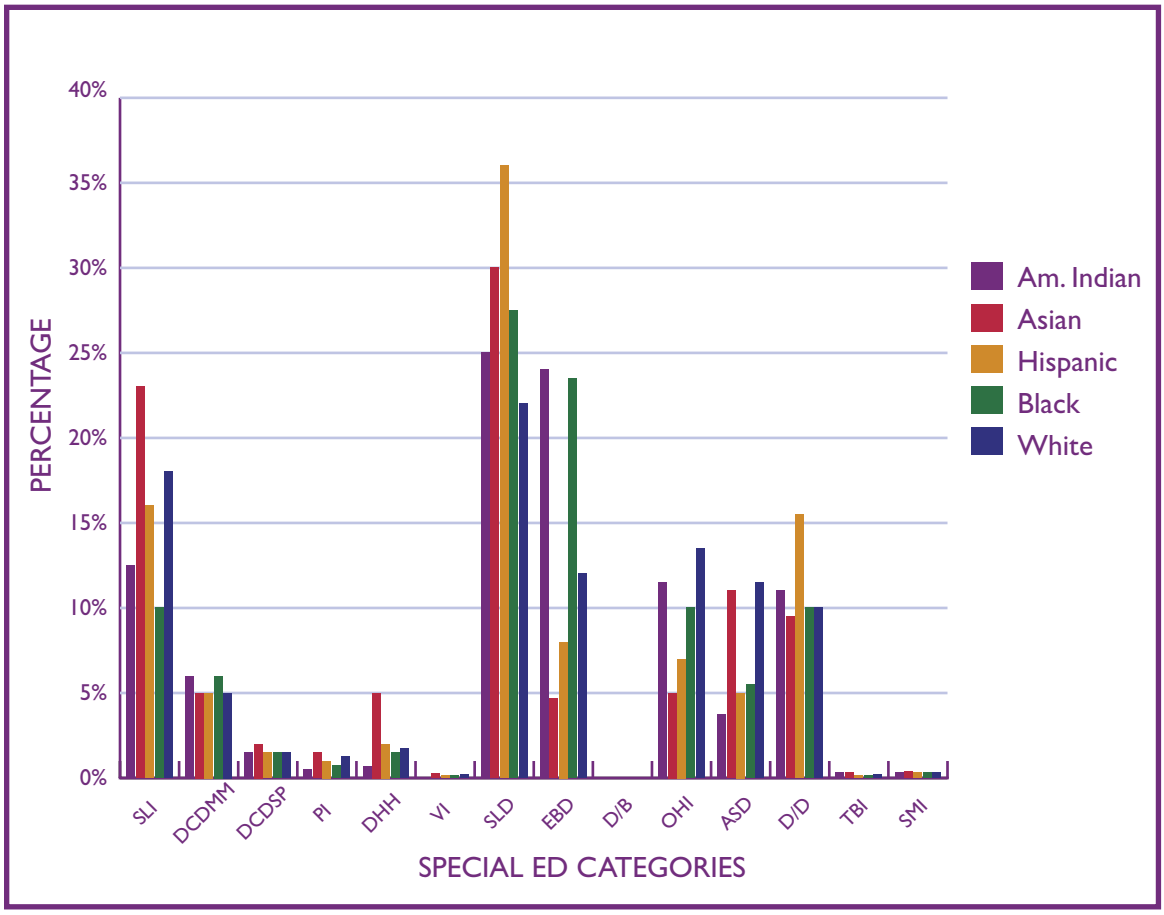
Special Education Spending

Special education professionals chronically complain about reporting requirements. Some claim that filling out reports and forms consumes anywhere between a third and half of all their time – time that could be devoted to the customer, the student. A 1997 report from the Office of the Legislative Auditor (OLA) confirmed that Minnesota imposes more administrative work and reporting on educators than the federal government requires. It is possible that practitioners record in a level of detail that is simply not necessary, either as a result of their training or worries about litigation. If indeed even a third of an educator's time goes to reporting activity, that translates to about a half-billion dollars of resources every year (across all 14 categories).

