Charting A Way Forward

A Path Towards Fiscal Stability For the State of Michigan

November 2009

Legislative Commission on Government Efficiency

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November 18, 2009

The Honorable Michael Bishop
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The Honorable Andy Dillon
Speaker of the House
MI House of Representatives
P.O. Box 30014
Lansing, MI 48909

The Honorable Jennifer Granholm
Governor
State of Michigan
111 South Capitol Avenue
Lansing, MI 48933

Dear Senator Bishop, Speaker Dillon, and Governor Granholm:

Pursuant to Public Acts 96 and 97 of 2007, the Legislative Commission on Government Efficiency is pleased to present this report of recommendations to consolidate, streamline, and make more efficient the functions of state government. The Commission was statutorily created in 2007 and is primarily comprised of individuals from the private sector to provide an objective analysis of Michigan's government operations and offer recommendations to reduce government expenditures. After examining the State's budget and exploring options to make State agency programs more efficient, we hope that our efforts and recommendations will be of service to you as you look for ways to solve Michigan's serious budgetary issues.

The attached report represents eighteen months of work and the collective input of the public, members of the Senate and House Fiscal Agencies, the executive branch, experts in the respective areas of focus, and other affected interest groups. Our recommendations relate to each major area of the State's budget and several areas that cross units of government. Commission members were assigned to ten specific review work groups: Corrections, Community Health, Education/School Aid, Higher Education, Information Technology, Local Government and Revenue Sharing, Personnel Practices, Public Employee Health Benefits, Purchasing/Strategic Sourcing, and Sustained Efficiency within State Departments.

Our goal was not to make recommendations that could solve the fiscal issues in any one year, but rather to make recommendations that, together, represent a "roadmap" towards fiscal stability for the State. The attached report, we believe, accomplishes that task. It is also important to note that many of our recommendations can be implemented in the near term and are relatively "easy" fixes, but many others will have to be implemented over several years and will be more difficult. We believe, however, that the situation today requires bold action and tough choices. Michigan's economy has fundamentally changed and the need for structural reform has become more acute. It is clear that the State's budget can no longer reflect the era of a wealthier state.

While the magnitude of the changes required is daunting in many respects, we remain optimistic that solid and significant reforms like those we recommend can put the State of Michigan back on firm fiscal footing and free up resources that can be invested in services and other areas that will generate growth and opportunity for the people of our State.

It is important to remember that this report is only a first step. The ultimate success of our efforts will depend on the implementation of our recommendations. To that end, we, along with our fellow Commissioners, pledge our full cooperation in working with you and stand ready to assist in whatever manner necessary to facilitate the execution of our proposals into reality.

Respectfully submitted,

James Patrick Curran
Co-Chairperson

Kevin Prokop
Co-Chairperson

cc: Members of the Michigan Senate
Members of the Michigan House of Representatives

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INTRODUCTION AND EXECUTIVE SUMMARY

BACKGROUND AND ESTABLISHMENT OF COMMISSION

The Legislative Commission on Government Efficiency (LCGE) was created by Act No. 96 of the Public Acts of 2007 and took effect October 1, 2007. The members of the Commission include the directors of the Senate and House Fiscal Agencies and 7 public members with knowledge of, education in, or experience with the best practices of one or more of the following fields:

(a) Organizational efficiency
(b) Government operations
(c) Public finance
(d) Administrative law

The creation of the Commission resulted primarily from the budget deliberations and debate of 2007. The intent of the legislature was to establish a bipartisan group of members of the private sector and public employees who could bring a fresh, independent perspective on how to address the growing budget deficits and the increasing structural issues that were becoming the primary cause of those deficits.

The Commission received substantial support from the Senate and House Fiscal Agencies and from executive branch state agencies that have allowed us, in many cases where appropriate, to make specific recommendations regarding a particular issue. While some of the specific recommendations are already included in state budget bills for the 2009-2010 fiscal year, we feel it is necessary to include them in this report because collectively they are part of the Commission's overall recommendations toward the evolution of a more efficient and a more effective state government. In certain cases, the recommendations proposed may be complex and enunciate an overarching principle but recommend either a summit of persons from either the public sector or private sector, or both, or further steps toward implementation.

While the statutory emphasis for the charge of the Commission was in the area of efficiency, considerable focus was also given to effectiveness thereby recognizing that efficiency at the expense of effectiveness is not necessarily the best outcome for the taxpayers of this state. In most instances, the Commission believes that the recommendations contained in this report will increase both efficiency and effectiveness of the services provided. The Commission wishes to emphasize that achieving the efficiencies put forth in this report will create funds for investment by the State that will increase the effectiveness of state services and also permit the State to invest in areas that will make the State more competitive. This will result in a growing tax base that will thereby provide future growth after many difficult years of state budget deficits and contractions in the tax base.

The recommendations contained in the body of this report represent the unanimous recommendations of the Commission except for those dissenting opinions on certain issues expressed by individual members of the Commission found in the Commissioner Statements section near the end of this report.

HOW WE APPROACHED OUR WORK

The Commission members were appointed by the Senate and House Majority Leaders. The group consisted of seven citizens from a wide range of business, legal, and political backgrounds and Directors of the House and Senate Fiscal Agencies. Staff assistance was provided by the Office of the Legislative Council Administrator.

The Commission conducted its work in three phases:

- **Phase One:** Initial Fact Finding Through Public Hearings and Information Gathering
- **Phase Two:** Issue Identification and Development of Initial Recommendations
- **Phase Three:** Synthesis and Final Recommendations

As a Commission, we examined each major area of the budget. When we recognized the complexity of the work before us, we divided the Commission into ten working groups, with at least two Commissioners in each working group. The work groups also included subject matter experts from the House and Senate Fiscal Agencies, resource persons from the Legislative Service Bureau, representatives of the executive branch and, in several instances, key outside experts. Most of the working groups also conducted separate hearings to obtain input from the citizens and other affected constituencies.

The ten working groups examined five key areas of the budget (Corrections, K12 School Aid, Higher Ed, Medicaid/Department of Community Health (DCH), and Local Government Revenue Sharing) and five cross-functional areas of the state budget (Information Technology, Purchasing, Employee Health Benefits, Personnel Practices, and Sustaining the Improvements through Internal Efficiencies).

The basic objectives of each working group fell into the following areas:

- Understand the magnitude of the structural issues
- Understand the factors driving these structural issues
- Develop a full list of potential actions
- Quantify the potential impact of each of these actions
- Rank each potential initiative based on i) the size of potential impact and ii) the ease of implementation

As part of this effort, each work group considered and evaluated a number of factors, including relevant measures of effectiveness and efficiency, historical trends, and factors affecting each area of the budget. In examining potential solutions, each working group considered and evaluated recommendations that came from a number of sources, including:

- What other work has been completed by similar groups in other states in its area;
- What other states have done in their respective areas; and
- Private sector groups that have done work in its areas.

Based on this work, each group developed an integrated action plan to achieve targeted savings levels in each area. Our goal was to identify savings across all groups that would be sufficient to generate $1.5 billion of savings over five years.

There are a wide range of options. Some are relatively “easy” to implement. Others are much more difficult. The objective for all of the work groups was to craft a series of recommendations that would achieve significant efficiencies and structural reform in each of the respective areas.

OVERARCHING PRINCIPLES

Certain key principles underpinned our recommendations. Chief among them is the fact that the State’s problems are largely structural, driven primarily by the changing nature of Michigan’s population, including shrinking population, aging population, and shifting population in terms of where they reside. The State’s problems are driven also by job loss, particularly in the manufacturing sector where the state has lost approximately 480,000 or 53% of the manufacturing jobs, and on the revenue side, tax policy and structure. The size of the State’s government is no longer appropriately linked with the State’s current resources/tax base, which is shrinking and not in sync with Michigan’s current economy.

Although beyond the scope of the Commission’s mandate, the Commission recommends that the legislature examine the structure of the State’s tax system and, in particular, the level of "tax expenditures," in order to evaluate if changes should be made that better align the tax system with the State’s current economy.

The following statistics indicate the issues:

- From 2000 to 2010, total state revenues measured as a percent of total state personal income declined $9 billion, from 9.55% of state personal income to less than 7.0% of personal income
- State income tax collections declined from 2.8% of personal income in 2000 to 1.52% of personal income in 2010 even though the rate increased
- State sales/use tax collections have declined from 2.99% of personal income in 2000 to 2.06% of personal income in 2010 even though the rate has not changed
- Between 1998 and 2008, the value of so-called “tax expenditures” – tax exemptions, deductions or credits – grew $13 billion faster than total State revenue

These statistics indicate that the tax system may not be aligned with the State’s current economy and that the structure of the tax system has been amplifying the State’s structural problems. Without more stability in the tax base, the State will continue to face issues of either increasing taxes or reducing services.

In particular, reducing the level of "tax expenditures" could not only significantly reduce the size of the structural budget deficit, but also potentially allow for a more broad based reduction in the overall corporate or personal income tax rate, much like the federal government achieved with the Tax Reform Act of 1986. The Commission believes a more systematic evaluation is warranted.

As such, the State’s solutions must deal directly with the structural problems. The size of the problem is such that the State's leadership needs to fundamentally re-think the size and structure of government across all levels and "who is doing what." If the structural deficits are left unchecked, they will likely grow larger each year in the face of increasing jobs loss and shrinking tax base. Neither an economic recovery nor incremental improvements in efficiencies will be sufficient to address the issues.

Because the nature of the issues is structural, short-term actions alone won’t be sufficient. The issues have developed over many years and, in many cases, they will take years to correct. As such, a series of actions are needed, from the short term to the long term to create a "road map" to fiscal health. We defined "short term" recommendations as those that could be implemented in the next year, "medium term" as those that could be implemented over 2 to 3 years and "long term" as those that might take 4 to 5 years to achieve. In light of this and in light of the magnitude of the structural issues, the Commission believes that a different approach is necessary.

All units of government are facing issues, so cost shifting won’t be productive. It is necessary to think about taking costs out "throughout the system" and exploring and capitalizing on existing collaborative efforts to drive increased efficiencies across all units of government, including state government, local units of government, and K12 school districts.

In summary, our approach was governed by the following approach and overarching principles:

- We took a holistic approach and sought to examine each of the key areas of the state budget
- We looked to optimize across all units and levels of government, taking advantage of cost savings opportunities where they existed
- We sought to create a clear path, or roadmap, to fiscal stability over multiple years
- We set savings targets that, collectively, were sufficient to make a difference.

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The recommendations that are summarized on the following pages and detailed in the body of the report represent the Commission’s recommendation for putting the State back on a path to a more sustainable fiscal situation. Together, they represented an annual savings opportunity of $1.5 billion. We believe they represent a comprehensive and holistic approach to addressing the structural issues the State faces and better aligning the size of the State’s government with the reality of its current and prospective economic situation.

SUMMARY OF RECOMMENDATIONS

Corrections

- Reduce the prisoner population – and close prisons – through more nuanced approaches to sentencing, parole and incarceration
  - Reduce the number of prisoners past their early release date (ERD) from 12,200 to 5,000 over the next five years; invest in GPS tether and other programs that provide parole boards with confidence that they can maintain public safety
  - Pursue and implement parole reforms, including legislative changes that move towards presumptive parole
  - Target reducing the prisoner intake rate by 10,000, primarily by investing in programs that are proven to reduce recidivism
  - Re-establish a sentencing guidelines commission with a mandate to collect and publish sentencing data, review and analyze sentencing guidelines, and make recommendations on changes
- Lower salary and benefits expense
  - Reduce overtime from $100 million to $50 million historical average
  - Re-evaluate prisoner classification levels, staffing levels, and relief factor ratios, all of which affect the number of corrections officers needed
- Reduce prisoner health care costs of $250 million per year, which represents 12.5% of the Michigan Department of Corrections' (MDOC) budget
- Implement other cost reduction opportunities
  - Explore privatization where it works
  - Review of current contracts
  - Re-introduction of the prisoner phone charge ($10 million per year)

Local Government and Revenue Sharing

- By a constitutional amendment, combine and restructure constitutional and statutory revenue sharing. The total dollar amount of revenue sharing will be guaranteed in the Constitution, but the distribution formulas, determined by the legislature, will be for specific, base-level services rendered by local governmental units rather than providing unrestricted funds.
- Increase local unit tax authority
- Create an Intergovernmental Advisory Office (IAO) to facilitate these actions, establish minimum operational standards and identify further opportunities for shared services, cost savings, and consolidations
- Facilitate and provide incentives for sharing of services (vertical and horizontal integration) and/or consolidation across local units of government

Medicaid/Department of Community Health

- *Design Strategies* -- approaches intended to influence expense-sensitive choices and behaviors of Medicaid clients and reduce costs while improving outcomes. These include increases in copays, use of alternative benefit plans, increasing the number of community health workers and federally qualified health clinics (FQHCs), increased care management, and a physician assessment intended to increase federal funding of higher Medicaid payments to physicians.
- *Coverage Strategies* -- approaches which will change the type and level of care provided to Medicaid clients. These include expansion of managed care, strengthening of the estate recovery law, increased community based long term care and other long term care programming.
- *Pharmaceutical Strategies* -- approaches to reduce the growth in pharmaceutical costs, including expansion of rebate collection and pharmaceutical pools
- *Other Medicaid* -- approaches to reduce overall growth in medical costs (even beyond Medicaid) by expanding use of technology and enhancing Medicaid anti-fraud efforts
- *Non-Medicaid Cost Reduction Strategies* -- approaches to trim the DCH budget without losing matching Federal dollars. These items include reducing funding for mental health multicultural services,

reducing or eliminating the Healthy Michigan Fund, and reduced funding for community mental health non-Medicaid services.

Higher Education

- Recommend the elimination or the restructuring of the Michigan Promise Grant Program. This is the only major financial aid program whose eligibility is not based on financial need.
- Encourage universities and community colleges to continue and expand on current programs
- Use of the "university center" model that brings four-year university programs to community colleges
- Use and expansion of group purchasing of goods and services
- More participation in the Voluntary System of Accountability
- Use and continued development of the "transfer wizard"
- More extensive use of public/private partnerships in the construction and renovation of campus buildings

K12 Education/School Aid

- Reallocate $300 million of School Aid Fund to community college funding in order to realize general fund savings to be phased in over three years
- Offset a portion of this reduction in state aid to schools by creating local savings by offering $5,000 state cash retirement incentives to be matched by local school districts and phased in over a three year period for school employees already eligible to retire; with a goal of inducing 10,000 employees to retire. This would cost the State $50 million per year, but districts would save as much as $30,000 per employee per year, and perhaps more, if they chose not to replace those employees.
- Achieve further cost reductions at the school district level through consolidation
  - Allowing the State Superintendent the option of requiring consolidation of school districts or intermediate school districts (ISDs) if savings of at least 5% can be shown
  - Providing a monetary incentive to ISDs that continue to consolidate non-instructional services among ISDs and school districts beyond what was reported to the Department of Education (DOE) as required in PA 63 of 2007

Personnel Practices

- Conduct a five-year workforce supply and demand forecast – with annual review and adjustment, if needed – to project the appropriate size and composition of the State's workforce
- Utilize a targeted voluntary separation program to adjust the size of the workforce if the forecast indicates that demand will be lower than supply
- Apply a consistent and credible methodology to streamline processes, reduce duplicated functions and overhead, achieve economies of scale and right-size spans of control
- Perform a market study of compensation levels to determine if salaries for some positions should be adjusted to ensure workforce attraction and retention without overpaying for talent
- Expand mutual gains approach to collective bargaining, which has proven to be effective in private and public sector organizations, where significant financial pressures exist and retention of jobs is at stake

Information Technology

- Study the Department of Information Technology's (DIT) structure and consider modifying the current legislative appropriation model. The current structure – departments funding DIT through their own agency IT and other appropriations – has caused IT project cost overruns of $90 to 130 million annually since FY 2003-04 and an inability to get a true picture of IT expenditures across state government
- Establish an information technology oversight group to manage and reduce IT cost overruns and identify and implement efficiencies in the executive, legislative, and judicial branches
- Consolidate and centralize IT systems management in the executive, legislative, and judicial branches
- Continue to pursue joint IT initiatives with local governments
- Convert paper files to electronic files in the Department of Environmental Quality (DEQ) and other departments

Purchasing and Strategic Sourcing

- Take into account the buying volumes of municipalities, other governmental units (e.g. school districts) and other states up front in negotiation of contracts for goods and services in order to maximize pricing power, rather than establishing contracts based on the State's anticipated buy and allowing others to purchase from that contract
- Identify types of goods and services that are common between state and local governmental units, including school districts, and develop a list of standard products and select vendors to be used for purchases of these types
  - Negotiate contracts with vendors based on preferred status and buying volumes of state and local governmental units
  - Provide incentives for parties to purchase the standard products and from the select vendors
- Modify standard purchasing processes and procedures to reduce confusion in bidding process and protect savings realized
  - Simplify and make standard the terms and conditions used in all Request for Quotes (RFQs) and contracts
- Improve existing purchasing system (ADPICS) with upgraded system that allows for better data mining activities and takes advantage of newer technologies, including collaborative data exchange to improve vendor access to information, to provide better, more cost effective services

Public Employee Health Benefits

- The State of Michigan should hire professional consultants with expertise in the area of employee health care benefits to review the following issues:
  - The appropriate level of the total cost of public employee health insurance borne by state government, local government, and public education employees through premiums and co-pays
  - Investigate the possibility of charging newly hired state employees a different rate to purchase health plans than existing employees
  - Investigate the feasibility of either allowing or requiring all public sector employees to purchase health insurance off of the State of Michigan health plans
  - Consider the option of conditioning a portion of the revenue sharing payments to units of local government on offering health benefits no richer than those afforded by the State to its employees
  - Conduct a complete review of the structure of public health plans in Michigan
  - Consider ways to pre-fund retiree health benefits, including the option of selling bonds to finance the long-term cost of retired employee health benefits

Sustained Efficiency Within Departments

- Improve documentation of the state organizational structure
- Decrease number of layers of management and adjust supervisor to employee ratios
- Institute a standardized performance management process with results oriented objectives tracked by a monthly scorecard
- Institute a standardized continuous improvement process that focuses on unleashing the workforce on their ideas and commitment to reducing cost, improving service, eliminating waste, and increasing value added results
- Institute a consistent step change process that utilizes proven event driven techniques

Other Recommendations That Should Be Considered

- Implement a "pay-as-you-go" budget process, similar to the systems periodically used at the federal level, to ensure that any new spending commitments or tax cuts are offset by other spending reductions or new tax revenue
- Implement other procedural changes that could provide additional transparency and visibility on the State's long-term fiscal outlook. These changes could include
  - Fiscal impact statements to all new legislation
  - Annual or biennial long-term (5 to 10 year) fiscal forecasts
  - Annual reporting on the use of one-time revenue sources or budget shifts

RECOMMENDATIONS

REDUCING CORRECTIONS COSTS

Key Findings and Recommendations:

From 1998 to 2008, the State General Fund expenditures on the Corrections budget grew 56.2%, from $1.27 billion to $1.98 billion.[1] This growth has been driven primarily by increases in:

- The number of prisoners
- Salaries and benefits costs, and
- Prisoner health care costs

Accordingly, the Commission recommends:

- Implementing a comprehensive set of policies that will safely reduce the prisoner population from 50,000 to 40,000 over 5 years
- Taking other actions to further reduce salary and benefits expense by $100 million annually
- Exploring opportunities to contain prisoner health care costs
- Implementing other initiatives which collectively could generate $20+ million of savings

If implemented, these initiatives could result in savings of

- Approximately $80 million in the first year of implementation
- Between $250 and $300 million in the intermediate-term (2 – 3 years)
- $500+ million over 5 years

From Fiscal Year 1997-98 to Fiscal Year 2007-08, Department of Corrections General Fund expenditures grew from $1.27 billion to $1.98 billion, a 56.2% increase fueled by a 17% increase in the prison and camp population, which grew from 42,363 in October 1997 to 49,600 in December 2008.[2] Increases in the prisoner population were in turn driven by various factors, including increases in the annual numbers of felony dispositions, the elimination of disciplinary credits and community placement for prisoners sentenced under truth-in-sentencing, increased personnel costs (salaries and wages, benefits, and overtime), and increased costs of prisoner health and mental health care.

The Commission believes that systematic and permanent reductions in correction costs must balance public safety and focus on:

- Closing prisons and reducing the prisoner population;
- Lowering salary and benefits expense; and
- Containing prisoner health care costs.

Over time, the Commission estimates that the State could save $500 million per year by implementing these initiatives.

Reducing the Prisoner Population and Closing Prisons

The largest opportunity to reduce corrections costs rests in reducing the number of incarcerated prisoners, moving prisoners from higher-cost to lower-cost rehabilitation settings, and doing so significantly enough to close and consolidate prisons and other facilities. As the chart on the next page indicates, the Department of Corrections budget has followed growth in the prisoner population.

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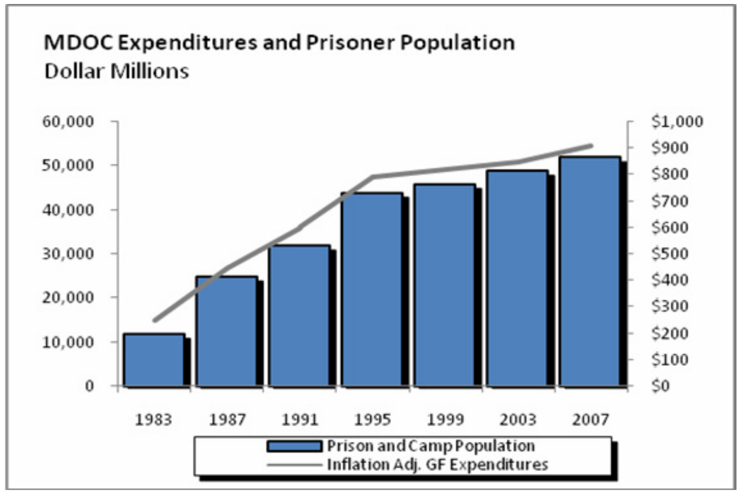
[1] Adjusted for inflation, the increase was only 18.3%, equivalent to the 18.5% increase in the average monthly prisoner population by fiscal year. However, the increase occurred despite a variety of staffing reductions and operational efficiencies undertaken in recent years. More significant, perhaps, is that Corrections' share of state General Fund expenditures rose from 15.0% in FY 1997-98 to 20.2% in FY 2007-08.