A further finding of the OLA in 1997 concerned the state's "percent reimbursement" approach. This funding mechanism might encourage schools (though not districts, which end up bearing the net total costs) to identify more students as "special" and "serve them in more expensive settings," the OLA report suggests. In contrast, eleven states used a "flat grant" approach to control costs.

Of the students in special education in 2008-09, a statewide analysis of students by race indicates that minorities, especially American Indians and Blacks, show up disproportionately in the special education classification. For example, in the Emotional Behavior Disorder category, 23.5 percent of blacks are classified "special education" compared with 11.9 percent of whites, 8.7 percent of Latinos and 4.5 percent of Asians.

VARYING FREQUENCY PERCENTAGE OF IDENTIFICATION OF DISABILITIES BY RACE



**Abbreviations refer to disability types in previous table*

Further questions about student identification are raised by data showing wide disparities in general in the proportion of students by districts classified as "special education." This raises questions about whether identification is a function of population scale, size of district, socio-demographic mix, or some other factor.

For four years, beginning in 2002, the Legislature capped the growth in special education spending. That hard cap was lifted in 2007, replaced by a growth rate ceiling from the General Fund of 4.6 percent per year.

Finally, a look at the range of spending by categories reveals wide variations in amounts spent per child each year. In a system where costs are driven in part by conflict between concerned parents and cost-conscious school districts, it is possible to imagine that much of this variation is a function of the adversarial system.

2006-07 RANGE OF AVERAGE SPECIAL EDUCATION COSTS BY DISABILITY FOR SCHOOL DISTRICTS THAT PROVIDED THE SERVICE AND THAT HAVE MORE THAN 500 STUDENTS					
	NON-ZERO MINIMUM	NON-ZERO MAXIMUM	NON-ZERO MEAN	NON-ZERO MEDIAN	% Mean > Median
Speech/Language Impaired	$ 1,189	$11,226	$4,506	$4,292	5.0%
Developmental Cognitive					
Disabilities: Mild-Moderate	1,048	68,114	18,319	15,709	16.6%
Developmental Cognitive Disabilities: Severe-Profound	202	158,445	42,918	32,253	33.1%
Physically Impaired	374	87,577	21,057	16,559	27.2%
Deaf - Hard of Hearing	116	47,973	11,019	7,859	40.2%
Visually Impaired	480	60,056	16,835	10,920	54.2
Specific Learning Disabilities	2,926	17,659	7,702	7,077	8.8%
Emotional Behavioral Disorders	3,093	41,303	13,131	10,927	20.2%
Deaf-Blind	1,192	8,753	12,969	7,111	82.4%
Other Health Disabilities	15	10,073	3,218	2,581	24.7%
Autism Spectrum Disorder	348	23,038	8,249	7,529	9.6%
Developmental Delay	370	17,325	7,187	6,583	9.2%
Traumatic Brain Injury	270	27,635	8,237	6,412	28.5%
Severely Multiply Impaired	123	58,688	15,722	10,199	54.2%
Total	**$4,967**	**$17,398**	**$9,784**	**$9,431**	**3.7%**

Note: Data used was for districts that provided service. To minimize the effects of outlier districts, the number used as the minimum was the 4th lowest with the 4th highest level in the data used as the maximum. Original data are from the Minnesota Department of Education, Uniform Financial Accounting and Reporting Standards.

3 An Alternative Approach

While challenging, there are ways to change the system – to lower the costs while improving the educational outcomes. Three approaches to consider include:

1. Lower the identification rate of special ed kids through systematic prevention – and where needed, more specific definitions;
2. Lower the cost per student by stipulating the level of support and reducing the level of conflict between districts and parents; and
3. Lower the costs of compliance.

How might these approaches be tested?

1. The Price of Mis-identification

First, the Legislature might consider unraveling the layers of Minnesota-specific definitions that enable children to be considered eligible for special education. The policy shift could be as simple as reverting to

federal definitions and standards. For example, the "Emotional Disorders" category would no longer have "behavioral" tacked on to it, which today likely invites variability in judgment.

Second, the state might, by regulation through the Minnesota Department of Education (MDE), institute a state-wide preference for prevention. Existing alternatives in Minnesota point to several avenues for prevention. Some young people develop a behavioral pattern that is destructive of their prospects for learning and disruptive to the rights of others. Rather than assess them as needing *special education* services, they often actually prosper when relocated to an *alternative learning environment.*

There are indications that school districts are moving toward a prevention model, with programs such as "Positive Behavioral Interventions and Support" (PBIS). Before referring a student for classification in the emotional/behavior disability category, teachers deploy a set of interventions. While there is not a long data record from this effort yet, the early results tend to be positive in helping students get back on track. The Emotional Behavioral category is the fastest growing of the 14; any substantial reduction in identifying students in this category produces large savings – and likely better achievement.

When some of these students continue to be "behavior" challenges, they may be resisting the traditional learning model. For these kids, this may indicate a need for an alternative learning environment such as that provided in project-based schools. Again, tracking data are not readily available, but project-based schools tell a consistent story: that once moved out of the course-and-class, teacher-centric model of education, a high proportion of these students find they can learn effectively by doing projects that require a multi-disciplinary approach. These students find they have to assume primary responsibility for their own learning. The teacher becomes a planner, a guide, a coach, perhaps a behavioral counselor, but not the primary source of knowledge. In these schools, whether they are alternative schools, area learning centers or other models, the student's behavior issues are frequently mitigated by providing a learning environment that more closely matches the student's needs.

The proof that special ed classifications can be lower lies in a certified best practice. The St. Croix River Education District (districts in Chisago and Pine counties) is a national leader in the use of the Response to Intervention model. Response to Intervention, like PBIS, is a whole-school system that starts by identifying those children who are not on track for meeting reading and math standards. Students are assessed early and their situation is addressed with research-based approaches. Their progress continues to be assessed weekly (rather than through high-stakes end-of-year tests), which yields progress data from which teachers make adjustments in the learning program. All this takes place prior to the point where so many kids fail.

Since the St. Croix River Education Districts (SCRED) have been using the Response to Intervention model for more than a decade, it is possible to evaluate results. The record shows that from 1996 to 2003 classifications for "learning disability" dropped from 4.2 percent to 4.1 percent for all Minnesota children. In the SCRED districts the percentage went from 4.4 to 2.5 amid general agreement that Response to Intervention spelled the difference. That is a 43 percent reduction in identifying children as special education.

In addition, some districts draw on the services of the Minnesota Reading Corps, which uses a system similar to Response to Intervention. (The MN Reading Corps is funded through the AmeriCorps program that combines federal dollars with a modest state grant and a stream of contributions from the private sector.) Reading Corps volunteers, after receiving expert level training and onsite coaching and mentoring, tutor children using specific reading interventions coupled with weekly formative assessments. Success rates on standardized tests are at the 80 percent level. Further analysis may show

that absent getting on track in reading, these students might have otherwise slipped into a category of learning disabled.

The incidence of special education classification for learning disability in schools using the Response to Intervention approach is at least a third less than average. Schools could more closely align the multiple pre-k program with the k-3 program to create a seamless "Age 3 to Grade 3" literacy approach significantly reducing the number of students that are assessed as in need of special education. Once assessed, students typically do not emerge from that system. Such "3 to 3 Models" can be funded with general education revenue, No Child Left Behind (NCLB) funds, and "compensatory revenue" funds, and draw on local Early Child Family Education (ECFE) funds for the Pre-K portion, the Minnesota Reading Corps Members, as well as any eligible child care funds and sliding fee scales.

If a third of the potential classifications could be avoided in just one of the 14 category types of special education – Specific Learning Disabilities – through alternative learning environments and early intervention through proven programs, the gross savings would be $71 million a year.

2. The Price of an Adversarial System

The wide range of spending currently is driven by the conflict-based adversarial system of negotiating between parents and schools districts. Government policy could, if the legislature chooses, convert that spending into a flat grant. The policy option: use the approach that the federal government uses for reimbursement: a flat payment for each Diagnostic Related Group (DRG) classification. Today, for districts that provide the service, the average cost (the mean) is 3.7% percent higher across the board than the median overall, but within each disability category the cost range is from *5% to 82%* (for schools with more than 500 students). Further analysis is needed to understand the drivers behind the cost-distortion in the system although both parents and professionals note the potential correlation to legal remedies when disputes emerge.