[2] These dates bracket a time when the prison and camp population peaked at over 51,000 in late 2006 and early 2007. The prisoner population has been declining since that time.

The State can achieve these savings through policy and other actions that reduce both the average length of stay for existing prisoners and the number of parole and probation violators, but achieving both objectives must be accompanied by a holistic and structured approach that addresses the root causes of the problem, rehabilitates prisoners and preserves public safety. The Commission believes that this approach has several elements, including:



- Reducing intake by being "smart" about who is sent to prison and for how long;
- Developing meaningful programming inside prisons to prepare prisoners for re-entry;
- Ensuring parolees are released into structured settings with organized aftercare programming that maximizes their chances of success;
- Working with prisoners, parolees, and probationers to ensure that they are treated in the lowest cost setting that they can be safely treated in;
- Creating incentives for prisoners, parolees, and probationers to successfully complete their rehabilitation programs; and
- Motivating communities to support parolees and probationers and to reduce the number of people being sent to prison.

Reducing the prisoner population from 50,000 prisoners to 35,000 or 40,000 over the course of five years

In short, sound corrections reform must ensure that the "right" people are in prison for the "right" crimes for the "right" amount of time and that prisoners are released into the "right" settings based on their risk to the community. The Commission recommends establishing a sentencing guidelines commission to routinely review sentencing guidelines and to regularly review the impact of these guidelines on the prisoner population and on public safety. All of this must be complemented with programs to appropriately rehabilitate the prisoner and with incentives for the prisoner to improve. At its core, this involves investing in programs that impact prisoner intake rates and the average length of stay.

Reductions in the prisoner population over the course of about five years could achieve $250 to $400 million in annual savings through closure of about a dozen facilities. Combined with other corrections changes, the Commission recommends the State could realize up to $500 million of annual savings against projected costs.

Recommendation: *Continue the MDOC's efforts to reduce the number of prisoners past their earliest release date to 5,000 over five years*

The most immediate opportunity to reduce the average length of stay is to continue MDOC's program to reduce the number of prisoners who are incarcerated beyond their earliest release date (ERD), with a particular focus on the more than 10,000 non-violent offenders who represent approximately 23% of the prison population. Reducing the number of prisoners past their earliest release date to 5,000 over five years would achieve more than half of the prisoner reductions needed to achieve the $250 to $400 million of savings. Investing about one-third of the costs of prison incarceration in GPS tethers and other programs can provide the parole board with the confidence to release prisoners sooner than it otherwise would.

Recommendation: *Pass legislation that requires presumptive parole for prisoners who complete individualized prisoner planning objectives that include rehabilitation and preparation for re-entry into the local community*

In the intermediate term, the Commission recommends that the legislature consider changes that move towards "presumptive parole" based on the completion of certain prisoner planning objectives[3], with the parole board retaining authority to deny parole under prescribed circumstances. This could further reduce the number of prisoners past their ERD and ensure that MDOC's efforts to reduce the number of prisoners past their ERD are sustained.

Recommendation: *Require that MDOC, working with outside experts, review their parole and probation risk assessment tools to ensure they conform to research-based "best practices" and require that MDOC implement parole reforms based on this analysis and assessment*

MDOC can create room for these new parolees within the current parole organization by simultaneously pursuing parole reforms to better address parolee and probationer risk. In particular, the Commission recommends re-examining parole guidelines based on new risk assessment tools and implementing performance incentives for parolees in order to free up supervision capacity for new prisoners being paroled under the Commission's other recommendations. Implementing policies based on "early indicators of parolee success" and leveraging technology such as kiosk reporting can also free up supervision capacity and focus this capacity on parolees that need more intensive supervision.

Parolees and probationers make up approximately 60% of the new prisoners each year

Recommendation: *Pass legislation to expand the range of interim sanctions to reduce intake rates of parolees and probationers*

In the short term, the largest opportunity to reduce prisoner intake is to develop and expand meaningful intermediate sanctions to reduce the number of parolees and probationers sent to prison**,** since parolees and probationers constitute almost 60% of prison admissions. Particular focus should be given to effective sanctions and programs for technical violators, who represent approximately 15% of prisoners. Short term residential facilities and day reporting centers can provide effective alternative sanctions for technical violators at a significantly lower cost than prison. The Commission also recommends considering ways to shorten the average length of stay for technical parole violators returned to prison; that period has averaged approximately 18 months.

Recommendation: *Fund/Implement programs that create economic incentives to reduce recidivism*

The Commission recommends that the State consider creating programs that create economic incentives for local government to reduce recidivism. Other states have successfully implemented similar programs. In Arizona, for example, local governments directly benefit from 40% of the savings by eliminating recidivism among parolees and probationers. According to Pew's Public Safety Performance Project, the State was able to reduce prison intake of parolees and probationers by 25%, which would imply a roughly 15% reduction in new admissions per year in Michigan. Although Michigan's criminal justice system differs significantly from Arizona's, there could be new and creative ways for Michigan to increase the use of alternative sanctions and reduce recidivism through the increased use of financial incentives.

[3] These prisoner planning objectives would include programs designed to rehabilitate the prisoner and prepare the prisoner for effective re-entry into the community.

Recommendation: *Reduce recidivism through increased investment in evidence-based programs such as the Michigan Prisoner Re-entry Initiative*

In the intermediate term, utilizing assessment tools and case management to ensure that prisoners, parolees, and probationers are referred to appropriate programming, services, and sanctions can help to address the root causes of recidivism and, over time, significantly reduce prisoner intake and the prisoner population. An example of such efforts is the Michigan Prisoner Re-entry Initiative (MPRI), which utilizes offender risk and needs assessments to develop case plans that are used to connect prisoners and parolees with appropriate programs and services. Early results from MPRI indicate a reduction of 9.6 percentage points in the percent of parolees being returned to prison, constituting an improvement of about 30% compared to the 1998 baseline comparison group. If the numbers of parolees and probationers coming to prison could be reduced by one-quarter, annual prison intake would decline by about 1,700; a one-third reduction would mean 2,200 fewer offenders entering prison each year.

Reducing intake of parole and probation violators by one-quarter would reduce prison admissions by 1,700 annually

Recommendation: *Establish a Sentencing Guidelines Commission to routinely review the State's sentencing guidelines and make recommendations for modifications where necessary*

The Commission recommends that the State establish a sentencing guidelines commission to determine whether sentencing guidelines should be modified. If implemented, changes in sentencing guidelines could affect both the intake rate and the average length of stay and thus could affect the number of prisoners and corrections costs.

As part of this analysis, the legislature should consider reinstating Community Residential Programs (CRP) as a pre-parole option for *select* non-violent inmates who meet strict eligibility criteria. This would require some modification to Truth-in-Sentencing laws, but not necessarily wholesale changes. The Commission recognizes that this is a politically sensitive recommendation, but notes that the history of CRP generally was very good[4] and that, if historical standards were used, this could move up to 3,000 to 4,000 prisoners to lower-cost venues and prepare them for the transition to parole.

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Collectively and over time, MDOC could reduce the number of prisoners by 10,000 to 15,000, allowing the State to close a dozen prisons and save up to $250 to $400 million annually.

Lowering Salary and Benefits Expense

Salary and benefits expense (or personnel costs) represents about three-quarters of the corrections budget so any effort to reduce the corrections budget must ultimately address salary and benefits expense. Reducing the prisoner population will allow the Department to reduce the number of officers over time, but the Commission also recommends looking separately at other efforts to reduce salary and benefits expense in the near term.

[4] For example, parole recidivism was better for CRP participants, and CRP participants enjoyed a 95% parole approval rate because of the ability to demonstrate parole readiness.

Recommendation: *Require that MDOC reduce overtime expenditures from nearly $100 million to no more than $50 million*

Overtime has increased from $48.1 million to $95.2 million over the past five years due largely to vacancies associated with closing several facilities and costs related to hospital coverage. Closing additional facilities complicates efforts to reduce overtime costs, but significant reductions in overtime can still be achieved by increasing the number of infirmary beds, making changes to how hospital coverage is provided**,** and appropriately filling current officer vacancies.

Recommendation: *Require MDOC to evaluate prisoner classification levels and relief factor ratios in order to optimize staffing levels and minimize overtime*

The Commission also recommends that MDOC evaluate other efforts to reduce staffing levels and optimize staffing patterns. In particular, the MDOC should leverage risk-based modeling to re-evaluate prisoner classification levels[5] and relief factor ratios, both of which drive staffing levels and, ultimately, salary and benefits expense. The MDOC's Efficiencies and Improved Policies Workgroup estimated that changes in relief factor ratios might save $15.7 million per year. With modest changes to both the classification system and relief factor ratios, the State could achieve savings of perhaps $30 to $35 million, some of which could be realized in the form of lower overtime expense relatively quickly.

Revisiting classification levels and relief factor ratios can help reduce overtime expenses in the short-term

Recommendation: *Require that MDOC develop a plan to consolidate prisons and prison operations where practicable*

Consolidating prisons and prison operations can reduce salary and benefits expense by eliminating redundant positions. The Commission recommends that MDOC continue recent efforts here, with a particular focus on consolidating contiguous prisons and other prison operations, including prison stores, infirmaries, human resource operations, accounting, distribution facilities, and other back office functions. The legislature should consider allocating modest amounts of money to allow MDOC to develop a comprehensive plan that captures the full opportunity for cost savings here.

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In total, reducing overtime to $50 million, re-evaluating classification and relief factor ratios and consolidating select operations could translate into an additional $100 million of annual savings over a five year period.

Reducing Prisoner Health Care Costs

Over the past five years, prisoner health care costs have increased by approximately 50%, due largely to systemic increases in health care costs. The Commission recommends aggressively pursuing opportunities to address cost increases by:

- Continuing to explore ways to reduce pharmaceutical costs by
  -- Finalizing the re-bid for the pharmaceutical contract that is underway[6]
  -- Consolidating health care purchasing with other agencies and communities to achieve additional purchasing leverage

[5] Recent data indicate that existing classification models may systematically overstate the risk that women and less healthy prisoners pose, leading to higher classifications and higher staffing ratios.
[6] Separating the pharmacy contract from the current health care provider contract should also appropriately align incentives and result in savings.

-- Exploring the opportunity to purchase drugs under the 340b program, which would provide MDOC with the most affordable pharmaceutical costs
-- Revising and updating the drug formulary to better utilize lower-cost medications where appropriate
-- Enforcing formularies and prescription patterns to ensure compliance

- Evaluating the use of technology to reduce health care costs
  -- Automated / remote dispensing and bar coding to reduce pharmaceutical service / distribution costs
  -- Telemedicine
- Increasing prisoner co-pays
- Increasing the number of infirmary beds in order to reduce third-party hospital costs[7]
- Implementing the health care recommendations made in other areas of this report

The Commission did not have an opportunity to examine mental health care in detail, but costs of providing mental health care to Michigan prisoners are rising (the Governor recommended an $8.0 million increase for FY 2009-10) and some reports put Michigan's mental health care costs significantly higher than other states' costs.[8] Moreover, the State has experienced difficulty in filling civil service positions for psychiatrists, necessitating the use of temporary and sometime-expensive contractual psychiatric services. There is the potential to significantly reduce costs through alternative models of providing mental health treatment to prisoners and parolees. The Commission recommends that the legislature explore privatization and other alternatives to realize these savings.

Over the past five years, prisoner health care costs have increased by approximately 50%

Health care is unlikely to be an area for savings in the corrections budget, but arresting the rate of growth in health care costs will certainly mitigate some of the structural pressures the corrections budget would otherwise face over the next five to ten years.

Explore and Implement Other Cost Reduction Opportunities

The Commission also recommends pursuing other opportunities to reduce corrections costs, including:

- Reviewing and evaluating privatization opportunities where they can be demonstrated to work;
- Consolidating purchasing with other areas of government and with state and local governments; and
- Implementing and / or expanding revenue-generating opportunities.

The last point, in particular, has been considered by the legislature when it eliminated the prisoner phone charge, which reduced annual revenue to MDOC by approximately $10 million. While the Commission understands the rationale behind the decision, it does not believe that this is the appropriate time to forego this revenue in light of some of the other difficult decisions that are needed to address the long-term structural issues Corrections faces. We also recommend exploring other revenue generating opportunities, including email, notary, videoconference and other charges and possibly the expansion of the Michigan State Industries program.

Please note that Commissioner Bargamian has further comments that can be found in the Commissioner Statements section beginning on page 53 of this report.

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No one recommendation can address the corrections problem but, taken together and implemented over time, these recommendations can reduce projected costs to the State by $500 million or more, an amount that would have a substantial impact in addressing the structural issues the State faces.

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[7] The Commission also recommends looking into whether centralizing / regionalizing and / or privatizing infirmaries would result in savings
[8] As an example, The Center for Michigan published statistics that indicated that MDOC's mental health services cost $1,660 per prisoner per year, compared to $662 in Minnesota and $415 in Texas.

LOCAL GOVERNMENT AND REVENUE SHARING

Key Findings and Recommendations:

The State Constitution dedicates 15% of the first 4¢ of sales tax to townships, cities and villages on a per capita basis. By statute, 21.3% of the gross collections from the first 4¢ of the sales tax are dedicated to the revenue sharing program. Although constitutional revenue sharing increased from fiscal year 2001 to fiscal year 2008 by approximately $45 million, it is expected to decline in fiscal years 2009 and 2010 due to the state economic situation. The rise in inflation, the reduction in property values and resulting decline in property tax revenue, and the decline in credit and stock markets have resulted in raising the cost of debt while lowering the value of investments, particularly in the areas of pension funds, further impacting local government revenue. One of the significant means of balancing the state budget has been to reduce statutory revenue sharing. Over the last five fiscal years, it has decreased by approximately $250 million.

Accordingly, the Commission recommends that the State implement the following recommendations, and that they be jointly implemented to maximize their impact:

- By a constitutional amendment, combine and restructure constitutional and statutory revenue sharing. The total dollar amount of revenue sharing will be guaranteed in the Constitution, but the distribution formulas, determined by the legislature, will be for specific, base-level services rendered by local governmental units rather than providing unrestricted funds. This will insure that the money will go to local governmental units that provide services, such as police, fire and road upkeep and improvement. In addition, it will provide local units with more certainty as to the funding they will receive from the State.
- Increase the authority of local units to tax their citizens for desired services above and beyond the base-level services that all local units provide
- Establish an Intergovernmental Advisory Office (IAO) within the State Department of Treasury to eliminate barriers and increase the likelihood of successful local government efforts to share services, collaborate, consolidate, and increase efficiency
- Provide incentives for local governments to be efficient with the funds provided by the State by providing incentives to local governments to enter into agreements to cooperate and collaborate in the provision of services

The potential for savings in local government expenditures is significant. For every 3% reduction in local government expenditures, the State saves $350 million.

The Commission recommends that the State take the following actions to ensure that revenue sharing is used to provide essential services to the citizens of local government units, while also providing more certainty to those units as to the funding they will receive from the State.

Revenue Sharing to Provide Essential Services

Recommendation: ***Restructure the distribution formula for revenue sharing***

The Commission recommends a constitutional amendment that would alter the distribution formula for revenue sharing by eliminating the per capita distribution and provide that the payments should follow the provision of certain designated base-level services such as police, fire, road upkeep and improvement, sewer, tax administration, elections, court functions, libraries, and mental health services.

This restructuring should be accompanied by a guaranteed level of funding to local governmental units to provide them with more certainty as to the funding they will receive from the State.

Counties should be included in constitutional revenue sharing distributions for their performance of functions on behalf of local units of government within their borders.

The restructured distribution formula should also designate a portion of the revenue sharing funds to provide incentives and research grants to local units of government to explore new means of collaboration and cooperation. These funds would be overseen by the IAO.

A summit of stakeholders should recommend those services to be supported through constitutionally guaranteed revenue sharing, among other responsibilities described in subsequent sections of this report. The statute creating the IAO can also provide for the state summit and the criteria used to determine participation in the summit, such as population size and both urban and rural units of government, to ensure that a variety of perspectives are represented. The summit of stakeholders should represent urban and rural counties, cities, townships, and villages. The division between urban and rural would be determined by statute.

Recommendation: *Increase the authority of local units to tax their citizens for desired services above and beyond the base-level services that all local units provide*

Local units wishing to provide additional services beyond the level funded by the State should have the authority to levy taxes to fund those services. Options for expansion of this authority include:

- Expanding the entities allowed to levy an income tax to include counties, villages and townships
- Increasing property tax millage limits
- Expanding local sales tax opportunities by constitutional amendment or by allowing greater use of selective sales taxes
- Linking specific increases in taxing authority to specific changes in revenue sharing payments
- Adopting legislation allowing the creation of more regional tax authorities to administer designated sales, income or property taxes
- Expanding opportunities for tax base sharing
- Developing constitutional amendments to address the interaction between the Headlee Amendment provisions concerning millage rollbacks and Proposal A changes, such as the development of taxable value caps

Recommendation: *Establish an Intergovernmental Advisory Office within the Department of Treasury to eliminate barriers and increase the likelihood of successful local government efforts to share services, collaborate, consolidate, and increase efficiency*

The State should create an entity within the state Department of Treasury, patterned after other boards or commissions such as the Michigan Gaming Control Board, the Liquor Control Commission or the Michigan State Housing Development Authority. The Intergovernmental Advisory Office (IAO) would have the following responsibilities.

- Establish common minimum operational standards, including accounting standards, for all local governmental units
- Evaluate and recommend changes to current statutes to enable and / or incent collaboration, cooperation and consolidation. The Commission received consistent testimony that these statutes were impediments or barriers to collaboration and cooperation. These statutes include

- Urban Cooperation Act of 1967 (Public Act 7 of 1967)
- Metropolitan Cooperation Act (Public Act 293 of 1937)
- Compulsory Binding Arbitration Act (Public Act 312 of 1969)
- Public Act 8 of 1967
- Intergovernmental Act 292
- Home Rule statute

- Oversee the distribution of a portion of the revenue sharing funds designated for exploration of innovative approaches to collaboration and cooperation.
- The funding for the IAO would come from the constitutionally defined funds; the summit of key stakeholders referenced above may be the appropriate body to determine the percentage of funds available to the IAO to distribute to local units of government.

Incentives for Sharing Services, Gaining Local Efficiencies and Cost Savings

There are many examples of intergovernmental collaboration that can be found across Michigan. The Commission held public hearings to get input and feedback from local governmental units, and heard examples of collaboration from cities, townships, counties and regions. However, the Commission also heard from local governmental units that barriers and disincentives still exist that, if addressed, could further promote cooperation and collaboration.

The State should promote integration of government services that exhibit economies of scale. The IAO should play a significant role in this promotion. Potential services include:

- 911 emergency services
- Court services
- Tax collection
- Property assessing / equalization
- Other administrative functions
- Significant capital expenditures

The State should consider a variety of means to promote collaboration and cooperation.

- Create an inventory of best practices and examples of successful collaborative efforts previously used
- Award grants to support innovative, but yet unproven pilot programs (similar programs can be found in New York and New Jersey)
- Create a loan fund from which collaborating local governments can borrow for the acquisition, purchase or construction of capital intensive items
- Offer grants to local governments that develop joint ventures for delivering government services
- Create online "want ads" for local governments seeking partners for collaboration

A summit of state and local leaders should identify minimum operational standards and inventory best practices and successful collaborative efforts that could be replicated. The summit should also review various statutes for potential changes in order to increase the potential for collaborative efforts. The summit should be facilitated by the IAO.

Please note that Commissioners Bargamian and Leonard have further comments that can be found in the Commissioner Statements beginning on page 53 of this report.

MEDICAID/DEPARTMENT OF COMMUNITY HEALTH

Key Findings and Recommendations:

The Michigan Medicaid program, by far the largest component of the Department of Community Health budget, is growing at an unsustainable rate.[9] Among important findings:

- Medicaid is consuming a growing amount of state resources, going from 10% of state spending from state resources in FY 1998-99 to 15% in FY 2009-10.[10]
- The main driver for this increase in spending is the extraordinary growth of Michigan citizens covered by Medicaid – 1.1 million in FY1998-99 to 1.7 million in FY2009-10, a 58% increase.

Based on these findings, the Commission makes the following categories of recommendations to achieve efficiencies and savings in the DCH budget:

- *Design Strategies* -- approaches intended to influence expense-sensitive choices and behaviors of Medicaid clients and reduce costs while improving outcomes. These include increases in copays, use of alternative benefit plans, increasing the number of community health workers and FQHCs, increased care management, and a physician assessment intended to increase federal funding of higher Medicaid payments to physicians.
- *Coverage Strategies* -- approaches which will change the type and level of care provided to Medicaid clients. These include expansion of managed care, strengthening of the estate recovery law, increased community based long term care and other long term care programming.
- *Pharmaceutical Strategies* -- approaches to reduce the growth in pharmaceutical costs, including expansion of rebate collection and pharmaceutical pools
- *Other Medicaid* -- approaches to reduce overall growth in medical costs (even beyond Medicaid) by expanding use of technology and enhancing Medicaid anti-fraud efforts
- *Non-Medicaid Cost Reduction Strategies* -- approaches to trim the DCH budget without losing matching Federal dollars. These items include reducing funding for mental health multicultural services, reducing or eliminating the Healthy Michigan Fund, and reduced funding for community mental health non-Medicaid services.

While the American Recovery and Reinvestment Act of 2009 prohibits the elimination of Medicaid coverage for existing eligibility groups through December 31, 2010, the Commission recommends that the State pursue the recommendations included in this report in the interim.

The Department of Community Health/Medicaid workgroup of the Commission has spent considerable time reviewing various aspects of the department's responsibilities. The workgroup bases the following proposals on the principles that (a) adequate funding should be provided to the Department to efficiently perform its key functions; (b) as much federal funding of the Medicaid program as possible be preserved thereby making the most efficient use of state general fund dollars (of the $10.9 billion projected Medicaid expenditure for FY2009-10, only approximately $4 billion is contributed by the State of Michigan); and

[9] While the Michigan Medicaid program has realized significant increases, it's also worth noting the State's success in containing cost increases, relatively speaking. For example, adjusted spending per Medicaid enrollee has grown by only 20% during the FY1998-99 to FY2009-10 period, significantly less than the 33% growth in the Detroit Consumer Price Index during the same period and far less than any measure of medical cost inflation.