The Legislature could start with that median level in each category, and even improve it by 10 percent to ensure quality. But make it a flat payment. Parents could then choose what services to buy and where to buy them. This shift would invite a more competitive market of providers of critical services for special education students. Parents, individually or in groups, could purchase service from a customized portfolio of providers. School districts, along with the state, would achieve more clarity as to costs.

There would be costs associated with this shift – mostly associated with providing information and guidance to parents sorting through service options and vendors. And there would be costs associated with licensure of providers and regular oversight by the MDE or other state agency.

The policy objective of this shift is not savings to the General Fund or to local districts but to drive the antagonism out of the system by increasing parental control and choice.

3. The Price of Compliance

If, as is commonly believed, teachers tend to write reports in more detail as a defense against criticism and conflict with parents, then removing that dynamic also reduces the cost of compliance. Indeed, in any category monetized to a flat grant, the paperwork ongoing would be minimal.

So it follows that if the system could be converted to flat grants, reporting on compliance could revert to the federal minimums. Assuming that special ed teachers spend somewhere between a third and a

half of their professional time in compliance activity, this shift should reduce that to something closer to 20 percent at the most.

So for purposes of advancing the argument, assume that teachers are spending 40 percent of time on compliance. If that percentage could drop to 20 percent, savings of $300,000,000 a year (based on the $1.5 billion spent in 2006-2007) are plausible. If the federal IDEA law requires waivers to use a Diagnostic Related Group approach, the state could pursue that as a national demonstration. If these savings were achieved, about 45% of this total dividend, or $135 million annually, would be savings for the state general fund.

4 Impact: Burdens and Benefits

Burdens

- A period of uncertainty would be inevitable, perhaps uncomfortable, as policies and practices shift. Many would be concerned that programs currently in place, which work well for some children, might be disrupted.
- Parents accustomed to open-ended arrangements and recurring negotiations could initially see the flat grant as capping their support.
- Groups and individuals whose own professional work is tied to the adversarial system will predictably resist change.
- Some advocates will be concerned about the effectiveness of new approaches compared to the approaches they already know (which have both strengths and weaknesses).

Benefits

- More kids realizing more student achievement gains and growth than today.
- Parents and their children liberated from the emotional and sometimes legal turmoil imposed by an adversarial system.
- Savings of approximately $165 million per year by reducing the cost of compliance and the mis-identification of students, less modest costs of investing in the changes. [2]
- A focus on success, on prevention, where special education instruction may not be necessary for student success.
- Success with prevention has the potential to make Minnesota a national model for reducing the incidence of special education classifications while improving student performance.
- Capping local liability, permitting reallocation to priority needs in school districts.

Investments

Experience indicates that the number one reason attempted changes fail is that they are undercapitalized. Therefore, for this alternative to succeed, investments are suggested to facilitate the transition to a new system. The funds for the investment are taken from the projected savings. Investments include:

- Promotion of changes in instructional approaches to parents - $500,000.
- Training of providers and school districts in the new intervention strategies - $1 million in the first year, $500,000 a year for the next three years.
- Increasing funding to the Minnesota Reading Corps by $500,000 for each of the two years of the biennium.
- Additional oversight and licensure administration that might arise from flat grant approach and the development of a larger, more complex market of vendors of services - $2 million a year.

MINNESOTA'S BOTTOM LINE

($ in millions)

FISCAL YEAR	2010	2011	2012	2013
Cost Reduction	165	165	165	165
(Transition Investment)	(4)	(3.5)	(3.5)	(3.5)
NET SAVINGS	161	161.5	161.5	161.5

The investments contained in the above tables are not a calculation of actual costs. That calculation is beyond the scope of this project

Questions for Public Dialogue

1. How could all districts widely adopt Response to Intervention as a practice?

2. What incentives could the state use to reinforce the use of evidence-based prevention efforts that result in fewer children from being misidentified as in need of special education services?

3. Would converting benefits to a flat grant be consistent with the obligation in law to provide children with disabilities a free and appropriate individualized education?

4. Will parents welcome getting a grant for each year that their child is considered eligible for special ed, and to use those funds to decide on the sources of service rather than negotiating all the decisions with special ed professionals?

Notes

[1] State Education Rules 3525.1325 through 3525.1352

[2] This includes $30 million of the $70 million for avoiding mis-classifications as well as the $135 million for reduced compliance paperwork.

Tax Expenditures: Minnesota's Hidden Spending

8

1 The Bottom Line: Clarify the Value for All Spending

What is the impact of "tax expenditures" – implicit spending for presumably good policy purposes – and how might Minnesota subject this imbedded category of spending to regular scrutiny and debate?

2 Background

Minnesota has accumulated some 222 state-level tax expenditures[1] that add up to approximately $11.4 billion per year, ranging from $100,000 (several) to over $2.3 billion (for sales tax exemptions on selected services).

"Tax expenditures," as defined by the Minnesota Department of Revenue, are "... statutory provisions which reduce the amount of revenue that would otherwise be generated [assuming no reduction in general tax rates], including exemptions, deductions, credits, and lower tax rates. These provisions are called "expenditures" because they are similar to direct spending programs." [2]

The Minnesota tax system with its current rates and taxes theoretically could take in over $29 billion in revenue per year, but in fact takes in over $11 billion less due to tax expenditures.

While some might argue tax expenditures are not really "spending," most public finance experts consider tax expenditures to be "conceptually equivalent" to direct spending. [3] After all, the term is "expenditures."

The Legislature recognized that tax expenditures tend to become permanent without regard to changing conditions when it enacted Minnesota Statutes, Section 270C.11: "Tax expenditures should receive a regular and comprehensive review by the legislature as to (1) their total cost, (2) their effectiveness in achieving their objectives, (3) their effect on the fairness and equity of the distribution of the tax burden, and (4) the public and private cost of administering tax expenditure financed programs."

In accordance with this legislative directive, the Minnesota Department of Revenue publishes a Tax Expenditure Budget (TEB) biennially. While the Tax Expenditure Budget clearly delineates tax expenditure amounts and describes what the expenditures are, elements number two, three, and four above do not appear to be covered. Any questions as to the purpose or objectives for which the tax expenditures were enacted, much less whether these expenditures are achieving a desired result, remain unanswered.

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**

The tax expenditures and general result areas fall into the categories listed below:

Policy Area of Tax Expenditure	2009 Impact ($ in Millions)
Sales Tax Base[5]	$5,426.8
Other	1,788.0
Medical	1,551.5
Income Security	1,247.5
Real Estate	801.0
Charity	277.0
Transportation	229.9
Education	63.1
Total	$11,384.8

3 Another Approach to Clarifying Value per Dollar Spent

What if tax expenditures were evaluated in terms of whatever results they are intended to achieve and authorized in an open and transparent process? Take three tax expenditure areas as prime examples: Medical, Income Security, and Real Estate. These consist largely of the exclusion from taxation of employer-provided health insurance; the home mortgage interest deduction; and, the tax shelter of contributions to pension programs.

To begin with, Minnesota could eliminate the employee exclusion from income tax of the value of employer-provided health insurance premiums. If it were intended to encourage employer-provided insurance, actual behavior has been in the opposite direction. Minnesota businesses have been dropping

coverage, down to 63 percent in 2004. If the intended result was income parity, research shows that 88 percent of these tax-free employer contributions goes to households with incomes at or above the median. Removal of the exclusion achieves parity for those individuals who do not have employer-provided insurance. This exemption removal could begin July 2010, to allow for individual tax planning purposes and for employer adjustment to their withholding systems. Elimination of this tax expenditure results in over one billion dollars for either the budget shortfall or for re-investment in health care payment reforms.

In the case of the mortgage interest deduction, there is no evidence that it increases rates of home ownership, its long-presumed justification. The policy basis for the pension exclusion proves somewhat more complex, but the benefit is clearly skewed toward those with higher incomes.