[10] The amount used to calculate the percentage of "State Spending from State Resources" is the total amount of State General Fund/General Purpose dollars used to earn the federal contribution to the Michigan Medicaid program, and does not include amounts generated from alternative financing methods such as the Quality Assurance Assessment Program or other provider assessments not funded using Michigan taxpayer revenues.

(c) the shifting of costs of the Medicaid program to employers and individual patients due to current Medicaid underfunding of payments to providers not be exacerbated.

Medicaid Plan Design Strategies

Recommendation: *Take steps to align patient treatment and lifestyle decisions with cost reduction.*

Projected Annual Savings: Maximum of $20 million if changes under Bush Administration rules are fully implemented

The Commission recommends increasing Medicaid patient co-pays, especially related to the use of emergency rooms for non emergency care, to the extent permitted by the Deficit Reduction Act of 2005 and provided that Medicaid payment rates are enough to ensure physician participation in Medicaid at a level sufficient to provide access to physician services by Medicaid beneficiaries such that the emergency department is not their only choice for health care services.

Also, the State should consider the use of Health Savings Accounts or similar alternative benefit plans for fee-for-service Medicaid clients. Each would receive from the State an established amount for expenditure on services other than preventive care. The amount would need to be set as a percentage of average per-beneficiary Medicaid costs to incent savings. Any amount remaining at the end of the year could be rolled over to the next year; or used by the client for certain other pre-approved services such as housing or childcare.

The State should also consider requiring Medicaid beneficiaries who smoke to participate in smoking cessation efforts. The extent to which the Department of Community Health is able to influence the personal choices of Medicaid recipients is limited by federal regulations, but specific lifestyle choices may improve health situations. Other states are exploring this type of option and a body of research is beginning to emerge. Although removal from eligibility based on individual decisions to *use* legal products would not be acceptable to the federal government, Michigan could apply to the federal government for a waiver to require Medicaid beneficiaries who smoke to enroll in smoking cessation classes or other cessation efforts.

Recommendation: *Design plans to treat patients in the lowest cost environment and enhance access to an appropriate care environment, including exploration of the medical home concept.*

The Commission recommends implementing a telephone health consultation service or nurse help line to provide access to basic medical advice for fee-for-service patients as a cost effective alternative to unnecessary office or emergency room visits.

Another consideration would be using local community health workers in areas with heavy Medicaid caseloads. This resource can be used to promote healthy behavior in Medicaid clients and would serve as a triage point for services thus decreasing emergency room and hospital visits.

The State should consider pursuing the expansion of federally qualified health clinics (FQHCs) in underserved areas. These clinics would serve as an access point to basic health care services and help to reduce utilization of more costly services. However, the State has only limited discretion in the approval of new FQHCs. An institution seeking designation as an FQHC must meet certain federal criteria, thereby making this issue ultimately one of federal discretion and authority.

The State should also consider transition toward the "medical home" model of care in order to improve access to and quality of primary care services. Several states have instituted pilot projects of this type. Michigan should continue to monitor the progress of these projects, although the high concentration of managed care in Michigan's program may decrease state savings from this new model of care.

The State should encourage - potentially with incentives - participation by pregnant Medicaid beneficiaries in all recommended prenatal programs and activities to reduce complications and premature births, thereby reducing need for the extraordinary expense of neonatal intensive care.

Recommendation: *Examine ways to better manage costs of high-cost medical conditions.*

The Commission recommends encouraging an increased level of care management for those patients with chronic diseases and other high-cost conditions. This measure could improve care coordination and increase access to necessary services. Chronic disease management has also been shown to reduce emergency room visits and inpatient care.

The Commission recommends increasing the use of case managers for the most expensive Medicaid fee-for-service patients. This would result in more efficient managed health care for these types of patients by eliminating unnecessary procedures and tests. Significant cost savings may not be achievable due to a steady decrease in the number of patients in this non-HMO component of Medicaid.

Recommendation: *Align incentives for physicians to improve quality and reduce costs.*

The Commission recommends that the State establish protocols for diagnostic tests and grant some degree of immunity to physicians who adhere to these established guidelines. This would have the effect of reducing utilization of ancillary services by creating a more uniform standard of care. The development of these protocols could also identify and discourage inefficient and unnecessary diagnostic tests.

The State should institute a physician provider assessment to access additional federal funding for Medicaid payments to physicians that would allow for increased payments to physicians, thereby increasing access to the Medicaid system, promoting healthier Medicaid participants, and lowering Medicaid costs. Increased reimbursement rates would encourage more physicians to accept Medicaid payments thereby increasing access to the system and potentially reducing uncompensated care costs. Increased payments could also be linked to quality outcomes (i.e., pay for performance). However, federal law requires that an assessment program may not benefit all participants, therefore, some physicians would likely incur taxes in excess of the return from the assessment program.

The State should consider increasing reimbursement for preventative treatment and instituting incentive programs for measurable results showing physician success in keeping patients healthy, reducing the need for treatment in emergency departments and other high expense environments.

Coverage Strategies

Recommendation: *Expand managed care to other populations not currently in managed care plans.*

Projected Annual Savings: Approximately $1.3 million

The Commission recommends enrolling recipients of MIChild benefits in managed care. Several states have experienced positive results with similar efforts. Use of this approach will provide enhanced coordination of care.

The State should also consider enrolling Children's Special Health Care Services beneficiaries in managed care. Managed care for these persons may potentially improve delivery of services and the coordination of care although cost savings in this area is uncertain because recipients of care are often high-cost patients even when care is efficiently managed.

Recommendation: *Consider measures intended to reduce long -term care costs.*

The State should use incentives to encourage health care providers to develop and implement more efficient long-term care innovations including, but not limited to, telehealth. This option would be favorable for patients who require limited supervision and care. As additional research is done, other methods should be studied and pilot programs implemented.

The State should also expand home and community-based alternatives to nursing home care. Other states have had success with similar programs. In certain cases, home or community-based care is a cost effective and patient-preferred option.

Recommendation: *Consider other coverage strategies intended to reduce cost and increase quality of care.*

The Commission recommends offering health maintenance organizations additional incentives for demonstrating efficiencies and improving the quality of healthcare. Department of Community Health is using this tactic already through the assignment of persons not expressing physician preference based on the HMO's achievement of quality measures.

In addition, the Commission recommends that evaluation could be done on the value of certain high-cost treatments, tests and procedures and then eliminate or reduce coverage for those that are determined to not provide sufficient value. The federal government is currently funding comparative effectiveness research in order to determine whether effectiveness procedures justify the costs incurred. If the federal government adopts the findings of the research for Medicare, Michigan should consider following suit for Medicaid.

Pharmaceutical Strategies

Recommendation: *Evaluate opportunities to increase pharmaceutical rebates.*

The Commission recommends expanding the state preferred drug list. The State currently receives millions of dollars each year in supplemental drug rebates by maintaining this list. In order to achieve significant savings, legislative action would be necessary since current law prohibits the State from granting favored status to certain mental health drugs.

The Commission also recommends urging Congress to change federal law to allow states to collect additional pharmaceutical rebates for drugs prescribed by Medicaid HMOs. Significant savings could be realized if this change were made. The Governor's budget office has projected potential annual savings of up to $50 million.

Recommendation: *Consider alternatives to align incentives and ensure the lowest cost effective drugs are prescribed.*

The State should transfer financial responsibility for anti-depressants and anti-psychotic drugs from the State to the prepaid inpatient health plans. This would make community mental health service programs responsible for mental health drugs thereby using greater discretion in their application and use.

Projected Annual Savings:
Approximately $4 million

The State should also require public disclosure, both online and personally to patients, of financial ties between physicians and pharmaceutical and/or medical device companies. This could increase the use of generic substitutes versus brand names and potentially decrease the prescription of drugs by physicians. It is unclear the effect this would have regarding Medicaid patients due to the preferred drug list and other restrictions.

As well, the Commission recommends establishing a pharmaceutical group purchasing pool that would include all state agencies that purchase pharmaceuticals. This arrangement could produce significant savings by increasing the size of existing pooling arrangements thereby producing additional drug rebates. It would be necessary, however, to secure a significantly higher degree of administrative reconciliations within the participating state agencies.

Other Medicaid Strategies

Recommendation: *Consider alternatives to improve anti-fraud measures and anti-abuse related to Medicaid reimbursement.*

The Commission recommends improving anti-fraud measures related to Medicaid reimbursement by adding staff to the Department of Community Health or within the Department of Attorney General specifically dedicated to ensuring compliance; some parties have estimated annual savings from such efforts at $100 million.

Projected Annual Savings:
$100 million

Recommendation: *Evaluate approaches to ensure that Michigan Medicaid is not paying health care expenses that should instead be paid by other parties.*

Projected Annual Savings:
In excess of $10 million

The Commission recommends discouraging third party liability cost avoidance through legislation that requires no-fault insurers to provide to the Michigan Medicaid program data for identification of primary insurance. If there is eligibility for no-fault insurance, Medicaid would avoid the cost of covering such claims.

The Commission further recommends strengthening Michigan estate recovery laws relative to persons who receive long-term care benefits. This would permit the State to recover additional funds for services provided and potentially prevent beneficiaries from sheltering assets by placing an additional cost-sharing requirement on beneficiaries' families.

Recommendation: *Encourage increased adoption and use of health care information technology, such as electronic medical records and e-prescribing.*

The Commission also recommends encouraging providers to use e-prescribing, electronic medical records, and other information technologies. Emerging technologies can reduce the incidence of human errors, duplication and inefficiencies, and increase convenience. Incentive options may include payment bonuses or tax incentives for adopting physicians and hospitals, similar to those offered under the American Recovery and Reinvestment Act of 2009.

The State should eliminate unhealthy foods from public facilities, and consider increasing access to healthier, nutritious foods through farm to school programs. This could positively impact health behaviors at earlier ages thereby achieving long term Medicaid savings.

Projected Annual Savings: Estimated by interested vendors to be in excess of $150 million

Non-Medicaid Cost Reduction Strategies

Recommendation: *Eliminate or reduce funding for certain select services.*

The Commission recommends eliminating or reducing funding for community mental health multicultural services, which has current state funding of $6.8 million. Elimination or reduction would not prohibit community mental health service programs from contracting for these services based on the needs of persons in their communities.

Projected Annual Savings: $6.8 million

The Commission also recommends that the State reduce funding for non-Medicaid community mental health services. These services are supported by general fund dollars so meaningful savings are possible. However, waiting lists for certain services are common so reduction in funding would further limit access to care and should be approached with caution. Projected savings would depend on the specific reduction sought also, but the line item is over $320 million.

The State should also eliminate or reduce funding of Healthy Michigan Fund programs. Currently, approximately $26 million general fund dollars are allocated to support these programs which are aimed primarily at treating chronic conditions and prevention initiatives. Savings would be generated with associated cuts in the programs.

Projected Annual Savings: Up to $26 million

The State should also consider further consolidation of, or closure of, state psychiatric hospitals. Savings are likely to be realized for those patients who are clinically appropriate to transfer to either outpatient or community based settings. The extent of the savings which would be related to fixed costs normally incurred at the institution will necessarily depend on the practicality of alternative treatment settings for patients. Treatment costs would be transferred to community mental health facilities.

Please note that Commissioners Curran and Bargamian have further comments that can be found in the Commissioner Statements section beginning on page 53 of this report.

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Significant Medicaid savings opportunities are available, although the State is restricted in some key respects by the American Recovery and Reinvestment Act of 2009, and the State should balance the need to provide critical services to its citizens. Nevertheless, significant long term savings are available with a comprehensive set of initiatives.

REDUCING HIGHER EDUCATION COSTS

Key Findings and Recommendations:

In order to achieve savings, the Commission recommends :

- Elimination of or restructuring of the Michigan Promise Grant Program.

The Commission further recommends the following items that are currently being used mostly on a partial basis:

- Use of the "university center" model that brings four-year university programs to community colleges
- Use and expansion of group purchasing of goods and services
- More participation in the Voluntary System of Accountability
- Use and continued development of the "transfer wizard"
- More extensive use of public/private partnerships in the construction and renovation of campus buildings

The Commission believes that while there are savings that can be made in the higher education area, these savings must not result in the substantial tuition increases that have occurred in recent fiscal years due to state budgetary constraints.

Recommendation: ***E**liminate or restructure the Michigan Promise Grant Program.*

In order to achieve savings, the Commission recommends elimination of or restructuring of the Michigan Promise Grant Program. If the program was eliminated beginning with the high school graduating class of 2010, students in the high school graduating class of 2009 who took the Michigan merit exam in the spring of 2008 would be the final group of students eligible for the program. There would be no savings to the State in the fiscal year 2009-10, but cost savings would begin in fiscal year 2010-11 until the total potential annual savings of $190 to 200 million is achieved in fiscal year 2015-16 if the program was eliminated.

If the Michigan Promise Grant is eliminated, it will be for one primary reason. The Michigan Promise Grant is the only state financial aid program that does not consider the financial status of the student's family receiving the financial aid. All other state financial aid programs target financial aid based on the financial needs of students and families. Under times of severe fiscal stress in the state, funding priorities in the student financial aid areas should focus on programs that are need based.

Expand and Implement Other Cost Reduction Opportunities

The Commission further recommends the following items that are currently being used mostly on a partial basis:

- Use of the "university center" model that brings four-year university programs to colleges to take advantage of lower-cost instruction at the community college level and the existing expertise and resources of the four year universities.
- Use and expansion of group purchasing of goods and services such as the State MiDeal contract program and the Midwest Higher Education Compact.
- Use and continued development of the "transfer wizard" to ensure students enroll in community college courses that count toward degree completion.

- More participation in the Voluntary System of Accountability which provides clearer information to students and families.
- More extensive use of public/private partnerships in the construction and renovation of campus buildings.

In addition, the Commission has considered the following issues for potential savings:

- Allowing public community colleges to phase out of the Michigan Public School Employees Retirement System. This would result in short term costs for the transition between systems, but could result in long term savings.
- Exploring options for independent colleges to self-insure if the self-insurer pool was large enough to provide cost savings.
- Explore options for independent colleges to participate in the State MiDeal contract program.

Please note that Commissioners Prokop and Bargamian have further comments that can be found in the Commissioner Statements section beginning on page 53 of this report.

K12 EDUCATION/SCHOOL AID

Key Findings and Recommendations

The Commission established a work group to review state law relative to education and school aid to determine and recommend potential efficiencies and potential savings with respect to aid for schools. The Commission recommends the following:

- Reallocate $300 million from the state school aid fund for funding community colleges to achieve general fund savings.
- Achieve further cost reductions at the school district level by allowing the State Superintendent to require consolidation of school districts or intermediate school districts if not less than 5 percent of savings can be shown or by providing a state monetary incentive to intermediate school districts that consolidate non-instructional services beyond the current level under certain conditions.

In fiscal year 2008-2009, nearly $16.9 billion in federal, state, and local revenue was spent on school aid in Michigan. While state revenue is the largest single source, the amount has been declining with the fiscal year 2009-2010 share expected to be at its lowest level since 1999-2000 at approximately $10.5 billion. This reduction reflects both declining revenues and, because state funding is tied to pupil membership, a declining student population. After a period of high birth rates that led to a peak pupil membership count of more than 1.7 million in fiscal year 2002-2003, membership has been dropping as birth rates decreased and as the downturn in the state's economy led to negative net population migration. In fiscal year 2009-2010, pupil membership is expected to be less than 1.6 million.

If as many as 10,000 school employees retired, the cost to the state would be approximately $50 million but local school districts would save as much as $30,000 per year per employee or more if the employee was not replaced.

While pupil membership has decreased, the total number of school districts has actually increased, due to the recent growth of charter schools. For fiscal year 2009-2010, there are 57 intermediate school districts, 551 traditional local school districts, and approximately 240 public school academies or charter schools.

Although administrative expenses vary greatly by district, there has been an increased effort to reduce non-instructional expenditures through the sharing of services such as transportation, human resources, professional development, food services, technology, and legal services. The State Department of Education report regarding Public Act 63 of 2007 includes information on intermediate school districts and the consolidation of services.

Given this information, the Commission established a work group to review state law relative to education and school aid to determine and recommend potential efficiencies and potential savings with respect to aid for schools.

Recommendation: *Reallocate $300 million from the state school aid fund to be used for funding community colleges in order to realize general fund savings.*

Reallocate $300 million from the state school aid fund to be used for funding community colleges in order to realize general fund savings. This reallocation would be phased in over a three-year period so that $100 million would be reallocated in the first year, $200 million in the second year, and $300 million in the third year and each year thereafter. A portion of this reduction in state aid to schools may be offset by creating local savings by offering a state cash retirement incentive of $5,000 each year for the first three years of a school employee's retirement. The state incentive would also be matched by an equal amount of $5,000 each year by the local district for a total combined retirement incentive of $30,000 over three years to those school employees who are already eligible to retire with a goal of persuading 10,000 school employees to retire. If as many as 10,000 school employees would retire, the cost to the State would be $50 million but local school districts would save as much as $30,000 per year per employee and more if the employee were not replaced. School districts would have the option to participate in the retirement incentive program; they would not be required to participate.

Cost Reduction Through Consolidation

Achieve further cost reductions at the school district level through consolidation under either of the following situations:

- By allowing the State Superintendent the option of requiring consolidation of school districts or intermediate school districts if savings of not less than five percent could be documented. If the State ordered a consolidation, it would remove local politics from the discussion and allow concentration to focus on achieving local efficiencies.
- By providing a state monetary incentive to intermediate school districts that continue to consolidate services between intermediate school districts and with constituent districts beyond their current level. Intermediate school districts and local school districts would jointly determine the services needed to raise the learning level of students. This would potentially eliminate duplication of services between intermediate school districts and their constituent districts.

Please note that Commissioner Bargamian has further comments that can be found in the Commissioner Statements section beginning on page 53 of this report.

PERSONNEL PRACTICES

RIGHT WORKFORCE – RIGHT SIZE, RIGHT SKILLS, RIGHT PRACTICES

Key Findings and Recommendations

Between 2001 and 2008, the State's workforce has declined by 11,300 employees (18%) in response to financial challenges. Reductions were achieved through attrition and an across-the-board early retirement incentive program, rather than planned reductions in the lowest risk areas. In 2008, the annual savings was $602 million in salaries. While significant, the benefits of the workforce reductions were offset by lost savings opportunities and penalties for reduced service levels. By way of example, impacts have been seen in:

- Loss of savings found via reduced audits in the Office of the Auditor General; reduction in staff resulted in 192 backlogged audits; eliminating the backlog would save an estimated $111 million
- Loss of savings via reduced Treasury audits of field and project recovery of delinquent tax revenue; Treasury estimates that one auditor returns ten times his/her salary in savings
- The recent slow revenue growth and early retirement offer kept staffing levels down in the Department of Human Services. As a result of a lawsuit related to the level of service provided, the State was required to increase staffing to achieve specified standards, enhance training and education requirements, reorganize and comply with new mandates. It is estimated that the settlement could mean $200 million in new costs over the next several fiscal years.
- In 2004, the Michigan Department of Transportation (MDOT) contracted out 60% of road and bridge design and 80% of its environmental work to consultants, following the early retirement program in 2002. In a 2004 analysis[1] MDOT established its optimal staffing mix – contract 35% of design work and 50% of environmental work, and do the remaining work with state employees. While this would result in hiring an additional 136 employees, the State would save $6 to $6.5 million a year. The 136 positions were not funded.

Accordingly, the Commission recommends that the State:

- Conduct a five year workforce supply and demand forecast – with annual review and adjustment, if needed - to project the appropriate size and composition of the State's workforce
- Utilize a targeted voluntary separation program to adjust the size of the workforce if the forecast indicates that demand will be lower than supply
- Apply a consistent and credible methodology to streamline processes, reduce duplicated functions and overhead, achieve economies of scale and right-size spans of control
- Expand mutual gains approach to collective bargaining, which has proven to be effective in private and public sector organizations, where significant financial pressures exist and retention of jobs is at stake
- Perform a market study of compensation levels to determine if salaries for some positions should be adjusted to ensure workforce attraction and retention without overpaying for talent

If implemented, these initiatives can result in savings of

- $8 million in the first year
- $200 million each year in years 2 and beyond

Between 2001 and 2008, the State's workforce has declined by 11,300 employees (18%) in response to financial challenges. Reductions were achieved through attrition and an across-the-board early retirement incentive program, rather than planned reductions in the lowest risk areas. In 2008, the annual savings was $602

[1] MDOT Contract Balancing Project Executive Summary, March 16, 2004 submitted as testimony before the Commission by John Eck, Secretary/Treasurer, SEIU Local 517M.

million in wages. While significant, the benefits of the workforce reductions were offset by lost savings opportunities and penalties for reduced service levels.

"Right-Sizing" the State's Workforce

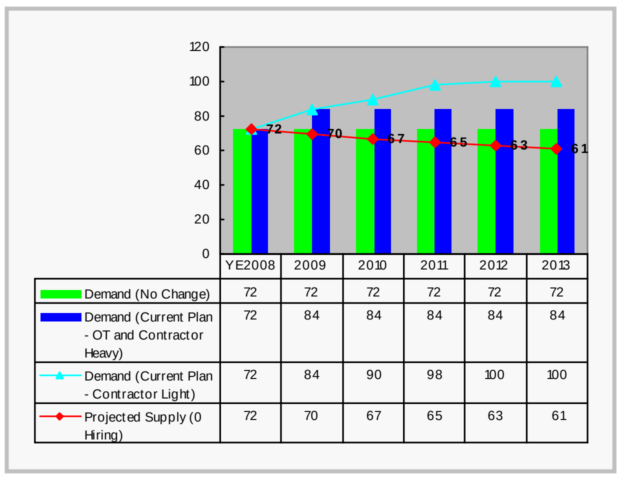
Recommendation: *Conduct a five year workforce supply and demand forecast – with annual review and adjustment, if needed – to project the appropriate size and composition of the State's workforce.*

The Commission believes that "right-sizing" the State’s workforce should not be driven by financial pressures, but rather by conducting a five-year workforce supply and demand forecast – with annual review and adjustment, if needed - to project the appropriate size and composition of the State’s workforce. Personnel practices to close any gap between supply and demand may include

- Targeted voluntary separation program if demand is less than supply
- Streamlining processes, reducing duplicated functions and overhead, achieving economies of scale and right-sizing spans of control to continuously take advantage of efficiency and effectiveness improvement opportunities
- Ensuring the State does not overpay or underpay for talent required by the workforce forecast
- Continued partnering with the unions to ensure the workforce forecast can be met on an ongoing basis

The largest opportunity to ensure a "right-sized" state workforce rests with the five-year workforce forecast, which helps the State to project the appropriate size and composition of the State’s workforce. On the supply side, the forecast should factor in projected turnover, productivity and efficiency improvement, streamlining processes, reducing duplicated functions and overhead, achieving economies of scale and right-sizing spans of control. On the demand side, the forecast should factor in state revenue projections, population trends, changing service levels and likely scenarios such as reduced or eliminated state programs or new programs with documented returns on investment.