To illuminate the process of enacting and monitoring tax expenditures to ensure that the people of Minnesota are getting good results for their money, one approach could be the following:

1. Ensure that current tax expenditures are affirmatively reauthorized and if required, enacted into law.
2. Prior to a Tax Expenditure becoming effective, its authorizing body must clearly:
    a. Determine the policy outcome desired (i.e. result) for which the tax expenditure in being enacted
    b. Assign appropriate performance measures for that outcome. Examples of appropriate performance measures could be the Twin Cities Compass measures produced by the Wilder Foundation. These measures address such things as Economy and Workforce, Housing, Education, Health, etc.
    c. In the biennium after the initial enactment, the authorizing body should consider whether the results are being met prior to reauthorization.
3. When authorizing tax expenditures, the tax expenditure authority must be reviewed with equal scrutiny as that applied to appropriations items as part of the budget process.
4. Each tax expenditure could sunset with the biennial budget and be reauthorized.
5. Each tax expenditure should have performance measures collected and reported on prior to any reauthorization.
6. An objective body, such as the Legislative Auditor, should be required to audit each of the tax expenditures based on the performance measures developed by the legislature and reported during the budget process.

4 Impact: Burdens and Benefits

Burdens

- Ensuring tax expenditures are more transparent may decrease the tax benefits of certain special interests.
- In addition, the Legislative Auditor would need to spend a certain amount of money auditing the performance measures from the new process. Compilation of the current Tax Expenditure Budget costs approximately $105,000 therefore it would be expected that the audit of performance measures would be a similar order of magnitude.

Benefits

- Minnesotans would know and understand the full range of spending that should provide a more accountable government.

Q Questions for Public Dialogue

1. How can the additional time and effort – additional transparency – in the legislative process produce better value from tax expenditures?

2. How will we ensure the legislature is able to develop appropriate performance measures for tax expenditures?

TAX EXPENDITURES GREATER THAN $60 MILLION *

2009 projected, $ in millions

	General Sales & Use	Individual Income	Local Property	Corporate Franchise	Estate, Insurance Premiums & Motor Vehicle Sales	Grand Total
Selected Services	2,376.4					2,376.4
Exempt Real Property			1,240.1			1,240.1
Contributions by Employers for Medical Insurance Premiums and Medical Care		878.4				878.4
Food Products	695.9					695.9
Employer Pension Plans		644.4				644.4
Motor Fuels	606.8					606.8
Home Mortgage Interest		448.6				448.6
Clothing & Wearing Apparel	378.7					378.7
Tax Increment Financing			344.0			344.0
Capital Gains at Death		258.5				258.5
Cafeteria Plans		251.9				251.9
Capital Equipment	247.1					247.1
Drugs & Medicine	243.2					243.2
Charitable Contributions		229.8				229.8
Medicare Benefits		211.7				211.7
Real Estate Taxes		176.0				176.0
Weighted Apportionment				171.6		171.6
Capital Gains on Home Sales		167.4				167.4
Social Security Benefits		165.6				165.6
Residential Heating Fuels	164.1					164.1
Working Family Credit		160.1				160.1
Accelerated Depreciation		61.6		94.4		156.0
Dividend Received Deduction				150.6		150.6
Investment Income on Life Insurance & Annuity Contracts		149.3				149.3
Individual Retirement Accounts		125.2				125.2
Marital Deduction					124.1	124.1
Local Goverments	121.6					121.6
Foreign Operating Corporations				107.1		107.1
Nonprofit Organizations	85.1					85.1
Health Maintenance Organizations & Nonprofit Health Service Plan Corporations					79.4	79.4
Price Reduced by Value of Trade In					78.1	78.1
Foreign Source Royalties				73.7		73.7
Insurance Companies				70.6		70.6
Publications	63.2					63.2
Green Acres Treatment of Agricultural Land			62.3			62.3
Marriage Credit		61.5				61.5
Hospitals and Outpatient Surgical Centers	60.8					60.8
GRAND TOTAL	**5,042.9**	**3,990.0**	**1,646.4**	**668.0**	**281.6**	**11,628.9**

* Note: this does not account tax expenditures less than $60 million.

Notes

[1] The Tax Expenditure Budget also lists 13 local property tax expenditures with an aggregate value of approximately $1.7 billion.