Sample Supply/Demand Gap Analysis



The State should train 3 Human Resources staff members in workforce forecasting and analysis methodology with the goal to have no more and no less staff than needed to perform the work of state government. This common methodology should be used across all state government agencies. The forecast should be used to establish hiring plans, personnel reduction needs, training requirements and budget.

The annual workforce forecast includes the following steps:

- Identify staffing levels and skills needed in the next five years (demand), based on likely scenarios related to state population trends, revenue projections and program changes
- Analyze current workforce demographics, retirement projections, skill availability and turnover rates (supply)
- Analyze gaps between supply and demand overall and for critical workforce segments
- Develop strategies to close the gaps
- Evaluate the validity of the plan to inform next year’s forecast

Develop Strategies to Close the Gap between Workforce Supply and Demand

The strategies are determined by the nature of the gap between workforce supply and demand, but may include the following:

- Utilize a consistent and credible methodology to streamline processes, reduce duplicated functions and overhead, achieve economies of scale and right-size spans of control. Members of the state Human Resources organizations should be trained to utilize the methodology to help state departments review their work and find ways to more effectively do "mission critical" work to meet the needs of constituents
- Where supply is greater than demand, explore where there may be opportunities to direct a part of the workforce that has an over-supply to an area that is currently outsourced
- Implement a voluntary separation program (with incentive) where employees interested in separating from employment with state government identify themselves. The State then determines if it is in the State's financial best interest to separate a particular employee, based on whether that employee would need to be replaced. Once established, the program can be reused. This strategy could be employed in conjunction with department efficiency improvements to manage staff reductions. Other benefits include improved morale with voluntary rather than involuntary reductions, reduced disruption and retraining costs of bumping associated with involuntary reductions and managed loss of institutional knowledge

Recommendation: *Expand mutual gains approach to collective bargaining, which has proven to be effective in private and public section organization, where significant financial pressures exists and retention of jobs is at stake.*

Mutual Gains Bargaining is a joint problem-solving approach that has been particularly successful when bargaining involves complex issues and significant financial challenges. It has been used successfully in both private and public sector organizations. The State and the unions representing state employees already conduct negotiations using many of the mutual gains bargaining principles, which is an inclusive process that focuses on funding what is especially important and supports a long term positive relationship between the parties. The State and the unions would need to reach agreement to pursue mutual gains bargaining when the next contracts are negotiated.

Recommendation: *Perform a market study of compensation levels to determine if salaries for some positions should be adjusted to ensure workforce attraction and retention without overpaying for talent.*

The Commission recommends that the State complete a comprehensive study of the nearly 600 types of jobs in state government to determine if salaries for some positions should be adjusted. Several vendors should be considered to perform this work before a contract is awarded. Where changes are necessary, the State should evaluate the benefits of making compensation changes for entry level positions and new employees who populate them and "grandfathering" existing employee compensation levels. Appropriate compensation levels should be discussed with the unions during the next contract negotiations.

INFORMATION TECHNOLOGY

A MOVE TOWARD TRANSPARENCY, EFFICIENCY, AND SAVINGS

Key Finding and Recommendations:

The Department of Information Technology (DIT) funding model differs from that of other executive branch agencies because it does not receive its own separate legislative appropriation. Rather, DIT is funded mainly by IT grants contained in the budgets of the State's various agencies. A Senate Fiscal Agency (SFA) March / April 2007 analysis on DIT's spending determined that DIT's funding model allowed documented IT cost overruns from $90 to $130 million annually, lacks transparency, and does not give DIT control over IT costs and projects.

The Commission recommends the following:

- Study DIT's funding structure and consider modifying the current Legislative appropriation model
- Establish an IT oversight group to oversee, manage, and reduce IT cost investment and identify and implement IT in the executive, legislative, and judicial branches
- Consolidate and centralize IT system management in the legislative and judicial branches with the executive branch
- Continue to pursue joint IT initiatives with local governments
- Convert paper files to electronic files in the Department of Environmental Quality and other departments, beginning with those departments and agencies that have a high level of Freedom of Information Act requests

DIT was created in October 2001 to oversee information technology (IT) for the State's executive branch of government. While DIT has accomplished great savings and efficiency by consolidating and streamlining many of the State's IT functions, DIT's legislative appropriation funding structure has created a dynamic that has resulted in DIT's inability to reach its full potential in leading and realizing cost-saving IT efficiencies across state government.

Despite the problems stemming from the current DIT budget model, DIT has streamlined certain IT functions and reduced agency IT spending by 24% from 2003 to 2008. DIT also recently opened an office to facilitate state and local government IT partnerships - an initiative that holds much promise. However, DIT will not be able to realize its full potential to manage State IT without a change in its funding model.

Recommendation: *Study DIT's funding structure and consider modifying the current legislative appropriation model.*

The current structure - departments funding DIT through their own agency IT and other appropriations - has caused IT project cost overruns of $90 to $130 million annually since DIT's creation, has resulted in an inability to get a true picture of IT expenditures across state government, and has facilitated a lack of transparency on IT spending and projects. (Reference Appendix vii)

Recommendation: *Establish an IT oversight group to oversee, manage, and reduce the IT cost investment and identify and implement IT in the executive, legislative, and judicial branches.*

Representation should include staff from the State Budget Office in the Department of Management and Budget, the DIT, and each remaining state department whose duties include management of large technology projects and approval or modification of projects. Creation of such a body would provide more complete understanding of information technology issues for state government supervisory personnel, improve efficiency in the management of projects, and likely lead to reduced state expenditures.

Recommendation: *Consolidate and centralize IT system management in the legislative and judicial branches with the executive branch.*

Executive branch IT management is repeated for the State's other two government branches. Consolidation could eliminate or reduce duplicated IT management functions.

Recommendation: *Continue to pursue joint IT initiatives with local governments.*

This would include allowing local governments access to state purchasing contracts, creating opportunities for local governments to pool purchasing power, and providing local government access to certain state computer systems like the CRASH system of the Department of State Police or the Center for Geographic Information in the Department of Information Technology. While these opportunities would necessarily improve relationships between the state and local governments, it is likely that any savings generated would be primarily at the local level.

Recommendation: *Convert paper files to electronic files in the Department of Environmental Quality and other departments.*

Convert paper files to electronic files in the Department of Environmental Quality and other departments, beginning with those departments and agencies that have a high level of Freedom of Information Act requests so that documents normally sought through FOIA requests can be made available to the public on the State's website. A pilot project in Grand Rapids has already produced positive results. This would clearly benefit the public through easier access to department information and could also reduce the staff necessary to produce paper files. It would take time to implement and is costly for the initial creation of the system (estimated between $12 and $17 million).

Other Areas to Examine

The Commission also identified other areas to examine and suggests:

- Centralizing management of the state telephone network as recommended in the fiscal year 2006-2007 budget bill. Savings through centralizing technology across state departments has already been historically effective and would be easy to achieve and measure. This change would require an initial $5 million over 2 years to implement and is necessarily a substantial undertaking.
- Continuing and increasing the use of video, audio, and web conferencing to offset the cost of travel by state employees. The State already has access to, and makes use of, these technologies. Because out-of-state travel has already been significantly reduced because of budget issues, the amount of savings will not be as significant as in immediately preceding years.
- Extending child welfare data from the state Department of Human Services to private contracted child welfare agencies. The granting of technology access to private agencies would eliminate the need for these agencies to submit paper reports to the state department and could reduce reporting errors.
- Reducing state reliance upon contractual staff for software development and programming activities by replacing current contractual staff with state employees, increasing internship opportunities, establishing a fast-track hiring process through civil service for certain positions, or retraining current workers on more current computer technology. Increased state employee staff would provide greater institutional knowledge within state government.

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If the key recommendations and the suggestions from the other areas examined are implemented, these initiatives can result in total estimated savings of:

- $90 to $130 million in the first year, assuming DIT's funding model changed to a direct general appropriation model and DIT stays within its appropriated budget.
- An additional $10 million in the intermediate term with increases to enhance paperless, electronic files and consolidate IT management for the legislative and judiciary in DIT.
- Incalculable additional sums in the long-term if the Commission's recommendations are adopted to create an oversight IT committee to reassert enterprise IT management over state government IT; give DIT control over the State's IT process; and expand state and local IT partnerships.

PURCHASING AND STRATEGIC SOURCING

Key Findings and Recommendations:

The State spends an estimated $1.1 billion per year on negotiable contracts. Significant annual savings are possible by:

- Taking into consideration at the time of contract negotiation the anticipated purchasing volume of goods and services of local units of government, including municipalities, school districts and other states in order to maximize volume discount potential
- Identifying types of goods and services that are common between the state and local units of government and develop a list of standard products and select vendors to be used for purchase of these goods and services
- Modifying standard purchasing processes and procedures by simplifying and, to the greatest extent possible, standardizing terms and conditions that cause vendors to add costs to compensate for potential unforeseen circumstances. In addition, the State should continue the current practice of separating contract management from the buying process.
- Improving the existing state purchasing system with an upgraded system that allows for
  - more improved technology for contract bidding and pricing
  - significantly improved data analysis pertaining to contract vendors and goods or services purchased
  - improved data exchange capabilities between the State and potential vendors

According to the Department of Management & Budget, the State currently spends approximately $1.1 billion per year on negotiable contracts.

Total State Contracts as of September 2008	
Total Contracts Portfolio	$19.1 billion
Non-Negotiable Health Care	$13.5 billion
Federal Pass Through	$1.2 billion
Zero Dollars Spent Contracts	$0.4 billion
Total Negotiable	$4.0 billion
Annual Estimated Negotiable Contracts*	**$1.1 billion**

*This figure represents the total of $4 billion divided by an average of 3.5 contract years.

The Commission believes that significant annual purchasing savings are available to the State by

- Leveraging the combined purchasing power of state and local governments
- Simplifying and standardizing terms to permit greater purchasing scale
- Investing in systems that allow for a more strategic and goal-oriented approach to purchasing

Recommendation: *Leverage the combined purchasing power of state and local governments*

The State should take into consideration at the time of contract negotiation the anticipated purchasing volume of goods and services of local units of government, including municipalities, school districts and other states in order to maximize the volume discount potential rather than establishing a contract price based on the State's needs and then allowing other governmental units to purchase from that contract. The Commission recommends that the State consider encouraging participation by other entities under the State's contracts, by sharing a portion of the savings realized by the State with other participants in the form of a rebate.

The Commission recommends identifying types of goods and services that are common between the state and local units of government and develop a list of standard products and select vendors to be used for purchases of these goods and services. Contracts would be negotiated with these vendors on a preferred basis using volume purchasing power of the state together with units of local government, including school districts and municipalities.

A savings of 3% through additional volume discounts would save the State approximately $30 million per year, exclusive of any savings realized by local governmental units.

The Michigan Delivery Extended Agreements Locally (MiDEAL) program provides local units of government the ability to purchase under State of Michigan contracts in order to realize a reduced cost on goods and services. The average savings to local units of government on the top four items (computers, vehicles, furniture, and road salt) negotiated through the MiDEAL program is approximately 25% per contract. In most instances, contracts are negotiated based on the State's purchasing needs only and do not take into account the anticipated purchasing volumes of other governmental units. By knowing up front the anticipated volume of items needed by each party to a contract, the State may be able to realize greater savings than the State or the participating local units would if purchasing the items separately, similar to a buying cooperative.

In select instances, the State has worked with local units of governments to identify anticipated purchasing volumes up front in order to maximize volume discounts. These include:

- Road salt
- Green janitorial supplies in conjunction with other states
- Buses (zero dollar state contract for the benefit of local governmental units)
- Airport equipment (zero dollar state contract for benefit of public airports)

Recommendation: *Simplify and standardize terms in order to permit greater purchasing scale*

A key element to achieving savings through group contracts is maximizing the number of instances where common goods and services can be purchased. While there may be certain considerations currently in place that would limit the ability to combine purchases, such as slight deviations in specifications or ordinances requiring purchases from local businesses, it appears that there are a number of common types of items that are purchased by all governmental units, such as office supplies, maintenance supplies and other office related items that have the potential to be commonized.

The State should modify standard purchasing processes and procedures by simplifying and, to the greatest extent possible, standardizing terms and conditions that cause vendors to add costs to compensate for potential unforeseen circumstances.

Terms and conditions are required in all state contracts in order to ensure applicable labor laws, environmental laws and regulations, and any other standards or laws are followed. A study should be conducted, perhaps with the use of focus groups consisting of vendors providing a broad section of goods and services, to understand what terms create uncertainty and, as a result, are the most difficult to address when providing a quote. By eliminating this uncertainty, the State can achieve lower costs.

Recommendation: *Invest and enhance in systems that allow a more strategic and goal-oriented approach to purchasing*

The State should continue the current practice of separating contract management from the buying process.

In addition, sourcing approaches and bidding strategies should be developed specific to major categories of goods and services purchased. One strategy should not be used for all types of purchases. Factors such as the uniqueness of the good or service being purchased, availability of suppliers and technical specifications required should be considered. Generally speaking, the more complex or specific the good or service being purchased, the more involvement the functional area should have in buying and contract management. The State is currently set up to support this type of structure, with nearly half of buyers being associated with functional areas and the other half doing broad based purchasing. The State should periodically review categories of purchases being conducted by functional areas to determine the feasibility for moving buying responsibility to a centralized function.

Lastly, it is common practice in private industry to build in anticipated savings in annual budgets that buyers will be able to negotiate with vendors. The State should consider setting targets for annual savings and compensating buyers based on savings achieved. While lowest cost should not be the only factor that dictates purchasing decisions, this can be an important area for annual savings that can easily be overlooked, especially if contracts are renewed on an annual basis. Further, changes should be made to the state budget process so that savings achieved are built into a budget ahead of time and the budget process is changed so that savings in one area cannot be used in another.

To facilitate this more strategic approach to purchasing, the State should replace the existing state purchasing system with an upgraded system that allows for more improved technology for contract bidding and pricing, significantly improved data analysis pertaining to contract vendors and goods or services purchased, and improved data exchange capabilities between the State and potential vendors. The State's current systems are dated and significantly limit the ability to perform the data analysis and communication necessary to achieve optimal pricing for goods and services, or to realize efficiencies in the recommendations above.

Some incremental improvements have recently been made through the implementation of a new system for vendor registration and notification that allows prospective vendors to register by industry code and to be notified of future solicitations, but there are still significant opportunities for improvement here.

Although the cost of implementing a new purchasing system is undetermined, achieving a 1% savings in negotiable contracts annually through the use of improved technology would pay for a $10 million implementation cost in one year.

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The State can drive significant annual purchasing savings through a more strategic approach to purchasing that leverages the combined spend of state, local, and county governments.

PUBLIC EMPLOYEE HEALTH BENEFITS

Key Findings and Recommendations:

Salaries and benefits together represent approximately fifty percent (50%) of the state general fund budget. Benefits costs alone represent 17% of the general fund budget. Overall benefits costs have increased at a rate of 7% per year despite fewer numbers of state employees according to Citizens Research Council (CRC). Moreover, CRC and other organizations expect benefit costs for current and retired state employees to increase at an unsustainable rate of 9 to 10% per year over the next 8 to 10 years, barring any other changes.

Rising healthcare and benefits costs have strained – and will continue to strain -- all units of government, including the state, local units of government, K-12 school districts, and institutions of higher education. Since this issue affects numerous units of government and various segments of public education, the Commission established a separate work group to consider various alternatives to curtail the rate of growth in costs attributable to healthcare benefits.

The Commission recommends that the State of Michigan hire professional consultants with expertise in the area of employee health care benefits to review the following issues:

- The appropriate level of the total cost of public employee health insurance borne by state government, local government, and public education employees through premiums and co-pays
- Investigate the possibility of charging newly hired state employees a different rate to purchase health plans than existing employees
- Investigate the feasibility of either allowing or requiring all public sector employees to purchase health insurance off of the State of Michigan health plans
- Consider the option of conditioning a portion of the revenue sharing payments to units of local government on offering health benefits no richer than those afforded by the State to its employees
- Conduct a complete review of the structure of public health plans in Michigan
- Consider ways to pre-fund retiree health benefits, including the option of selling bonds to finance the long-term cost of retired employee health benefits

The Commission recognizes the complexity associated with this issue. It is, therefore, the recommendation of the Commission that the State retain professional consultants with expertise in healthcare benefits to evaluate and make recommendations on *specific ways* to significantly reduce these costs for units of government and institutions of education in the following areas:

- Bringing governmental employees benefit packages and premium contributions in line with public employees in other states and with private sector employees
- Implementing health insurance plan design changes intended to reduce costs
- Leveraging the purchasing power and professional benefits negotiation services of the State to lower costs throughout the system while preserving the employee's choice of plan design and health insurance or health maintenance organization
- Evaluating different methods to pre-fund retiree health benefits

Recommendation: *Evaluate and, if appropriate, increase the employee funded portion of the health benefits package to levels commensurate with public and private sector benchmarks*

Although the percentage of premiums paid for healthcare benefits by Michigan state employees was increased to 10% in 2007 (for both employee-only and family coverage), this rate is comparable to most other states for employee-only coverage but is still lower than most other states for family coverage. According to the

Kaiser Family Foundation, the national average for state employees is 10% premium contribution for employee-only coverage and 21% premium contribution for coverage of employees and eligible family members. The Commission therefore recommends that the consultants determine and recommend whether an increase in the employee funded portion of the benefits package is appropriate. Increasing the premium contribution for coverage of employees and eligible family members from 10% to 21%, as an example, would result in $55 million in savings per year.

Overall benefits costs have increased at a rate of 7% per year despite fewer numbers of state employees according to Citizens Research Council (CRC)

The increase in this premium contribution could be implemented and phased in over time. Alternatively, state employees hired on or after a certain date would pay a different rate than existing employees.

Recommendation: *Evaluate and implement health insurance plan design changes intended to further reduce health care costs and create appropriate employee incentives*

The design of an employee health care benefits plan can have a dramatic impact on the underlying benefits costs of the plan. The plan design may create incentives toward decreased use of healthcare services, improved health behaviors and lifestyles, and other significant cost factors. The Commission, therefore, recommends that the professional consultants evaluate and recommend plan changes that create effective incentives for employees to more efficiently utilize healthcare services and to engage in healthier lifestyles.

These recommendations could include, among other recommendations, range of services covered, levels of premiums or co-payments required for certain benefits, and incentives for healthy behaviors.

Recommendation: *Evaluate opportunities to reduce benefits costs through pooling health care plans across levels and units of government*

The Commission recommends professional consultants evaluate the feasibility of either requiring or allowing all public sector employees to purchase healthcare benefits through a state negotiated health plan or, as an alternative, consider incentives such as conditioning a portion of revenue sharing payments to local units of government, school aid payments to K-12 school districts, or appropriations to public universities and community colleges on the condition that these entities charge a premium to their employees for their health insurance benefits of not less than the same premium state civil service employees are charged for similar benefits. The legislature should also consider an exemption for any required purchase of benefits via a State plan if the unit of government can show that the cost per employee is less expensive than that available through the State plan.

CRC and other organizations expect benefit costs for current and retired state employees to increase at an unsustainable rate of 9 to 10% per year over the next 8 to 10 years, barring any other changes.

Recommendation: *Consider and evaluate ways to pre-fund a portion of future health care liabilities*

Pre-funding promised health benefits for existing employees and retirees may lessen some of the future financial pressure the State may otherwise experience. Although cash resources do not exist due to the State's current financial condition, the State and other units of government should consider and evaluate the issuance of bonds (so-called “other post employment benefit” bonds or “OPEB bonds”) to cover all or a portion of the anticipated expense. To the extent the interest rate on the investments that the proceeds from such an issuance is greater than the interest rate paid on the bonds, the projected liability of the State and the future costs to the State would be reduced.

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In addition, the Commission recommends the reduction of health benefit costs for public and private employers through decreasing or eliminating cost-shifting by health care providers to commercial insurers due to nonpayment of services or payments that do not cover the cost of providing those services. Possible recommendations include insurance coverage for all state residents in order to eliminate losses resulting from charity care or lack of payment to providers by uninsured patients and ensuring that the state Medicaid program reimburses healthcare providers at a level sufficient to cover the costs of providing care, provided that cost-efficiency and quality measures are met by the provider.

Please note that Commissioner Bargamian has further comments that can be found in the Commissioner Statements section beginning on page 53 of this report.

A series of actions and changes can significantly reduce the rate of increase in health benefits costs for the state and other units of government.

SUSTAINED EFFICIENCY WITHIN DEPARTMENTS

Key Findings and Recommendations:

There are proven best practices for establishing a culture that embraces and sustains efficiency. Below are five recommendations that should be the common leadership practices in all areas of government. The good news is there are pockets of excellence within state government today. These practices need to become fundamentally systemic. If this is accomplished, the workers within the State will be empowered and will be the best source of how to operate in the most efficient manner.

- Documentation of the state organizational structure is poor. Serious improvement of the visual layout for the chain of command is required.
- A significant decrease in the number of layers of management/organization along with an increase in the span of the number of employees reporting to any supervisor is needed. General rule for the span is no less than 8 personnel and no more than 15 reporting to any one supervisor.
- The existing performance management system needs some modifications. 1) Performance objectives should be documented with a results driven scorecard for all leadership positions from department chiefs to first line leaders. 2) The civil service system should be modified to allow managers to provide merit recognitions for excellent performers and hold non performers accountable. 3) There should be an annual performance evaluation using the scorecard (the what) and observed reinforcing behaviors (the how). These evaluations should be conducted by the employee's immediate supervisor – not by others.
- A consistent continuous improvement process for all departments that applies tools and techniques in statistical control, six sigma, LEAN, 5S, and several other well known functional tools.
- A consistent step change process for all departments that utilize proven event driven techniques such as Kaizen and value stream mapping. These techniques do require some training and possibly consultants. There is an organization within existing state government that is knowledgeable and competent to implement these techniques – The Office for Great Workplace Development.

The State of Michigan employs approximately 52,000 people. Each of these people comes to work everyday with the ability and energy to create a service or product to benefit the state. Their efficiency, as individuals or a group, is a function of the leadership ability of the civil servant management staff. These 52,000 people know best how to do their job, improve services/products, reduce cost, and achieve a high rate of return on a myriad of functions. What is needed is to unlock and unleash their creativity, motivation, and energy to provide for a sustainable system that addresses efficiency on a daily, monthly, and annual basis.

This section of the report is to address the need for a performance management system that employs a best practice process of techniques and tools to achieve sustained efficiencies. It needs to be noted that when it comes to managerial leadership systems there are many pockets of excellence in many departments throughout the State. Some notable departments are the Secretary of State, Information Technology, Department of Transportation, as well as the Budget Office. This does not mean these departments are perfect, in many of these cases, the pockets of excellence are driven by the personal energy of several managers and not because it was the system or process.

Another point to be made is that parts of the processes, systems, tools, and techniques to be discussed further are being done in many departments. But doing them is not a "check the box" exercise. Leaders must believe in their use all the time and in the quality of the products demanded. Leaders who practice these managerial best practices must have a high degree of commitment, courage, and perseverance in order to achieve the excellence needed to have a sustained efficiency culture and practices within a department or state offices in general. Being a manager/supervisor is a profession with its own set of particular technical and leadership skills, no different than an accountant, a mechanic, or a computer programmer.

During the investigation into efficiency improvements for government, a request was made for the documentation for organizational structure of the entire state government. It became clear, that such a document was not readily available. Interviews with personnel from several departments led to the conclusion that many employees don't understand the chain of command and where they fit into the organization. Organizations need to understand the chain of command and who the decision makers are. It is imperative for vertical and horizontal alignment. With a clearly documented organizational structure, analysis of command efficiency across the state and within each department can be accomplished.

Recommendation: *Documentation of the State Organizational structure is poor. Serious improvement of the visual layout for the chain of command is required. Many employees do not know how they fit into the organizational structure of their own department much less the State.*

What is also important about organizational structure documents is it facilitates redesign and efficiency discussions. Leaders and managers should use these organizational structure documents to periodically re-examine better ways to utilize their people's talent. Organizations should be built around the strengths of their people. As people come and go, the organizational structure needs to change as well. Because of this, there is no perfect organizational structure. However, there are some best practices or rules of thumb that can be applied to all organizations. More specifically, the span of control a supervisor/manager should be able to handle and the resultant number of layers of management. The goal is to increase span and reduce the number of layers. Obviously, this is a balance. Increasing the span should reduce the number of manager/supervisors, improve alignment and reduce the possibility of message dilution up and down the organization, as well as a whole host of other efficiencies. The general rule of thumb is a supervisor/manager can manage anywhere from a minimum of eight to a maximum of fifteen employees. Less than eight employees and the leader is possibly too inefficient and the number of layers will likely increase. More then fifteen employees and the leader may be extended beyond the capability to manage adequately.

Recommendation: *A significant decrease in the number of layers of management/organization along with an increase in the span of the number of employees reporting to any supervisor is needed. General rule for the span is no less than eight personnel and no more than fifteen reporting to any one supervisor. There are too many levels of management of where two or three employees report to one – this should happen extremely rarely. The number of layers is dependent on the span. For instance, a department of 1000 people should have no more than three levels of management.*

A 52,000 person organization is very diverse. However, what is important to all of them is that management leads/treats them consistently. The key to this is a consistent performance management system. There are several fundamental parts to a good performance management system: 1) a balanced scorecard of the objective results driven goals – the "what"; 2) periodic (semiannual and annual) reviews of the behaviors that reinforce the "what" is being accomplished in a healthy sustainable manner – the "how".

The balanced scorecard technique – the "what" - is a known best practice. The key to its success is the following: 1) to keep the number of key performance measures (KPMs) in the 8-12 range; 2) each KPM needs to be a results driven objective, i.e. actual budget performance, # of transactions, completing projects on time/on budget/meeting desired goals, etc (KPMs are not activity based like doing a customer survey, making a visit, or doing a project); 3) establish minimum and maximum objectives for each KPM; 4) establish a weight percentage for each KPM totaling to 100%.

The balanced scorecard is not enough. Supervisors/Managers need to establish a set of behaviors they expect their employees to emulate and improve upon such that the success of their objectives are accomplished in a manner that will be sustainable and bring out the best in individuals and teams. This is the "how". Examples of such behaviors are building an effective team, listening and communicating, managerial courage, managing through systems, or whatever the organization believes are the right behaviors.

Lastly, all supervisors/managers should conduct semi annual and annual reviews of all of their employees. The civil service system needs to be modified to allow managers to recognize excellent employees and hold non performing employees accountable. Currently, the system can leave high performers demotivated and excessively protect non-performers. Any one team should have employees who fall into at least three groups: Exceeds Commitments, Meets Commitments, Needs Improvement. It should be extremely rare that any team doesn't have some employees that don't fall into one of these three categories. Regardless of which category any one employee falls into, all employees deserve an honest evaluation with an appropriate action plan to reinforce their good behaviors and results and improve upon less than desirable behaviors and results.

Recommendation: *The existing performance management system needs some modifications. 1) Performance objectives should be documented with a results driven scorecard for all leadership positions from department chiefs to first line leaders. 2) The civil service system should be modified to allow managers to provide merit recognitions for excellent performers and hold non performers accountable. 3) There should be an annual performance evaluation using the scorecard (the what) and observed reinforcing behaviors (the how). These evaluations should be conducted by the employee's immediate supervisor – not by others. The supervisors should rate employees into groups that recognize excellent performance, reinforce solid work, and address those with significant opportunities. All departments should have significant numbers of employees in all three categories.*

The next step in sustaining efficiency is to build a practice of continuous improvement (CI) into the state working structure. This is not complicated and can be done fairly easily if leaders/managers 1) employ the previous recommendations in the spirit they were intended, 2) are committed to CI, 3) embrace help from the pockets of excellence throughout state government that are currently and successfully using these techniques, 4) engage the office of Great Workplace Development for advice and help.

Build into everybody's scorecard an individual CI goal for the areas they are responsible. A 2-3% cost reduction or a similar non tax revenue improvement is an example. Making these goals explicit into the scorecard sets the expectation that this is part of everybody's job. Next use the myriad of tools that are available to analyze opportunities in everyday service or product costs. Some employees may need basic training, but many people today are training themselves quickly and easily by going online and using very straight forward tutorials or reading about many of the fundamentals for themselves. Some basic statistical tools, initial elements of six sigma and LEAN manufacturing can provide some great starting points. It is understandable that many people may wonder what are these techniques and how do they apply to government. Many aspects of government provide services and products no different than many businesses. The key to CI success is to avoid relying on anecdotes and giving credibility to hunches, intuition, and preconceptions. Let the data lead to the proper solutions and don't skip or jump to conclusions. Many organizations are finding these techniques to be very engaging and empowering for the workforce. It helps people take charge of some part of their destiny. The Office of Great Workplace Development can assist with how to apply these techniques.

Recommendation: *A consistent continuous improvement process for all departments that applies tools and techniques in statistical control, six sigma, LEAN, 5S, and several other well known functional tools. These tools do not require a lot of training.*

With the current state of the economy, especially in Michigan, the "business as usual" model for all organizations is under fire and rightfully so. This makes the time and need ripe for step change improvements. Just as with CI, there are some commitments needed by leaders/managers: 1) open minded thinking to new ways of organizing and executing work, 2) engage and utilize the people who do the work – they know where the waste is hidden and what work is value added, 3) embrace help from the pockets of excellence throughout state government that are currently and successfully using these techniques, 4) engage the Office of Great Workplace Development for advice and help.

As with the CI section above, build into everybody's scorecard an individual goal of a 5-10% cost reduction or a similar non tax revenue improvement for the areas they are responsible. Remember this is step change! The techniques for these processes are more complicated and do require some new skills or help. Some of the most powerful tools are value stream mapping and Kaizen events. These tools focus on questioning and evaluating work processes and long standing methodologies on how work is accomplished and the resources expended to accomplish them. These tools use data along with process owner engagement to remove waste, keep current value added tasks and incorporate new value added tasks. Many organizations have not re-examined themselves in years and are performing the functions of their jobs because that's the way they have always done it. This complacency is expensive, disengages employees who have better ideas, and frustrates customers – nobody is winning here. This is not about automation or new equipment– even though that is possible – its about building the way you want processes to perform if you could start over today (within certain boundaries).

Several departments have used these techniques very successfully such as the DEQ and MDOT.

Recommendation: *A consistent step change process for all departments that utilize proven event driven techniques such as Kaizen and value stream mapping. These techniques do require some training and possibly consultants. There is an organization within existing State government that is knowledgeable and competent to implement these techniques – The Office for Great Workplace Development.*

Please note that Commissioner Bargamian has further comments that can be found in the Commissioner Statements beginning on page 53 of this report.

IMPLEMENT A "PAY-AS-YOU-GO" SYSTEM AND OTHER PROCEDURAL CHANGES

Key Findings and Recommendations:

In recent years, budget policy decisions based on short-term solutions have contributed to the current long-term structural budget problems facing state government.

The Commission recommends that the legislature consider procedural changes to address these issues. In particular, the Commission recommends that the legislature:

- Implement a "pay-as-you-go" budget process, similar to the systems periodically used at the federal level, to ensure that any new spending commitments or tax cuts are offset by other spending reductions or new tax revenue
- Implement other procedural changes that could provide additional transparency and visibility on the state's long-term fiscal outlook. These changes could include
  - Fiscal impact statements to all new legislation
  - Annual or biennial long-term (5 – 10 year) fiscal forecasts
  - Annual reporting on the use of one-time revenue sources or budget shifts

Background

Unlike the federal government, the State of Michigan is required to implement a balanced budget each fiscal year.

- Article V, Section 18 of the 1963 Michigan Constitution, which requires the Governor to submit a budget to the legislature for the ensuing fiscal year, states: "Proposed expenditures from any fund shall not exceed the estimated revenue thereof."
- Article IV, Section 31 of the Michigan Constitution, which deals with appropriations bills as they are signed into law, states, "One of the general appropriation bills as passed by the legislature shall contain an itemized statement of estimated revenue by major source in each operating fund for the ensuing fiscal period, the total of which shall not be less than the total of all appropriations made from each fund in the general appropriation bills as passed."
- Article V, Section 20 of the Michigan Constitution requires the reduction of expenditures authorized by appropriations whenever it appears that actual revenues will fall short of revenue estimates on which appropriations were based.

Nevertheless, there are elements of the current legislative appropriations process that increase the difficulty of adopting a balanced budget, by allowing difficult decisions about budget trade-offs to be pushed forward until the end of the process. For example, consideration of an amendment (or substitute bill) to increase spending in a budget bill takes place without a requirement that a funding source or offsetting budget reduction be identified. As a result, the budget bills passed by one house of the legislature or the other may not represent a balanced budget, potentially making negotiations regarding a final resolution to the budget more difficult.

Further, while policy changes to state programs and taxes must be balanced on a one-year basis, legislative actions often have significant impacts on the state's long-term financial situation. Examples include the following:

- The use of one-time revenue sources, in addition to ongoing baseline revenue sources, to support budgets

- Deferral of expenditures--such as pension obligations or infrastructure maintenance--to subsequent fiscal years
- Changes in tax policy that are revenue neutral (or even increase available revenue) in the year for which they are initially enacted but result in declining or stagnant revenue in outlying years
- Legislative changes to state programs that do not have immediate impacts on state spending but result in increased state costs in subsequent years without an associated funding source

These actions, even within the context of annual balanced budgets, contribute to a long-term structural deficit, ultimately making the task of achieving the constitutional mandate to balance the state budget each year more and more difficult.

Recommendations

Recommendation: *Implement a "pay-as-you-go system" in the Michigan budget process*

Adoption of effective pay-as-you-go-type procedures could improve the legislature's ability to make budget decisions. Pay-as-you-go budgeting makes explicit the requirement to balance projected revenues and expenditures. Proposals for new spending commitments or tax cuts are to be offset by other spending reductions or new tax revenue. The goal of a pay-as-you-go system is to emphasize the need for budgetary trade-offs in order to achieve fiscal restraint. This goal should apply both to adoption of annual state budgets and within the larger context of the State's long-term financial situation.

Examples of procedural changes that could help address issues related to annual budget development include the following:

- Provide for the adoption of a budget resolution by each house of the legislature prior to action on individual budget bills, specifying the amount of revenue to be appropriated (accounting for any proposed changes to tax or other revenue sources) and specific amounts to be appropriated in the various areas of the state budget. This would establish a baseline for decisions made by that house of the legislature as budget bills move through the legislative budget process and would help ensure that those decisions are made in the context of the end goal of arriving at a balanced budget.
- Require that amendments and substitutes to budget bills that increase spending from an agreed-to baseline (either the executive budget or a legislative budget resolution, as described above) include identification of an anticipated funding source or offsetting budget reduction by which the spending increase would be funded.
- Similarly, require that tax-related legislation projected to reduce state revenue specify offsetting revenue increases or budget reductions through which the tax reduction would be funded.

Recommendation: *Implement other procedural changes that provide additional visibility on the State's long-term fiscal outlook*

Examples of procedural changes that could help address long-term structural financial issues include the following:

- Include fiscal impact statements as an addendum or cover page to bills as they are considered by the legislature. Currently, these statements are included as part of separate documents that may or may not be read prior to legislators voting on the bills. Those statements would include an assessment by nonpartisan experts regarding both the short-term and long-term fiscal impact of the legislation.

Adequate staff resources and adequate time to prepare the required analyses would need to be devoted to this process, but attaching them to bills would make the financial implications of the proposed legislation more clear.

- Direct the Department of Treasury and / or the legislative fiscal agencies to prepare a long-term forecast (5 - 10 years) of the costs of maintaining the state's ongoing spending programs relative to revenue available from ongoing sources to determine how large the state's structural deficit is and whether it is likely to grow or shrink under current policies. Adequate staff resources would need to be devoted to the task, but this could be done on either an annual or biennial basis.
- Require annual reporting on the use of one-time revenue sources or budget shifts (e.g., delayed payments) as part of the state budget, as the use of those budgetary devices contributes directly to long-term structural budget problems.

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The goal of any changes to the state budget process should be to make both the short-term and long-term fiscal impacts of legislative decisions more explicit and transparent, both to policy makers and the general public. Ideally, such procedural changes would discourage adoption of policy changes that contribute to or exacerbate the State's ongoing structural budget deficit and facilitate the ability of policy makers to eventually bring ongoing expenditures in line with ongoing revenue sources.

The Commission recommends that the legislature adopt procedural changes that will encourage fiscal discipline and provide a long-term perspective on the impact of current policy and proposed policy changes.

REVIEW STATE'S TAX STRUCTURE FOR CHANGES THAT WOULD RESULT IN A STABLE REVENUE BASE

Key Findings and Recommendations:

The State’s current tax system – and in particular the level of tax expenditures – has been a key contributor to the structural budget issues:

- From 2000 to 2010, total state revenues measured as a percent of total state personal income declined $9 billion, from 9.55% of state personal income to less than 7.0% of personal income
- State income tax collections declined from 2.8% of personal income in 2000 to 1.52% of personal income in 2010 even though the rate increased
- State sales/use tax collections have declined from 2.99% of personal income in 2000 to 2.06% of personal income in 2010 even though the rate has not changed
- Between 1998 and 2008, the value of so-called "tax expenditures" – tax exemptions, deductions or credits – grew $13 billion faster than total State revenue

The Commission recommends that the legislature

- Establish a joint legislative committee to examine and make recommendations regarding tax policy options that would
  - Produce revenue changes more consistent with changes in the state economy
  - Broaden the tax base by eliminating tax expenditures
  - Lower tax rates
- Require a regular review of state tax expenditures and/or sunset provisions on new tax expenditures to ensure that there are regular evaluations of whether tax expenditures are meeting their policy objectives

Changes to the State’s current tax structure and elimination of tax expenditures could both reduce the structural budget deficit and allow the legislature to reduce marginal tax rates, much the way the federal government did with the Tax Reform Act of 1986.

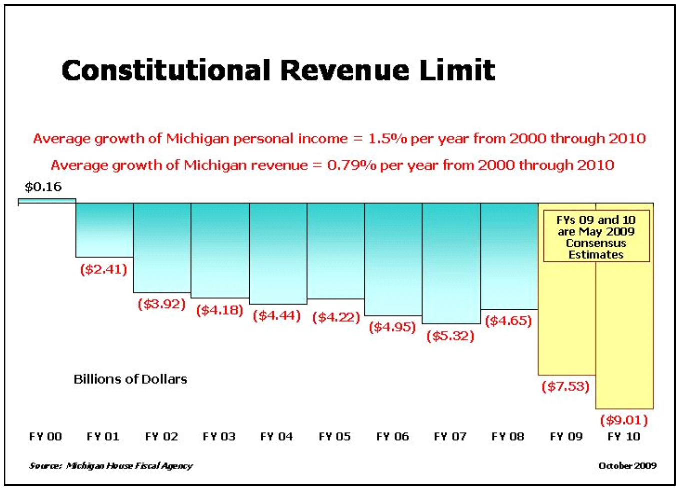
Background

Although beyond the scope of the Commission's statutory mandate, solving the State's structural problems will require an examination of the State's tax base and tax expenditures in order to stabilize the current tax base. The following statistics demonstrate the magnitude of the current problem:

Constitutional Revenue Limit

- Article IX, Section 26 of the State Constitution--added in 1978 as part of the "Headlee Amendments"--imposes a limit on the amount of revenues the State can collect (excluding federal revenues) equal to 9.49% of the State's personal income
- In FY 1999-2000, the State collected almost exactly the amount of revenue allowed under the revenue limit ($160 million over)
- In contrast, the amount of revenue collected by the State in FY 2009-10 is projected to be more than $9.0 billion below the constitutional revenue limit--an amount significantly larger than any current source of state tax revenue and larger than total General Fund/General Purpose spending in the current fiscal year. [See graph.]
- Over the ten-year time period, state revenue as a percentage of the State's personal income has declined from 9.55% to 6.94%

- Given that personal income is a reasonable measure of the size of the State's economy, this decline demonstrates that the State's tax system has not kept pace with the State's relatively meager economic growth over the last decade



Major State Taxes

- The two largest sources of revenue for the State of Michigan are sales and use taxes (estimate of $7.3 billion for FY 2009-10) and the state income tax (estimate of $5.4 billion for FY 2009-10)
- State sales / use tax collections have declined from 2.99% of personal income in FY 1999-2000 to 2.06% of personal income in FY 2009-10--even though the tax rate is the same as it was ten years ago
- State income tax collections have declined from 2.8% of personal income in FY 1999-2000 to 1.52% of personal income in FY 2009-10--even though the tax rate has increased from ten years ago. [See table.]
- The decline in sales / use tax revenue as a percentage of personal income over the last decade is largely attributable to the continuing shift in consumer expenditures from taxable good to nontaxable services.

The decline in income tax revenue as a percentage of personal income has resulted from a combination of demographic and economic shifts as well as tax policy changes (such as the Earned Income Tax Credit)

Major Revenue Sources
as a Percentage of State Personal Income

State Tax	FY 1999-2000	FY 2009-10	*% Change
Sales/Use Tax	2.99	2.06	-31.1%
Income Tax	2.80	1.52	-45.7%
Total State Revenue Collections	9.55	6.94	-27.3%

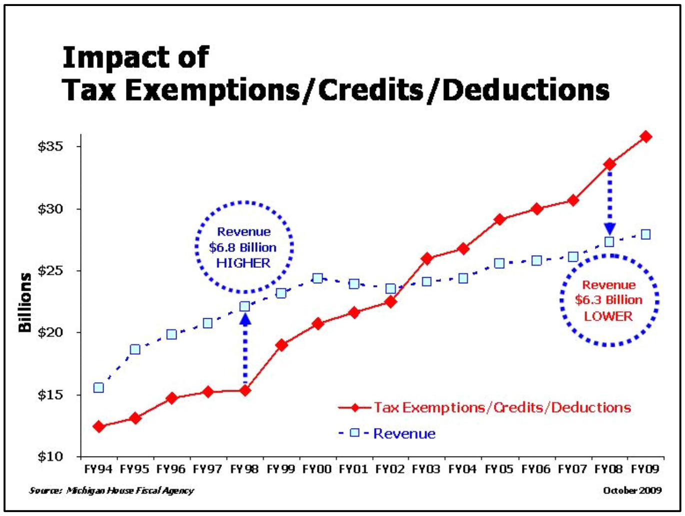
Note: FY 2009-10 amounts are estimates
**Percentage reduction in share of state personal income collected through tax source*

Tax Expenditures

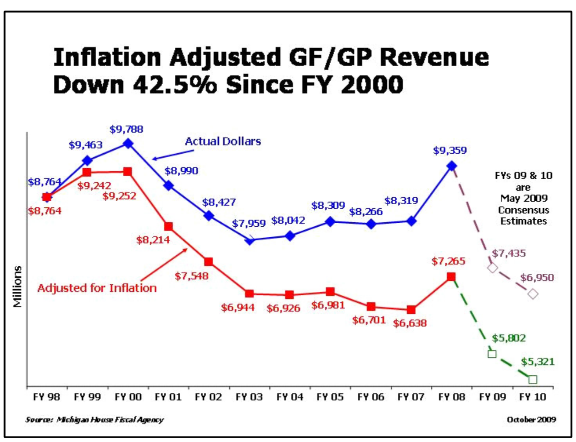
A tax expenditure is an exemption, deduction, credit or other provision of tax law that provides a tax benefit to certain taxpayers at the cost of foregoing revenue that would otherwise be collected by the State. Over the past ten years, the number and size of tax expenditures has grown significantly, resulting in increased pressure on an increasingly narrow tax base.