[2] *State of Minnesota Tax Expenditure Budget Fiscal Years 2008-2011.* Minnesota Revenue Tax Research Division. February 2008. p. 1

[3] Howard, Christopher. *The Hidden Welfare State: Tax Expenditures and Social Policy in the United States.* Princeton University Press, Princeton, NJ. 1997

[4] *Tax Expenditure Budget, and Minnesota Tax Handbook: A profile of State and Local Taxes in Minnesota.* Minnesota Revenue Tax Research Division, January 2009. p. 3

[5] This policy area overlaps with some other policy areas (e.g., the exclusion of medical devices from the sales tax). This table uses Sales Tax Base as the primary category.

A Better Approach to Service Sharing

9

Introduction

Three hundred forty-seven school districts all have similar "back room" operations that could be shared. Some are unique to school districts; others could be shared with cities and counties that also have duplicative functions. In the Metro area alone there are over 170 cities, all within spitting distance of one another. In this time of severe fiscal pressure, there may not be receptivity to consolidation, but at least there should be a serious dialogue about massive service sharing among local governments and school districts.

It should be added that there are already numerous service sharing arrangements among Minnesota cities, counties, school districts and special purpose districts. Some have been very successful at *both* reducing cost and improving service through economies of scale. While these initiatives prove the value of the concept, they represent but a drop in the bucket of the potential sharing that could be done.

It's easy to see how sharing can save money. More difficult is to both save money and maintain or improve service to the customers of these shared services. As these arrangements catch on incrementally, there is widespread interest among state officials to substantially accelerate the process. Some would mandate sharing. In either case, the methods used will make a big difference to the bottom line: better results for the dollar.

The "Soviet" Approach

Approaches that only focus on cost saving miss the idea of the bottom line and the real potential of sharing arrangements to both improve customer service as well as save a lot of money. Most common among such cost saving approaches is to require jurisdictions, usually in a geographic area, to share services. A single central source of the service is established to serve all the jurisdictions. Everyone is forced to use that source. A reason there hasn't been more widespread service sharing is that often a large central bureaucracy delivers worse service than several smaller "local" service providers. Most managers of these jurisdictions believe that what they gain in cost sharing will be more than offset by losses in quality, customer service, and control. Whether this is true or not, it is a barrier. Thus, resistance to this approach.

Customer Choice

An alternative approach is to simultaneously take steps to improve service and quality while reducing cost substantially. This may not have been possible 20 years ago, but today's IT infrastructure renders geography irrelevant for many (but not all) shareable functions. Consider for example, health insurance for employees, risk management, payroll, accounting, purchasing, benefits administration, travel

management, IT services, data base management, banking, and many more functions that do not rely on geographic proximity to produce great service at a great price. There is a very real possibility that these services could effectively be delivered statewide. But, while the Soviets have taught us that having a single monopolistic supplier might save money, it also hurts service quality.

Markets work better to both save money and improve service. While local governments and school districts may resist any kind of forced sharing, they will be much more open to the possibility if they have a) choice; and b) providers who are strongly accountable to them for service quality. Fortunately, creating a manageable market is easy to do for these kinds of services.

Option A. One approach is to forbid jurisdictions from providing these services themselves, and allow them to contract with whomever they wish for the service. This gives them choice and accountability. And, it is reasonable to expect at least some savings as a result of market competition.

Option B. Another approach is to organize the market so as to take full advantage of economies of scale, but to still give jurisdiction a choice of suppliers. Under this model, the state certifies several suppliers of the service (but not an indefinite number). For instance, the state might certify three suppliers of risk management services. The opportunity to corral that much volume is attractive to suppliers who can be expected to compete by offering very good prices and high service quality standards. In the certification process, the state can also specify certain standards that all suppliers must meet. For instance, it could require accounting suppliers to comply with the state's accounting codes and GASB requirements.

These suppliers could be public or private entities. For some functions, the state may want to limit the competition to public suppliers—either existing entities, or the state could establish public corporations (as the Canadians often do) to provide the services. For example, the state might establish three travel management enterprises that would compete with one another for local government travel business.

The key is that, under any of the various Option B approaches, savings from economies of scale are maximized and so, too, is accountability for service quality. The combination of the two improves both the numerator (service quality) and the denominator (cost) of the bottom line for these services.

Choice and competition maximize the benefits of sharing,