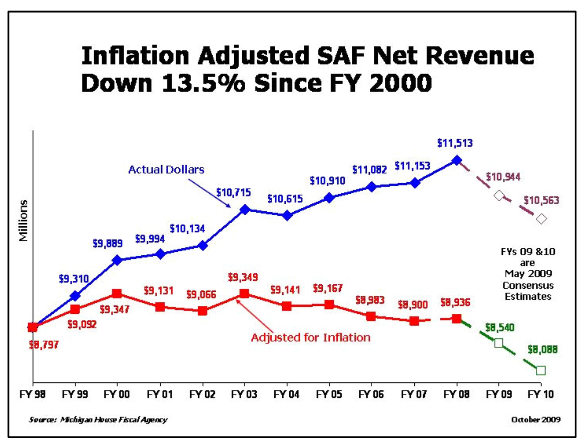
For example, in FY 1997-98, the amount of revenue collected by the State through state taxes was $6.8 billion higher than the total amount of tax expenditures provided under state law. In FY 2007-08, the situation had reversed and the amount of revenue collected was $6.3 billion lower than the total amount of tax expenditures.

The total swing of $13.1 billion over a ten-year period illustrates the substantial amount of revenue foregone by the State--due to either underlying economic shifts or explicit tax policy changes--and, therefore, unavailable for expenditure through the state budget



The practical impact of the trends detailed above on the resources available for programs and services funded by state government has been a decline of 42.5% in inflation-adjusted GF/GP revenue since FY 1999-2000 and a decline of 13.5% in inflation-adjusted School Aid Fund net revenue over the same period. These declines have occurred at a time when demands on government services have increased.





The total amount of state revenue to be collected in FY 2009-10 is projected to be $24.5 billion--as compared to the $33.5 billion the state's constitutional revenue limit would permit. In other words, as measured as a percentage of the State's economy, the resources available to state government are less than 75 percent of what were available ten years ago. This erosion of the State's revenue base has been a significant factor in the recent struggles to balance the State's budget.

Recommendations

Recommendation: *Conduct a review of options to build a more stable state revenue base.*

Changes in the state tax system tend to occur on an ad-hoc basis, or through no action at all, in the case of economic shifts. This can result in unintended long-term effects on the State's tax system.

The legislature could establish a joint legislative committee (and/or direct the existing Finance/Tax Policy committees) to examine and make recommendations regarding tax policy options that would result in long-term growth in Michigan's tax system consistent with growth in the economy of the state. The baseline for this process would be the long-term forecast produced by the Department of Treasury and/or the legislative fiscal agencies under the recommendations contained in the previous section of this report. Experts from the private sector and academia could contribute valuable input as part of this process.

Generally speaking, creating a more stable tax revenue base would involve broadening tax bases and lowering tax rates. The result would be a tax system that produces revenue changes more consistent with changes in the state economy and less likely to experience long-term declines tied to shifts within the state economy, as opposed to overall declines in state economic activity.

By significantly reducing the level of tax expenditures and broadening the tax base, the State could not only offset future spending pressure, but also lower the overall marginal tax rates, much the way the federal government did with the Tax Reform Act of 1986.

Recommendation: *Require a regular review of state tax expenditures and/or sunset provisions on new tax expenditures.*

Unlike state expenditures made through budget appropriations, which have to be approved annually by the legislature, tax expenditures generally continue on an indefinite basis. As an example, a financial aid program receiving an appropriation in the state budget has to reviewed by the legislature each year, whereas a tax credit provided to college students to help offset tuition costs can exist indefinitely without being reviewed. In both cases, state resources are effectively being allocated for the same policy goal.

The legislature could require an annual or biennial legislative review of exemptions, credits, and deductions allowed against Michigan's major state taxes to evaluate the effectiveness of those mechanisms relative to the cost in foregone state revenue. This would ensure that both tax expenditures and budget expenditures are regularly reviewed to determine whether the State should continue to allocate resources toward them. When new tax credits or exemptions are enacted into law, sunset provisions should be considered so that the policy mechanism can be specifically reviewed on a regular basis.

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It will be difficult, if not impossible, to solve the long-term structural budget deficit without bringing the tax structure in line with the State's economy. A more strategic and holistic tax structure and policy could both reduce the structural budget deficit and allow the legislature to reduce marginal rates.

COMMISSIONER STATEMENTS

Commissioner Georgi-Ann Bargamian

Reducing Corrections Costs
Commissioner Bargamian concurs in the report's acknowledgment that sentencing reform is needed to reduce Michigan's prison population. However, she believes that the report falls short by not acknowledging that the articulated recommendations centering on Corrections cost reductions depend largely on sentencing reform measures passing the Legislature.

Commissioner Bargamian dissents from the following recommendation: "Require that MDOC reduce overtime expenditures from nearly $100 million to no more than $50 million." A sounder recommendation would be: "Require MDOC to formulate, implement, and revise as appropriate a prison staffing plan to account for ongoing fluctuations in prison population; proper staffing levels are required to reduce overtime expenditures driven by long-term understaffing and high prison population." The report acknowledges that unfilled corrections officer vacancies and increased prisoner populations due to the state's correctional facility closures continue to be the twin main drivers leading to high overtime costs. Nevertheless, the report does not articulate a recommendation which is consistent with the report's text, as set forth in this dissent.

Local Government and Revenue Sharing
Commissioner Bargamian dissents from the report's Local Government and Revenue Sharing recommendations, presented by the Commission for unified implementation. The package of recommendations proposes fundamental changes to the relationship between the state and local government units inconsistent with Michigan's "home rule" laws.

"Home rule" is embedded in Michigan's history and, as such, has served as the basis for the state's laws which smartly recognize and respect the geographic and economic differences among the state's local government units. This recognition is necessary to allow for their independent growth opportunities. Indeed, "home rule" serves as a balancing and stabilizing factor for the state as a whole.

Implementing the Commission's package of recommendations – which were generally opposed by public elected officials testifying at the Commission's August 2009 public hearings – would create unavoidable deep inequities among Michigan local government units and dilute or remove altogether local government decision-making authority over what works best for that local government's constituents. This dynamic would be neither efficient nor economically wise.

Medicaid/Department of Community Health
Co-Chairman Curran and Commissioner Bargamian dissent from the Commission's general recommendation to "[e]liminate or reduce funding for certain select services" with respect to the specific recommendation, "The State should also consider further consolidation of, or closure of, state psychiatric hospitals. Savings are likely to be realized for those patients who are clinically appropriate to transfer to either outpatient or community based settings."

Whereas 20 years ago Michigan supported 15 public psychiatric hospitals, as of the date of this report, there are only three state adult psychiatric hospitals remaining: Caro Center, Caro; Kalamazoo Psychiatric Hospital, Kalamazoo; and Walter Reuther Psychiatric Hospital, Westland. These three hospitals are the only Michigan public institutions left to serve the most severe adult psychiatric cases and each facility is already stretched thin to serve the needs of psychiatric residential clients for the entire state.

Further dismantling Michigan's already overtaxed public psychiatric adult in-patient system will not save the state money. Rather, additional closures will only shift those care costs to other budgets, including those of the Michigan Department of Corrections and local jails and county community mental health agencies. Surely, such a move would not generate long-term savings for the state or be in the best interest of those being served at Michigan's three remaining adult in-patient psychiatric hospitals.

Reducing Higher Education Costs
Commissioner Bargamian dissents from the Commission's recommendation to eliminate the Michigan Promise Grant Program. She concurs with the portion of the recommendation that advocates "restructuring" the program to include a

needs-based component. The state's distressed economic situation requires access to education more than ever as Michigan works to diversify its economy and reverse "brain drain." Total elimination of the Promise Grant is counter to those connected economic diversification and population retention goals.

K-12 Education/School Aid

Commissioner Bargamian dissents from the Commission's recommendation to reallocate $300 million from the state school aid fund to fund community colleges. The recommendation is supported by a secondary recommendation to partially "offset" this financial hit by having the state offer a $5,000 voluntary retirement incentive to high seniority school employees, with the local entity offering an additional $5,000 matching retirement incentive.

The recommendation places K-12 education in a needless precarious position and relies on a partial offset cushion that is likely not to materialize in light of the state's current economic situation and the reality that school employees who are of retirement age cannot afford to retire.

A more fruitful area to examine for savings would be K-12 and community college employee retirement costs and moving separate retirement plans to a state system. This consolidation could reduce widespread administrative costs that currently are incurred to local systems.

Commissioner Bargamian also dissents from the recommendation permitting the consolidation of school districts based on a minimum 5 percent savings trigger. Although the State Superintendent may have the authority to order such consolidation, Commissioner Bargamian believes that this recommendation is not realistic and could not be unilaterally imposed politically because of local opposition to forced consolidation from students, parents and guardians, and school employees and administrators. Commissioner Bargamian also opposes an arbitrary financial savings trigger to force consolidation, which will not address or assuage local opposition.

A better recommendation would be to bring together constituent groups of the school district community to discuss and formulate a voluntary consolidation plan that would have the support of such constituent groups to better ensure a successful and smooth consolidation mechanism for the sake of students and school employees. Indeed, legislation is pending in Michigan House of Representatives calling for the formation of such a group.

Public Employee Health Benefits

Commissioner Bargamian dissents from each of the Commission's recommendations. Although the Commission has couched its recommendations in terms that advocate additional assessment and study by retained "professional consultants," what the Commission is really recommending is that Michigan's state, local, and school employees and their employers lose control in determining the appropriate level of health care benefits that works for them.

The recommendations are based on flawed assumptions so that the claimed savings touted as potentially garnered by implementing the recommendations are grossly overstated. This is because the recommendations assume that huge public employee health care pools don't exist already (they do) and that public employees are not paying as much for their health care costs as they should be (they are).

Although the Commission has denied that its recommendations are different from those pending in House Bill 5345 - the "Dillon" health care bill – careful examination of the Commission's recommendations and pending House Bill 5345 shows that any distinctions are without a difference.

The reality is that Michigan public employees are currently in large health care pools and economic savings to be obtained through finding further administrative pooling efficiencies are nil. Further, the recommendations ignore the fact that health care benefits are part of a total employee compensation package, and Michigan public employers – and the State – will not be able to attract the best and brightest employees to work in the public sector if control over a critical component of that total compensation package is decimated.

Tellingly, at the Commission's August 2009 public hearings on its then-interim recommendations, both public employees and local and school government administrators and elected officials opposed these recommendations because they understood that they would lose control over the decision-making process on what total compensation should be, whether *determined in the collective bargaining process for union-represented employees or on some other basis in non-unionized settings.*

In addition, with national health care changes on the horizon – but still unknown – it is inefficient and counterproductive to offer such recommendations at this time.

An October 19, 2009 paper dismantling the efficacy of House Bill 5345 – and thus, the substance of the Commission's public employee health care recommendations – can be found at www.publicpolicy.com. The paper is entitled, "Review and Analysis of Speaker Dillon's Proposal for a Mandatory State Government-Run Public Employee Health Insurance Plan."

Sustained Efficiency Within Departments

Commissioner Bargamian dissents from this section's recommendation that "[t]he civil service rules should be modified to allow managers to provide merit recognitions for excellent performers and hold non performers accountable." The current Michigan Civil Service Commission rules and regulations do not preclude managers from evaluating their employees and "holding non performers accountable." Indeed, supervisors are required to provide annual reviews of classified employee performance and more frequent reviews if classified employees are not doing their jobs.

Civil Service Rule 2-3, Performance Ratings, details that supervisors are required to make probationary, annual, interim, and follow up ratings for classified employees. The rule also sets forth the penalties a classified employee will receive for garnering an unsatisfactory evaluation and the rewards generated by a positive evaluation.

If supervisors are unaware of their stated performance evaluation responsibilities as already set forth in the Civil Service Rules – or reluctant to perform them – perhaps a more appropriate recommendation would center on management staff training to ensure that supervisory personnel are following the specific Civil Service rules centering on mandatory performance evaluations and concomitant rewards and penalties associated with such evaluations.

Commissioner David Leonard

Local Government and Revenue Sharing

In this Commissioner's personal view, the Local Government and Revenue Sharing recommendations should more emphatically embrace consolidation of local units of government. Although significant efficiencies and cost savings could be achieved through collaboration between local units of government with regard to the provision of certain services, great opportunity also exists in the consolidation of local units of government. One case in point is Kent County, Michigan, which was the subject of a 2001 study stating: "In our regular elections in Kent County, we elect 637 people to run local government in the County. They make up 47 local units of government: The county, 12 cities, 29 townships and 5 villages. In addition to the mayors, supervisors, and village presidents, all of them have councilmen, city managers, deputy city managers, planning directors, police chiefs, fire chiefs, public works directors, city attorneys, clerks, treasurers, assessors, librarians, park directors, etc. In the aggregate, they spend $625,000,000 every year. If we could just streamline these units of government by 5%, it would free up over $30 million year after year after year." Consolidation should not be undertaken just for the sake of consolidation, but instead only in situations where local leadership determines that units may be consolidated in a manner which (1) saves significant amounts of taxpayer dollars; and (2) continues to serve the residents, businesses and other constituencies of the consolidated units both efficiently and responsively. Michigan statutes and the Michigan Constitution should be reviewed and amended to grant cities, villages, townships and counties the ability to freely consolidate if local government leaders, voters and taxpayers determine that such consolidation is in the best interests of the constituencies of the local units.

Commissioner Kevin Prokop

Higher Education

Commissioner Prokop is supportive of restructuring the Michigan Promise Grant and the other higher ed recommendations but would also support establishing a body to oversee higher education spending that would focus on ways to maximize the efficiency of the State's investment in higher education by better coordinating the delivery of certain educational programs.

IN SUMMARY

In summary, the Legislative Commission on Government Efficiency is pleased to present this report of recommendations to consolidate, streamline, and make more efficient the functions of state government. This report represents eighteen months of work and the collective input of the public, members of the Senate and House Fiscal Agencies, the executive branch, experts in the respective areas of focus, and other affected interest groups. Our recommendations relate to each major area of the State's budget and several areas that cross units of government.

Our goal is not to make recommendations that could solve the fiscal issues in any one year, but rather to make recommendations that, in total, represent a "roadmap" towards fiscal stability for the State. Because the budget problems are so large and because they are deep-rooted in the structure of the State’s government and budget, we believe that any sustainable and lasting changes will require a different approach to solutions. In particular, any recommendations must think broadly and holistically about the solutions and look to optimize service delivery across all units and levels of government. They must also be aspirational and of sufficient magnitude to make a difference in light of realistic revenue forecasts given Michigan’s tax base.

We believe the recommendations in this report collectively satisfy these objectives. In total, they represent annual savings opportunities of $1.5 billion, achievable over several years.

We also wish to emphasize that, while many of our recommendations can be implemented in the near term and are relatively "easy" fixes; many will have to be implemented over several years and will be more difficult. We believe, however, that the situation today requires bold action and tough choices. Michigan's economy has fundamentally changed and the need for structural reform has become more acute. It is clear that the State's budget can no longer reflect the era of a wealthier state.

While the magnitude of the changes required in total are substantial in many respects, we remain optimistic that solid and significant changes like those we are recommending can lead to the return of the State of Michigan to solid fiscal condition and free up resources that can be invested in services and other areas that will generate growth and opportunity for the people of our State.

It is important to remember that this report is only a first step. The ultimate success of our efforts will depend on the implementation of our recommendations. To that end, we pledge our full cooperation and stand ready to assist in whatever manner necessary to facilitate the execution of our recommendations into reality.

APPENDIX

Act No. 96
Public Acts of 2007
Approved by the Governor
October 1, 2007
Filed with the Secretary of State
October 1, 2007
EFFECTIVE DATE: October 1, 2007

STATE OF MICHIGAN
94TH LEGISLATURE
REGULAR SESSION OF 2007

Introduced by Senators Kahn, Richardville, Patterson, Kuipers, Birkholz, Gilbert, Pappageorge, Jelinek and Brown

ENROLLED SENATE BILL No. 396

AN ACT to amend 1986 PA 268, entitled "An act to create the legislative council; to prescribe its membership, powers, and duties; to create a legislative service bureau to provide staff services to the legislature and the council; to provide for operation of legislative parking facilities; to create funds; to provide for the expenditure of appropriated funds by legislative council agencies; to authorize the sale of access to certain computerized data bases; to establish fees; to create the Michigan commission on uniform state laws; to create a law revision commission; to create a senate fiscal agency and a house fiscal agency; to create a Michigan capitol committee; to create a commission on intergovernmental relations; to prescribe the powers and duties of certain state agencies and departments; to repeal certain acts and parts of acts; and to repeal certain parts of this act on specific dates," (MCL 4.1101 to 4.1901) by adding chapter 7A; and to repeal acts and parts of acts.

The People of the State of Michigan enact:

CHAPTER 7A

Sec. 751. As used in this chapter:
(a) "Commission" means the legislative commission on government efficiency established in this chapter.
(b) "State agency" means 1 or more of the following:
(*i*) A department, commission, authority, or board in the executive branch.
(*ii*) The supreme court, court of appeals, state court administrative office, or other commission, office, or agency in the judicial branch.

Sec. 752. (1) The legislative commission on government efficiency is created within the legislative council.

(2) The commission shall consist of the following 9 members:
(a) One member appointed by the speaker of the house of representatives.
(b) One member appointed by the minority leader of the house of representatives.
(c) The director of the house fiscal agency.
(d) One member appointed by the majority leader of the senate.
(e) One member appointed by the minority leader of the senate.
(f) The director of the senate fiscal agency.
(g) Three members jointly selected by the speaker of the house of representatives and the majority leader of the senate.

(3) The members first appointed to the commission shall be appointed within 60 days after the effective date of the amendatory act that added this chapter.

(4) Members of the commission shall serve for a term of 3 years. A member of the commission shall discharge the duties of his or her position in a nonpartisan manner, with good faith, and with that degree of diligence, care, and skill that an ordinarily prudent person would exercise under similar circumstances in a like position.

(5) Except for the members appointed under subsection (2)(c) and (f), public employees are not eligible to be a member of the commission. A person with a business or financial interest in a contract with this state is not eligible to be a member of

the commission. Members of the commission shall be individuals who have knowledge of, education in, or experience with the best practices of 1 or more of the following fields:
(a) Organizational efficiency.
(b) Government operations.
(c) Public finance.
(d) Administrative law.

(6) If a vacancy occurs on the commission, the member shall be replaced in the same manner as the original appointment.

(7) The first meeting of the commission shall be called by the speaker of the house of representatives not later than 60 days after the effective date of the amendatory act that added this chapter. The member appointed by the majority leader of the senate and the member appointed by the speaker of the house of representatives shall be co-chairpersons of the commission. The chairperson position shall rotate each month between the co-chairpersons. The member appointed by the speaker of the house of representatives shall be the chairperson of the commission for the first month. At the first meeting, the commission shall elect from among its members other officers as it considers necessary or appropriate. After the first meeting, the commission shall meet at least monthly, or more frequently at the call of the chairperson for that month or if requested by 3 or more members.

(8) A majority of the members of the commission constitute a quorum for the transaction of business at a meeting of the commission. A majority of the members are required for official action of the commission.

(9) The business that the commission may perform shall be conducted at a public meeting of the commission held in compliance with the open meetings act, 1976 PA 267, MCL 15.261 to 15.275.
(10) A writing prepared, owned, used, in the possession of, or retained by the commission in the performance of an official function is subject to the freedom of information act, 1976 PA 442, MCL 15.231 to 15.246.

(11) Members of the commission shall serve without compensation. However, members of the commission may be reimbursed for reasonable and necessary expenses incurred in the performance of their official duties as members of the commission, subject to available appropriations.

(12) Not later than December 31, 2008, the commission shall do all of the following:
(a) Review and investigate ways to make state government more efficient.
(b) Review, investigate, and collect information necessary to evaluate all functions and services provided by each state agency, including, but not limited to, all of the following:
(*i*) Human resource duties and responsibilities.
(*ii*) Payroll services.
(*iii*) Internal auditing, accounting, and financial services.
(*iv*) Purchasing programs.
(*v*) Printing services.
(*vi*) Mail services.
(*vii*) Maintenance services.
(*viii*) Janitor or cleaning services.
(*ix*) Motor vehicle fleet operations.
(*x*) Transportation services.
(*xi*) Fiscal analysis.
(c) Determine the complete cost of each function or service performed by a state agency.
(d) Determine the total number of FTEs for each function or service performed by a state agency.
(e) Determine how each function or service is funded in each state agency.
(f) Determine the total and complete cost of all functions and services combined.
(g) Review and investigate all funded and unfunded mandates imposed on state agencies in state law.
(h) Review and investigate all reporting requirements imposed on state agencies in state law.
(i) Determine the complete cost of each funded and unfunded mandate imposed on a state agency in state law.
(j) Determine the complete cost of each reporting requirement imposed on a state agency in state law.

(13) Not later than October 1, 2009, the commission shall make specific determinations of the items described in subsection (12) and report those determinations to each house of the legislature and the governor. The commission shall also make an interim report to each house of the legislature and the governor on the status of its determinations of the items described in subsection (12) not later than June 1, 2009.

(14) The governor may direct that state agencies subject to the supervision of the governor under section 8 of articleV of the state constitution of 1963 provide information to the commission to assist the commission in fulfilling its duties under this section. Upon request of the commission, the commission shall be given access to all information, records, and documents in the possession of a state agency that the commission considers necessary to fulfill its duties under this section. The commission may hold hearings and may request that any person appear before the commission, or at a hearing, and give testimony or produce documentary or other evidence that the commission considers relevant to its duties under this section.

(15) In connection with its duties under this section, the commission may request the legislative council to issue a subpoena to compel the attendance and testimony of witnesses before the commission or to compel the production of a book, account, paper, document, or record related to the duties of the commission under this section. The legislative council may issue the subpoena only upon the concurrence of a majority of the house members and a majority of the senate members of the legislative council. A person who refuses to comply with a subpoena issued by the legislative council under this subsection may be punished as for contempt of the legislature.

Enacting section 1. Chapter 7A of the legislative council act, 1986 PA 268, MCL 4.1751 to 4.1753, is repealed effective September 30, 2010.

Enacting section 2. This amendatory act does not take effect unless all of the following bills of the 94th Legislature are enacted into law:
(a) House Bill No. 5194.
(b) House Bill No. 5198.

This act is ordered to take immediate effect.

Secretary of the Senate
Clerk of the House of Representatives
Approved
Governor

Act No. 97
Public Acts of 2007
Approved by the Governor
October 1, 2007
Filed with the Secretary of State
October 1, 2007
EFFECTIVE DATE: October 1, 2007

STATE OF MICHIGAN
94TH LEGISLATURE
REGULAR SESSION OF 2007

Introduced by Senators Richardville, Patterson, Kuipers, Kahn, Pappageorge, Gilbert, Birkholz, Jelinek and Brown

ENROLLED SENATE BILL No. 397

AN ACT to amend 1986 PA 268, entitled "An act to create the legislative council; to prescribe its membership, powers, and duties; to create a legislative service bureau to provide staff services to the legislature and the council; to provide for operation of legislative parking facilities; to create funds; to provide for the expenditure of appropriated funds by legislative council agencies; to authorize the sale of access to certain computerized data bases; to establish fees; to create the Michigan commission on uniform state laws; to create a law revision commission; to create a senate fiscal agency and a house fiscal agency; to create a Michigan capitol committee; to create a commission on intergovernmental relations; to prescribe the powers and duties of certain state agencies and departments; to repeal certain acts and parts of acts; and to repeal certain parts of this act on specific dates," (MCL 4.1101 to 4.1901) by adding section 753.

The People of the State of Michigan enact:

Sec. 753. In addition to the report required under section 752, not later than December 1, 2009 the commission shall report to each house of the legislature recommendations on how to consolidate, streamline, and make more efficient the functions and services conducted by state agencies, including, but not limited to, recommended reforms to reduce the number of position classifications and layers of management positions within state agencies and to assure greater consistency within state agencies and throughout this state in the application of administrative rules and standards consistent with state law.

Enacting section 1. This amendatory act does not take effect unless all of the following bills of the 94th Legislature are enacted into law:
(a) House Bill No. 5194.
(b) House Bill No. 5198.

This act is ordered to take immediate effect.

Secretary of the Senate
Clerk of the House of Representatives
Approved
Governor

Legislative Commission on Government Efficiency
Summary of Activities to Address Statutory Obligations

The Legislative Commission on Government Efficiency has reviewed detailed information, including an updated written report from the Department of Management & Budget, and received extensive testimony in response to the directives in Public Act 96 of 2007, Sec 12. Four of the Commission's first five meetings were devoted to data gathering, which included receiving testimony from the Directors of the Department of Management, Information Technology, Civil Service and other state agencies, plus the Office of the Secretary of State. The Directors of the Senate and House Fiscal Agencies provided information regarding the state budget process, budget summaries, and directed us to House and Senate Fiscal Agencies' sites that provided departmental budgets by program and FTEs. We reviewed and discussed the House Fiscal Agency's document "The Reports Required by Boilerplate".

The Commission also received outside views on the State's fiscal projections from The Citizen's Research Council and Michigan Fiscal Responsibility Project besides those of the House and Senate Fiscal Agencies. In addition, we have received testimony from Michigan State AFL-CIO, Michigan AFT, Council 25 on AFSCME plus Michigan SEIU and a representative of SEIU Local 517M.

While the Commission has spent considerable effort to fulfill its obligations under the statute, the eleven areas of State government operations to be studied by the Commission amounted to only 1.6% of the State's estimated total expenditures in FY 2008. In light of the relatively small percentage of the State budget this represents and the progress the Department of Management and Budget has made in the areas to be reviewed pursuant to Section 12, the Commission has focused much of our attention on larger structural issues and will begin conducting public hearings around the State before finalizing recommendations to the Michigan Legislature and the Governor.

More specifically, with regard to Sec. 12:

(a) The State Budget Director, Office of the State Budget, and state departments have been forced to address budget challenges and resolve growing budget deficits since 2001, when Michigan's recession began. Cost-saving measures have been and continue to be implemented in all areas of state government operations. Cash savings and cost avoidance have been and will continue to be obtained through efficiencies, programmatic changes, and consolidation of services.

(b) The Commission collected information necessary to evaluate functions and services provided by state agencies, in particular, those functions and services listed in Sec. 12 (b). Since 2003, the Department of Management and Budget (DMB) has identified over $2.7 billion in cost reductions or future cost avoidance through very specific actions. Below are examples of activities and savings amounts generated:

- $762.1 million in savings from implementing purchasing controls, such as reviewing contracts; re-opening contracts for price concessions; re-bidding contracts; prohibiting certain contracts; requiring justification for memberships, dues, and subscriptions; mandating the use of online resources; and restricting and/or eliminating procurement card usage.
- $1.5 billion in retirement savings derived from actuarial assumption changes adjusting investments to current market value; taking advantage of the Medicare Advantage plan for public school and state employees; encouraging the use of mail order prescription services; making retiree health plan adjustments; implementing Medicare Part D; and re-bidding pharmaceutical contracts for state and public school retirees.
- $116.3 million in savings from refinancing existing State Building Authority bonds and taking advantage of declining interest rates wherever possible.
- $146.2 million in savings from lease/rent reductions, such as consolidating state office space; approaching all rental property owners for voluntary rent concessions; canceling leases; taking advantage of public/private partnerships; moving tenants into downtowns; and co-locating complementary functions and operations.
- $73.7 million in savings from the sale of surplus property, eliminating maintenance expenses for property sold, and continuing to review property holdings for property that is no longer needed.
- $72.7 million in savings from implementing aggressive energy reduction efforts, such as requesting "power down"; installing software that integrates building heating, ventilation, and air conditioning; installing daylight harvesting ballasts; instituting energy audits; installing energy-saving technology; implementing other conservation measures; consolidating electric bills for multiple buildings in order to take advantage of non-peak rates; and entering into an energy-purchasing consortium that enables the State to buy energy at a reduced rate.
- $2.2 million in savings from reducing building maintenance and janitorial services, such as reducing the levels of frequency for janitorial, trash hauling, and other operational services in State-owned and leased buildings.

- $2.9 million in savings from reducing building security costs by using technology and automating building access controls in order to reduce guard usage.
- $.5 million in savings from reducing printing services, and, in some cases, eliminating the use of color copiers.
- $28.6 million in savings for redesigning mail services, such as purchasing advanced presort equipment to increase presort savings on outbound mail; eliminating non-critical mailings; receiving additional postage discounts due to technology and improved read rates; and improving mail design.
- $5.2 million in savings in the area of transportation services achieved by canceling parking leases, eliminating shuttle bus services from remote parking lots, and using state employees to transport interdepartmental mail and packages between state facilities instead of the U.S. Postal Service.
- $.8 million in savings from reducing, and, in some cases, eliminating cell phone usage.
- $18.7 million in savings from reductions in vehicle fleet services, such as consolidating fleet management operation in DMB; negotiating a new fleet management contract; reducing the size of the fleet; reviewing vehicle assignments; implementing strict usage guidelines; eliminating personal usage of vehicles; eliminating on-site car washes; enhancing fuel card controls; improving fleet maintenance; creating additional motor pools in out-state areas for multi-departmental use; implementing a contract with a rental vendor for occasional vehicle use in areas where a motor pool is not practical; and encouraging employees to utilize personal vehicles when it is in the economic best interest of the State.

In addition, human resources duties and responsibilities, payroll services, and internal auditing services have been consolidated.

(c), (d), (e), and (f)
There are numerous documents provided by both the House and Senate Fiscal Agencies, via hard copy and the Internet, which provide the information required by subsections (c), (d), (e), and (f). In particular, line item summary documents and program description documents are provided by the fiscal agencies and state departments. These documents give details on programs/services funded by the state, sources of funding for programs/services, FTE positions associated with programs/services, and the legal basis for programs/services.

(h) and (j)
The House Fiscal Agency annually provides, via hard copy and the Internet, a report which lists all reporting requirements contained in boilerplate in each of the budget bills. With regard to the costs associated with reporting requirements, the Legislature has put forth a concerted effort over the past 10 years to eliminate requirements for reports which cost state departments money to produce. Also, reports are now required to be posted on the Internet in order to save on printing, mailing, and other distribution-related costs.

(g) and (i)
With regard to funded and unfunded mandates imposed on state agencies, the Legislature has taken action to require that funding be provided for new mandates when implemented.

STATE OF MICHIGAN
DEPARTMENT OF MANAGEMENT & BUDGET
LANSING

JENNIFER M. GRANHOLM
GOVERNOR

LISA WEBB SHARPE
DIRECTOR

June 3, 2009

MEMORANDUM

TO: Jim Curran, Co-Chair, Legislative Commission on Government Efficiency
Kevin Prokop, Co-Chair, Legislative Commission on Government Efficiency

FROM: Lisa Webb Sharpe, Director LWS
Department of Management and Budget

SUBJECT: DMB Efficiencies Since FY 2003

EFFICIENCY COMMISSION

Public Act 96 of 2007 created the Legislative Commission on Government Efficiency (LCGE). The statute listed eleven areas of State government operations to be studied by the LCGE. In FY2008, estimated spending in these areas, allocated across five State agencies, amounted to 1.6% of estimated total expenditures.

The Department of Management and Budget (DMB) responsibilities are divided into those managed by the State Budget Office and those services provided by the management side of DMB. Seven of the areas listed in the Act are the responsibility of DMB management.

The DMB management-related items are:

- Purchasing programs
- Printing services
- Mail services
- Maintenance services
- Janitorial or cleaning services
- Motor vehicle fleet operations
- Transportation services

An additional item, not addressed in the statute, but discussed in the LCGE Purchasing Workgroup was:

- Real estate operations

The following items included in PA 96 are addressed by other agencies:

- Internal auditing, accounting, and financial services – State Budget Office
- Payroll services - Civil Service Commission

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- Fiscal analysis – State Budget Office
- Human resource duties and responsibilities - Civil Service Commission

Below you will find an overview of the cost-saving measures implemented by DMB since FY 2003 in all areas of our operations. This includes both cash savings and cost avoidance through efficiencies, programmatic changes, and consolidation of services. Following the narrative, you will find a spreadsheet which lists the savings and cost avoidance by category, limited to the DMB items listed in the statute (Attachment A).

THE CHALLENGE
Due to Michigan's recession which began in 2001, the budget challenges have been enormous. Since taking office in 2003, Governor Jennifer M. Granholm has been forced to resolve nearly $6 billion in budget deficits, including over $3 billion in cuts to State programs. In 2009, the State is expecting another $1.3 billion shortfall.

Despite the challenges, Michigan government continues to receive recognition for good management practices. In both 2006 and 2008, the Pew Center's Government Performance Project, in conjunction with *Governing Magazine,* has consistently identified Michigan as one of the best managed states.

DMB-RELATED COST SAVINGS
Since 2003, DMB has identified over $2.6 billion in cost reductions or future cost avoidance through very specific actions. Here are some of those activities:

Purchasing controls:
Reducing the State's spend within its $23 billion contract portfolio was a high priority. The Purchasing Operations staff engaged in several rounds of contract reviews, including the use of a spend analysis contractor and re-opening of most major contracts for price concessions. Current contracts were rebid if savings seemed possible. Certain types of contracts were prohibited. Memberships, dues, and subscriptions required justification. Use of on-line resources was mandated wherever possible. Since 2003, through all these contract actions, the State realized over $756 million in true cost reductions or future cost avoidance. Today, emphasis is on ensuring Michigan businesses benefit from State contracts wherever cost and quality are equal.

Retirement savings:
Actuarial assumption changes adjusting investments to current market value, taking advantage of the Medicare Advantage plan for public school and State employees, encouraging the use of mail order prescription services, retiree health plan adjustments, and implementation of Medicare Part D all contributed to $1.5 billion in savings. Currently, pharmaceutical contracts for State and public school retirees are being rebid around a transparent pricing model. This approach shows promise for significant additional health care savings.

Refinancing of State Building Authority bonds:
Taking advantage of declining interest rates, the State chose to refinance existing bonds whenever possible. While this slowed in 2008/2009 due to the current financial crisis, the State realized $116.3 million in savings on future principal and interest payments.

Lease/rent reductions:
DMB engaged in an aggressive campaign to consolidate State offices into State-owned space wherever possible and approached all rental property owners for voluntary rent concessions. Space reductions and lease cancellations resulted in over $146 million in savings over existing lease terms. Consolidated space planning is now underway to address statewide data center needs, regional office buildings, and lab projects. Strategic real estate planning includes taking advantage of public/private partnerships, moving tenants into downtowns, and co-location of complementary functions and operations. While rental rates may have stabilized, costs associated with multiple telecommunications networks and excess common space from multiple building locations still show promise for additional savings.

Sale of surplus property:
The sale of excess real estate generated $71 million in revenue and eliminated $2.5 million in maintenance expenses. The state continues to review its property holdings for property that is no longer needed. Future sales are likely.

Aggressive energy reduction efforts:
Energy reduction efforts began with simple "power-down" requests, saving over $770,000 in two years. With the issuance of an Executive Directive requiring additional energy savings, efforts were implemented including installation of software that integrates building heating, ventilation and air conditioning, installation of daylight harvesting ballasts in several State office buildings, instituting energy audits in all buildings, installing energy-saving technology, and implementing other conservation measures. The result: a 23% reduction in energy use at State facilities. If this reduction had not been achieved, the State would have paid an additional $31 million in annual utility costs due to utility rate increases. As a result of energy consumption savings, the State has avoided approximately $70 million in additional expense as utility rate increases have occurred since 2006. Additionally, to offset rate increases, the department entered into an energy-purchasing consortium that enables the State to buy energy at a reduced rate. This has resulted in $1.8 million in savings since 2004. Recently, Governor Granholm challenged State government to further reduce our reliance on fossil fuels for generating electricity by 45% from 2003 levels by 2020. This approach will require an investment in both renewable energy and energy efficient technologies. We currently are seeking American Recovery and Reinvestment Fund Act (ARRA) funds to assist with this.

Building maintenance and janitorial services:
Reductions have been taken in levels of janitorial service, trash hauling, and other operational costs in State-owned and leased buildings. Annual savings are estimated at $2.1 million. Parking leases have been cancelled and shuttle bus service eliminated from remote parking lots saving $750,000. The cost of maintenance services has been benchmarked to Buildings Owners and Managers Association (BOMA) national standards. DMB services are provided at rates that are at a minimum 10% and $1.66 to $7.58 per square foot below those national standards for office buildings in the government sector.

Building security:
After 9/11, the State increased the presence of building security services at considerable cost. Through the introduction of technology, these costs have been reduced by $2.9 million with more reductions expected as building access controls are further automated.

Miscellaneous administrative savings:
Little things add up to big dollars.

- The State purchased advanced presort equipment to increase presort savings on 72 million pieces of outbound mail annually, resulting in incremental presort savings over FY2003 levels. The State's presort savings are over $5 million annually, covering the cost of new equipment, offsetting postal service rate increases and promising returns for many years to come.
- DMB regularly evaluates whether use of State employees to transport inter-departmental mail and packages between major State facilities results in savings. That analysis indicates that the State saves annually about $1.9 million over the U.S. Postal Service's standard postage rates which would be required if no service was provided.
- Cell phone usage was reviewed and plans consolidated, saving $772,000.
- Procurement card assignments were reviewed and procurement card purchase limits on types of purchases were instituted resulting in savings of $6.3 million.
- Color copiers were turned off saving $525,000.

Fleet savings:
The State of Michigan has a consolidated fleet management operation in DMB, including responsibility for all State vehicle assignments, acquisition, maintenance, resale, and fueling. With two Executive Directives issued by Governor Granholm requiring fleet reductions, all vehicle assignments were reviewed with departments with strict usage guidelines implemented. As a result of these reviews, over 2,600 vehicles were removed from the State fleet at a projected savings of $18.7 million since 2003. Strict targets for fleet size were given to each department. The State already had significant limitations on personal use of vehicles by any State employee. Those limitations were further tightened as department directors, judges and justices turned in vehicles that had been allowed for limited personal use.

On-site car washes were eliminated, fuel card controls enhanced, and a new fleet management contract was negotiated. Fleet maintenance, which had been largely outsourced to a network of discounted repair shops and dealerships statewide, was scrutinized for repair trends that could be improved. Vehicle purchases with longer vehicle warranties were factored into maintenance costs. Additional motor pools were created in outstate areas for multi-departmental use; a contract with a rental vendor was implemented for occasional vehicle use in areas where a motor pool was not practical. Policies were implemented to encourage employees to utilize personal vehicles when it is in the economic best interest of the State.

PUBLIC ACT (PA) 96 OF 2007
Attached you will find a spreadsheet (Attachment A), which lists the savings and cost avoidance by PA 96 category. Note it is limited to the DMB-related items listed in the statute.

If you have questions on the information presented, or DMB operations in general, please contact me directly at 373-0666, or our Director of Government Affairs, Bob Burns, at 241-3779.

Attachment

c: Bob Burns

ATTACHMENT A
DMB STATEWIDE COST AVOIDANCE/SAVINGS
FY 2003 through YTD FY 2009
PA 96 of 2007 Items, plus Real Estate Items

PA 96 of 2007 Category (DMB - related Items)	DMB Item	Total Cost Avoidance/Savings To Date FY'03 - FY'09	Comments
Purchasing Programs	Contracts	$ 755,804,983	Savings and cost avoidance over contract life from renegotiation and competitive bidding.
	Cell Phone Usage Reductions and Eliminations	$ 772,469	Two year estimate only, but spending restriction continues.
	Procurement Card	$ 6,329,597	Restrictions and eliminations of procurement cards.
Janitorial or Cleaning Services	Reduction in Janitorial Services	$ 820,000	Reductions in frequency of janitorial services, and switch to day-time cleaning.
Maintenance Services	Other Service Contract Reductions	$ 80,000	Reductions in other service contracts.
	Cancellation of Parking Leases and Shuttle Bus Services	$ 750,000	Elimination of parking services.
	Reduced Operational Costs	$ 1,300,000	Reduced operational costs for Cadillac Place and One Division buildings compared to maintenance/operating costs included in lease rate.
	Energy Management/Power Down	$ 772,462	Utility cost reduction in DMB managed facilities only.
	Aggregate Billings (Lansing Board of Water & Light)	$ 97,646	Consolidated electric bills for multiple buildings to take advantage of non-peak rates.
	Energy Savings through Efficiency Measures	$ 70,000,000	Cost avoidance for state facilities due to reduced energy usage.
	Energy Partnership	$ 1,670,370	Energy purchasing consortium to buy energy at bulk rates.
	Security	$ 2,900,000	Reduced guard usage through increased use of technology.
Mail Services	Mail Savings	$ 28,592,000	Elimination of non-critical mailings; additional postage discounts due to technology and improved read rates; and improved mail design.
Transportation Services	ID Mail Savings vs. USPS Postal Rates	$ 4,437,000	Savings from in-house delivery of mail.
Printing Services	Color Copying	$ 525,916	Two year estimate only, but spending restriction continues.
Motor Vehicle Fleet Operations	Fleet Expenditure Reductions	$ 16,724,274	Savings resulting from fleet reductions.
Other Savings - Real Estate			
Real Estate	Lease/Rent Reductions	$ 146,200,837	Savings from multiple years. Includes reductions and cancellations.
	Sale of Property	$ 71,143,613	Revenue from property sales.
	Land Sales Maintenance	$ 2,597,539	Operational cost savings from sold property.

Note: Savings and efficiencies have enabled the administration to respond to ongoing budget pressures in prior year and current year budgets.

SECTION 108(1): DEPARTMENT OF MANAGEMENT AND BUDGET

The Department of Management and Budget (DMB) has legal authority under the Management and Budget Act, 1984 PA 431, and is the central management element of the Executive branch of state government. The DMB is an interdepartmental service and management agency responsible for all of the following: ensuring proper financial record keeping for state agencies, managing capital outlay projects, managing property for the state (i.e., managing state leases, selling surplus property), executing cost-effective purchasing programs, managing the state's retirement systems, supervising the state motor vehicle fleet, administering travel policies, and providing office support services to state agencies.

The DMB has several autonomous units, including the Office of the State Budget, which prepares, presents, and executes the state budget on behalf of the Governor; the Office of the State Employer, which is responsible for central labor relations as the employer of the state classified work force; the Office of the Children's Ombudsman, which investigates the actions, decisions, policies, and protocols of the Department of Human Services and child placing agencies as they relate to children in Michigan's child welfare system; the State Administrative Board, which reviews and approves qualifying state contracts and serves as a forum for public comment on those contracts; the Michigan State Fair; Civil Service, which implements policies established by the Civil Service Commission, administers a statewide merit system that provides classified job opportunities within state government, including administering competitive examinations for classified positions, setting pay scales, administering employee benefits, and administering the Civil Service Commission's Employment Relations Policy, as well as maintaining ongoing statewide recruitment; and various boards and commissions.

Full-time equated unclassified positions	7.0	Full-time equated (FTE) positions not in the state classified service.
Full-time equated classified positions	1,424.0	Full-time equated (FTE) positions in the state classified service.
Total full-time equated positions	1,431.0	Total number of all full-time equated positions (includes classified and unclassified).
GROSS APPROPRIATION	**$551,059,700**	**Total of all applicable line item appropriations.**
Total interdepartmental grants/intradepartmental transfers	167,603,800	Total of all funds received from other departments and transfer of funds.
ADJUSTED GROSS APPROPRIATION	**$383,455,900**	**Total net amount of all line item gross appropriations less (or minus) interdepartmental grants (IDGs) and intradepartmental transfers (IDTs).**
Total federal revenue	10,743,700	Total federal grant or matchable revenue.
Total local revenue	1,992,900	Total revenue from local units of government.
Total private revenue	150,000	Total private grant revenue.
Total state restricted revenue	77,694,100	State revenue dedicated to a specific fund (other than the General Fund); or revenue earmarked for a specific purpose.
GENERAL FUND/ GENERAL PURPOSE	**$292,875,200**	**The state's primary operating fund; the portion of the state's General Fund that does not include restricted revenue.**

SECTION 108(2): MANAGEMENT AND BUDGET SERVICES

This unit funds statewide administrative, budget, financial management, building construction, real estate, mail delivery, other operation services, the Office of the State Employer, and the state's motor vehicle fleet.

Full-time equated unclassified positions	6.0	Full-time equated (FTE) positions not in the state classified service.
Full-time equated classified positions	674.5	FTE positions in the state classified service.
Unclassified positions – 6.0 FTE positions	$636,500	Salaries of Director, State Budget Director, and State Employer (appointed by Governor); Legislative Liaison and Director of Communications (appointed by State Budget Director); and Public Information Officer (appointed by Director). Funding Source(s): GF/GP 636,500 *Related Boilerplate Section(s): None*
Executive operations – 10.5 FTE positions	1,489,600	Director's office; services to state agencies, universities/colleges, and other government units include strategic planning, program/ policy direction and monitoring, public affairs, communications, internal audit and business quality assurance. Funding Source(s): IDG 366,600 Restricted 608,300 GF/GP 514,700 *Related Boilerplate Section(s): 704, 706, 710*
Administrative services – 56.5 FTE positions	5,293,700	<u>Organizational services</u>: for employees, payroll, benefit, and human and labor relations; internal communications. <u>Financial services</u>: reports, projections, year-end statements, accounts payable, collection/revenue control, internal control, analysis, business planning, automated billing, contract/lease management, data collection. <u>National Association Dues</u>: for state's membership in National Governor's Association, National Association of State Budget Officers, National Association of State Auditors, and GASB. Funding Source(s): IDG 916,800 Restricted 3,622,700 GF/GP 754,200 *Related Boilerplate Section(s): 704, 706*
Budget and financial management – 164.5 FTE positions	16,786,400	<u>Office of the State Budget</u>: coordinate/manage Executive budget; maintain historical budget data; prepare and monitor transfers and supplemental appropriation requests. <u>Office of Financial Management</u>: oversee accounting and payroll functions; develop/issue/monitor financial/accounting policies; maintain central vendor/payee file; aid state accounting system users; prepare State of Michigan Comprehensive Annual Financial Report. <u>Local Government Claims Review Board</u>: advise DMB on compliance with 1978 Headlee Amendment to State Constitution; hear/decide claims/appeals from local units. Funding Source(s): IDG 7,349,000 Restricted 1,364,300 GF/GP 8,073,100 *Related Boilerplate Section(s): 704, 706, 708, 710*

Office of the state employer – 23.0 FTE positions	2,793,300	Central labor relations (employer of state classified workers); represents Governor, Executive departments, and Legislative Auditor General in employee relations and state management before Civil Service Commission and Employment Relations Board for non-exclusively represented employees; worker's compensation, long term and statewide disability management, safety/health promotion, drug/alcohol tests, counseling services. Funding Source(s): IDG 124,700; Restricted 1,813,200; GF/GP 855,400 *Related Boilerplate Section(s): 704, 705, 706, 707, 710*
Design and construction services – 40.0 FTE positions	5,357,400	Administer state capital outlay program; select/survey sites for new state facilities; survey/evaluate state buildings; recommend maintenance/ repair procedures; review plans and inspect state facilities to comply with laws/regulations; prepare/review bids and recommend bid awards; provide administration/inspection services during construction. Funding Source(s): IDG 5,357,400 *Related Boilerplate Section(s): 704, 706, 710, 712, 713, 716, 717, 718, 719, 721, 722, 723*
Business support services – 84.0 FTE positions	8,429,700	<u>Acquisition Services</u>: procure supplies/equipment/services for state agencies; approve/execute statewide contracts/leases; provide access to state purchasing for local units of government, local/intermediate school districts, non-profit hospitals, higher education institutions, community/ junior colleges; support State Administrative Board (state department administration, fund investments, travel regulations, small claims against the state). <u>Real Estate Services</u>: obtain/manage state leased-space, acquire real estate, grant/receive state easements, sell/transfer surplus property; jurisdictional transfers. <u>ID Mail Program</u>: centralized interdepartmental mail/delivery services for state agencies. <u>State Building Authority (SBA)</u>: issue revenue bonds and other short-term debt for construction/facility acquisition for state and agency use; monitor SBA-financed construction; risk management for vehicles, non-health related insurances. Funding Source(s): IDG 948,300; Restricted 3,125,300; GF/GP 4,356,100 *Related Boilerplate Section(s): 702, 704, 706, 710, 711, 716, 716a, 717, 718, 719, 723*
Building operation services – 250.0 FTE positions	89,004,600	Operate state facilities; administer building services in state-owned facilities (except state hospitals/institutions/parks); operate and maintain buildings, equipment, and grounds; risk management; insurance/ security/utilities/parking; statewide asset and preventive maintenance planning. Funding Source(s): IDG 89,004,600 *Related Boilerplate Section(s): 704, 706, 709, 710, 712, 713, 716, 716a, 717, 718, 719, 721, 722*
Building occupancy charges, rent, and utilities	4,262,000	DMB space in private and state-owned buildings. Funding Source(s): IDG 583,200; Restricted 1,308,700; GF/GP 2,370,100 *Related Boilerplate Section(s): 704, 709*

Internal audit services	989,100	Human resources services provided by Department of Civil Service to DMB. Funding Source(s): IDG 108,800; Restricted 463,900; GF/GP 416,400 *Related Boilerplate Section(s): 720*
Motor vehicle fleet – 46.0 FTE positions	56,920,400	Acquire, lease, maintain, operate, replace, and dispose of state motor vehicles for Executive departments/sub-units; regulate use of privately-owned motor vehicles on official business; maintain motor vehicle title/insurance inventories; assign motor vehicles to higher education institutions; set motor vehicle use rates and per mile reimbursement for privately-owned vehicles used on official state business; grant special reimbursement rates for unique situations; display distinctive plates and other external markings on state motor vehicles; establish/operate motor vehicle repair centers/motor pools; vehicles are assigned to agencies and furnished at a rate to cover cost of operation/maintenance; agencies billed monthly for services rendered. Funding Source(s): IDG 56,920,400 *Related Boilerplate Section(s): 715*
GROSS APPROPRIATION	**$191,962,700**	**Total of all applicable line item appropriations.**
Total interdepartmental grants/intradepartmental transfers	161,679,800	Total of all funds received from other departments and transfer of funds.
Total state restricted revenue	12,306,400	State revenue dedicated to a specific fund (other than the General Fund); or revenue earmarked for a specific purpose.
GENERAL FUND/ GENERAL PURPOSE	**$17,976,500**	**The state's primary operating fund; the portion of the state's General Fund that does not include restricted revenue.**

State Notes
TOPICS OF LEGISLATIVE INTEREST
March/April 2007

Department of Information Technology: Appropriations and Expenditures
By Stephanie Yu, Fiscal Analyst

The Department of Information Technology (DIT) was created by Executive Order 2001-3 by then Governor Engler in October 2001. No additional funding was provided to support DIT. Instead, funds from existing appropriations within State departments and agencies were shifted to DIT as a series of interdepartmental grants. Each department has a line item in its budget for information technology services and projects, the sum of which constitutes DIT's total appropriation. That structure remains in place, and overall changes to DIT's budget are generally spread across departments, although certain projects can be targeted.

The Department of Information Technology is responsible for the information technology needs of the Executive Branch and its departments and agencies. These include 55,000 computers, 2,300 servers, and 25,000 telephone lines. The Department is also responsible for the security of the entire system and faces the threat of 8,400 e-mail viruses daily. In its short history, the total budget for DIT has varied from over $500.0 million to $360.0 million.

Since the creation of DIT, the amounts DIT has charged to other departments and agencies for information technology (IT) services have exceeded the amounts appropriated to DIT by considerable margins. Individual departments retain considerable control over the funds marked in their budgets for DIT, and a number of projects and services are not included in DIT's appropriation. The discrepancy between amounts appropriated and funds spent is explained in the final section of the article, "Appropriations vs. Expenditures".

Budget History

Fiscal Year (FY) 2002-03 was the first year DIT was included in the General Government appropriation bill. The total appropriation for the Department was $503,086,800. The initial appropriation for FY 2003-04 was $360,239,300. A supplemental appropriation brought the total to $371,269,300. The initial appropriation for FY 2004-05 was $360,738,600. A supplemental appropriation increased the interdepartmental grant (IDG) from the Department of State Police by $1,304,100. Executive Order 2005-7 required $4.34 million in reductions of user fees and service charges to other departments, as well as $2.06 million in savings through expenditure reductions under the Master Computing Contract. Total savings of $10,876,800 were achieved.

For FY 2005-06, $365,194,400 was appropriated to DIT. Public Act 153 of 2006 made adjustments totaling $19.5 million to the DIT budget to align the appropriation with the departmental authorizations, for a year-end total appropriation of $384.7 million. In FY 2006-07, the DIT budget began the fiscal year at $378,222,000, but Executive Order 2007-3 reduced it to approximately $369.0 million. Reductions to DIT included statewide cuts of $47,000 and retirement savings of $5.8 million, as well as $75,000 in administrative efficiencies in the Michigan Administrative Information Network (MAIN) and delayed projects in the Department of Human Services. Table 1 shows the gross appropriation by year, and Table 2 shows the total appropriation by department. The inconsistency between the two tables reflects the discrepancy in appropriations to DIT and IT appropriations in other departments.

Table 1

Gross Appropriations to the Department Of Information Technology

Year	Enacted Budget	Supplementals	Transfers	Reductions	YTD Total
2002-03	$424,006,800	$41,588,700	$37,491,300		$503,086,800
2003-04	360,239,300	11,030,000			371,269,300
2004-05	360,738,600	3,996,600		(10,876,800)[a]	353,858,400
2005-06	365,194,400	19,512,300			384,706,700
2006-07	378,222,000			(3,171,400)[b]	375,050,000

[a] EO 2005-7 required reductions to the DIT budget. Total savings of $10,876,800 were achieved.
[b] EO 2007-3 contained reductions to IT in various departments.

Table 2

Year-To-Date Gross Appropriations to the Department of Information Technology by Department

Department	FY 2002-03	FY 2003-04	FY 2004-05	FY 2005-06	FY 2006-07
Agriculture	$1,884,100	$1,515,700	$823,200	$1,469,600	$1,536,600
Attorney General	859,400	773,600	773,600	701,900	738,100
Career Development	6,492,700	---	---	---	---
Civil Rights	1,082,000	786,200	786,200	754,600	779,800
Civil Service	3,317,600	3,827,000	3,827,000	3,788,400	3,817,800
Community Health	35,173,100	29,751,900	29,751,900	30,468,800	31,424,400
Consumer & Industry Services	26,067,300	---	---	---	---
Corrections	15,524,700	13,822,000	13,822,000	14,076,000	16,612,700
Education	3,183,200	2,489,800	2,489,800	2,532,900	2,611,400
Environmental Quality	7,200,200	6,632,500	6,632,500	6,607,700	6,809,700
Gaming Control Board	---	1,100,600	1,100,600	1,143,500	1,286,000
History, Arts, & Libraries	1,166,100	926,300	926,300	790,700	945,700
Human Services[b]	226,719,000	128,618,300	122,922,300	151,396,600	132,706,100
Labor & Economic Growth	---	42,159,400	42,159,400	42,486,200	43,188,500
Lottery	---	4,236,700	4,236,700	4,397,000	4,421,500
Management & Budget	27,816,200	24,433,200	24,433,200	27,268,900	28,433,600
Military & Veterans Affairs	1,230,800	1,159,400	1,159,400	1,119,200	1,161,100
Natural Resources	15,492,200	8,557,700	8,557,700	8,704,200	9,001,500
State	20,928,600	21,885,300	21,885,300	22,188,500	23,626,900
State Police	22,067,800	21,999,000	21,999,000	21,529,100	21,026,500
Transportation	26,396,400	26,827,300	26,827,300	27,000,000	27,826,500
Treasury	23,102,400	16,052,500	16,052,500	16,282,900	16,720,600
Total	**$465,703,800**	**$353,858,400**	**$351,165,900**	**$384,706,700**	**$374,675,000**[a]

a) This total does not reflect $5.8 million in retirement savings in Executive Order 2007-3, since the distribution across departments is unknown. That adjusted total would be $368.9 million.
b) Formerly named Family Independence Agency.

Required Reporting

As required in previous years, Section 578 of the Omnibus appropriation bill (Public Act 345 of 2006) requires DIT to submit a report by March 1 for the preceding fiscal year to the General Government subcommittees of both houses. The report must include:

(a) the total amount of funding appropriated for information technology services and projects, by funding source, for all principal executive departments and agencies;
(b) a listing of the expenditures made from the amounts received by the Department of Information Technology, as reported in subdivision (a).

Fiscal Year 2002-03

The report for FY 2002-03 indicated that DIT invoiced other departments a total of $494,458,416.07. The total amount appropriated at fiscal year-end was $465,703,800, a difference of $28,754,616. Table 3 shows that difference by department.

Table 3

Department of Information Technology Appropriations and Amounts Invoiced FY 2002-03

Department	FY 2002-03 YTD Appropriation	Total Expenditures	Difference
Agriculture	$1,884,100	$2,765,743	$881,643
Attorney General	859,400	916,320	56,920
Career Development	6,492,700	6,033,944	(458,756)
Civil Rights	1,082,000	831,714	(250,286)
Civil Service	3,317,600	1,775,836	(1,541,764)
Community Health	35,173,100	45,232,181	10,059,081
Consumer & Industry Services	26,067,300	45,441,797	19,374,497
Corrections	15,524,700	19,827,582	4,302,882
Education	3,183,200	5,514,576	2,331,376
Environmental Quality	7,200,200	8,784,531	1,584,331
Family Independence Agency	226,719,000	218,036,815	(8,682,185)
History, Arts, & Libraries	1,166,100	970,575	(195,525)
Management & Budget	27,816,200	27,265,807	(550,393)
Military & Veterans Affairs	1,230,800	1,009,171	(221,629)
Natural Resources	15,492,200	17,144,594	1,652,394
State	20,928,600	18,630,012	(2,298,588)
State Police	22,067,800	23,996,437	1,928,637
Transportation	26,396,400	23,511,395	(2,885,005)
Treasury	23,102,400	26,769,385	3,666,985
Total	**$465,703,800**	**$494,458,416**	**$28,754,616**

Fiscal Year 2003-04

For FY 2003-04, the Department modified its report to show total expenditures by category and department. Total expenditures exceeded total appropriations of $353,858,400 for the year by $131,894,980. Table 4 shows that comparison by department. The Department of Information Technology spent less than the amount appropriated for the Departments of Civil Service, Military and Veterans Affairs, and State. Department of Information Technology expenditures for all remaining departments exceeded those appropriations.

Table 4
Department of Information Technology
Expenditures and Appropriations
FY 2003-04

Agency	YTD Appropriations	Total Expenditures	Difference
Agriculture	$1,515,700	$3,352,124	$1,836,424
Attorney General	773,600	2,031,559	1,257,959
Civil Rights	786,200	865,017	78,817
Civil Service	3,827,000	3,061,176	(765,824)
Community Health	29,751,900	45,501,662	15,749,762
Corrections	13,822,000	20,107,250	6,285,250
Education	2,489,800	7,542,813	5,053,013
Environmental Quality	6,632,500	9,766,070	3,133,570
Family Independence Agency	128,618,300	142,169,824	13,551,524
Gaming Control Board	1,100,600	2,499,095	1,398,495
History, Arts, & Libraries	926,300	1,247,666	321,366
Labor & Economic Growth	42,159,400	52,890,422	10,731,022
Lottery	4,236,700	39,020,550	34,783,850
Management & Budget	24,433,200	30,747,935	6,314,735
Military & Veterans Affairs	1,159,400	1,118,102	(41,298)
Natural Resources	8,557,700	19,189,302	10,631,602
State	21,885,300	20,557,182	(1,328,118)
State Police	21,999,000	31,451,386	9,452,386
Transportation	26,827,300	30,955,203	4,127,903
Treasury	16,052,500	21,679,042	5,626,542
Total	**$353,858,400**	**$485,753,380**	**$131,894,980**

Fiscal Year 2004-05

The Department of Information Technology's expenditures for FY 2004-05 totaled $441,608,516. The Department's total appropriation for the year was $351,165,900, a difference of $90,442,616, as detailed by department in Table 5. The Departments of Civil Service and Human Services did not exceed their appropriations; the remaining departments did.

Table 5

Department of Information Technology Expenditures and Appropriations FY 2004-05			
Agency	**YTD Appropriations**	**Total Expenditures**	**Difference**
Agriculture	$823,200	$2,964,872	$2,141,672
Attorney General	773,600	2,118,930	1,345,330
Civil Rights	786,200	837,352	51,152
Civil Service	3,827,000	3,081,748	(745,252)
Community Health	29,751,900	37,652,140	7,900,240
Corrections	13,822,000	18,498,727	4,676,727
Education	2,489,800	4,656,938	2,167,138
Environmental Quality	6,632,500	8,850,611	2,218,111
Gaming Control Board	1,100,600	2,041,829	941,229
History, Arts, & Libraries	926,300	1,163,898	237,598
Human Services	122,922,300	116,935,680	(5,986,620)
Labor & Economic Growth	42,159,400	52,135,540	9,976,140
Lottery	4,236,700	41,360,563	37,123,863
Management & Budget	24,433,200	26,980,301	2,547,101
Military & Veterans Affairs	1,159,400	1,259,817	100,417
Natural Resources	8,557,700	16,419,158	7,861,458
State	21,885,300	22,573,530	688,230
State Police	21,999,000	32,643,673	10,644,673
Transportation	26,827,300	28,776,580	1,949,280
Treasury	16,052,500	20,656,629	4,604,129
Total	**$351,165,900**	**$441,608,516**	**$90,442,616**

Fiscal Year 2005-06

Department of Information Technology expenditures for FY 2005-06 totaled $494,804,483. Amounts appropriated in the DIT budget totaled $384,706,700. Table 6 shows the difference by department. The Department reported an additional $66.0 million appropriated in other departments' non-IT line items, as well as $36.4 million in prior-year funds. Departments can use authorization in other line items to pay DIT user fees, but do not have to specify which line items.

Table 6

Department of Information Technology Expenditures and Appropriations Fiscal Year 2005-06			
Agency	**YTD DIT Appropriations**	**Total Expenditures**	**Difference**
Agriculture	$1,469,600	$2,695,252	$1,225,652
Attorney General	701,900	2,825,143	2,123,243
Civil Rights	754,600	851,923	97,323
Civil Service	3,788,400	3,464,258	(324,142)
Community Health	30,468,800	40,155,605	9,686,805
Corrections	14,076,000	21,114,035	7,038,035
Education	2,532,900	6,159,684	3,626,784
Environmental Quality	6,607,700	8,873,238	2,265,538
Gaming Control Board	1,143,500	1,996,080	852,580
History, Arts, & Libraries	790,700	1,134,546	343,846
Human Services	151,396,600	142,911,056	(8,485,544)
Labor & Economic Growth	42,486,200	56,480,737	13,994,537
Lottery	4,397,000	43,891,534	39,494,534
Management & Budget	27,268,900	28,648,202	1,379,302
Military & Veterans Affairs	1,119,200	1,287,295	168,095
Natural Resources	8,704,200	16,654,605	7,950,405
State	22,188,500	31,086,635	8,898,135
State Police	21,529,100	31,476,397	9,947,297
Transportation	27,000,000	30,954,863	3,954,863
Treasury	16,282,900	22,143,394	5,860,494
Total	**$384,706,700**	**$494,804,482**	**$110,097,782**

Fiscal Year 2005-06 Overexpenditures

In fiscal year 2005-06, the Departments of Corrections and State Police had net overexpenditures in their budgets. Both departments overspent their information technology line items, the Department of Corrections by $2.2 million, and State Police by $1.7 million. Public Act 3 of 2007 made supplemental appropriations to cover the shortfall In March 2007. The structure of DIT funding allows individual departments to transfer to and from the information technology line item with or without the agreement of DIT, although DIT was aware of the shortfall in these departments before the end of the fiscal year.

Appropriations vs Expenditures

Since the creation of DIT in 2001, the amounts charged to other departments and agencies have exceeded the amounts appropriated to DIT by considerable margins, though FY 2005-06 was the first year departments officially overspent their IT line items. The Department of

Information Technology provides information with its invoices that explains the breakdown of the various charges and reviews those charges monthly with the departments or agencies. Throughout the budget planning process and the fiscal year, DIT works with the departments to provide the services requested and to provide advice on information technology (IT) needs. Despite these efforts at cooperation, departments can adjust their IT line items, and often do, without similar adjustments made to the DIT appropriations. As a result, the DIT appropriations and the line items in individual departments often do not match at the end of the fiscal year, and as in FY 2005-06, this fluidity in what is included in the line item can lead to significant and unpredictable discrepancies in what is appropriated and what is spent.

The Department of Information Technology states that a portion of the discrepancy between appropriations and expenditures stems from the fact that telecommunications services are not included in the IT appropriations but are managed by the Department, although that is not consistent across departments. The Department of Management and Budget (DMB) maintained telecommunications services as an internal service fund until 2001, when it was transferred to DIT. It remains an internal service fund, charging each department for usage. Also, it varies whether the authorization for many other DIT services appears in the DIT budget.

Beginning with fiscal year 2005-06, DIT's expenditure report has included appropriation funds that are not included in the IT line items. The Department reported an additional $66.0 million that was appropriated for DIT services in other line items, but the Department does not receive any detail regarding the individual fund sources, although it does track Federal and State spending broadly. The Department of Information Technology and the departments or agencies being served work together to develop individual IT plans, but this is not reflected in the way DIT is appropriated. Since FY 2003-04, the difference between what is appropriated in the DIT budget and what is spent by the Department has ranged from $90.0 million to $130.0 million. These expenditures constitute a significant portion of total expenditures, between 20.0% and 30.0% per year. The departments, along with DIT, track the funds that are not included in the IT line items, but those amounts are rolled up in other line items and not transparent in the appropriations process.

The structure of DIT funding is complicated, and there are a number of projects and services that are not included in DIT's appropriations. The ability of departments to transfer to and from that line item, thus affecting the DIT budget, adds an additional layer of complexity. As demonstrated in the FY 2005-06 overexpenditures, individual departments retain considerable control over funds marked for DIT. The number of services that DIT provides outside its appropriation distorts the true picture of DIT expenditures, which significantly exceed that appropriation.