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GAME CHANGING OPPORTUNITIES TO HELP STATES DEAL WITH FISCAL CRISIS

Over the past two decades, the Public Strategies Group has developed a series of strategies designed to transform government bureaucracies. Some of them not only produce dramatically better results, but save significant amounts of money. You might think of them as "game-changing opportunities."

Game changing ideas alter assumptions about 'the way we've always done it.' This does not happen overnight; some of these ideas will take longer than others. Some will have more leverage than others. Some will require more resources than others. Thus these ideas are not best used individually but as part of an explicit strategy to change the way government works in a state.

The table below suggests several different dimensions of such a change. The selection of individual strategies should fit into an overall understanding of where state leaders want to go.

FROM → **TO**

Traditional bureaucracy	Transformed government
Statute & rule directed	Mission & results directed
Hierarchically driven	Team & network driven
Control centralized	Decentralization & empowerment
Primarily accountability for conformance to rules	Primarily accountability for results
Manage costs	Manage value
Assume people cheat; control them	Assume people perform; empower them
Quality defined as adherence to standards	Quality defined as meeting or exceeding customer expectations
Exclusive service mandate	Choice and competition
Focus on what's best for organization	Focus on what's best for citizens

Charter Agencies (or Charter Departments)

Description

Agencies regularly complain about the red tape and bureaucracy that frustrates their ability to manage and perform. Charter Agencies pioneer a new, bureaucracy-busting deal. Agencies wishing to be chartered commit to producing measurable results – and improvements in those results – and lower operating expenses. In return, the Charter Agencies are freed from red tape by being given waivers to certain rules, as well as special authorities.

Based on what each side wants -- and is prepared to give -- the basics of the new deal would be negotiated between the head of the Department and the head of each Charter Agency. Each volunteering Charter Agency would negotiate a Flexible Performance Agreement with the department head, including what measurable results they will produce, lower net expense targets, and what authorities and flexibilities they will receive. An innovation fund can also be included, to jump start productivity-enhancing and money-saving projects the Charter Agencies could not otherwise fund. Some more extensive authorities and flexibilities would probably require authorizing legislation. These and the benefits to be achieved would need to be negotiated with the legislature.

Whole departments could also be made Charter Departments, receiving department-wide flexibilities in return for performance commitments. These arrangements would be specified and controlled through Flexible Performance Agreements between the department head and the Governor.

Example

The State of Iowa implemented "Charter Agencies" in 2003. The initiative saved the taxpayers $20 million a year for the first two years and $50 million in the third year, while improving results. It won a Harvard Innovations in American Government Award in 2005 and also the Council of State Governments' Innovation Award. Please see the attached booklet for more detail.

Implementation/ Requirements

- One year
- A champion at the top and solid staff support to hand-hold, particularly at the start
- Courageous agency and department heads eager to have more flexibility and authority to lead and willing to commit to results to get that flexibility and authority
- Coaching for Charter Agencies during the first year; regularly share early successes and lessons among them
- Investment: $250,000 - $500,000, which can be recovered from the Charter Agencies' net lower appropriations
- Savings: Iowa example suggests the scale: $50 million/year from only six agencies

Internal Enterprise Management

Description

Enterprise management makes service organizations that can sell their services "earn" their budgets by selling to other agencies – often in competition with private providers. Suddenly, survival depends on how well they please their customers and at what price. Many governments have turned their maintenance, printing, training, data processing, vehicle fleet, and other internal service operations into competitive enterprises. Iowa, Minnesota, Milwaukee, the Edmonton school district, even Australia and the United Kingdom have used this approach. It can save 10 percent a year for several years.

Internal services that do not need to remain monopolies are called "marketplace" services; their appropriations are spread among their customers (minus a 10% per year efficiency dividend), and those customers are allowed to purchase the service anywhere. Hence the marketplace service must compete to earn its keep, based on its quality and cost. Internal services that need to remain monopolies (for example, telecommunications) are called "utilities;" their appropriations (minus the dividend) are spread among their customers, but those customer cannot purchase from anyone else. Still, they can choose how much they want to purchase. Those customers also get seats on a Customer Council, which helps negotiate the rates charged by the utility.

Internal support functions that play a leadership or compliance role remain as they were, with appropriations from the General Fund.

Example

In Iowa, the Department of Administrative Services (DAS) successfully used enterprise management to deliver more streamlined, cost-effective services to customer agencies. Beginning with the 2003 legislation that created the new agency, DAS established marketplace enterprises to handle training, conference planning, motor pool vehicles, repairs, printing, graphic design, and a variety of IT services, including mainframe, networking, and e-government solutions. Those enterprises are now utilizing accrual accounting, business plans, competitive pricing, and customer satisfaction measures to run their businesses. The Department of Administration had already been cut by $35 million when it launched enterprise management; the reforms allowed it to work effectively despite the deep cuts. In addition, other departments saved more than $1 million a year because of lower rates from the enterprises.

See pp. 12-13 of *Transforming Iowa* for a more detailed description of the Iowa initiative. Also see the DAS website http://das.iowa.gov.about_DAS/index.html, where you can a link to the DAS Annual Reports and the DAS Strategic Plan.

Implementation/ Requirements

- Separate policy, compliance, and customer service components of the organization.
- Classify each service function as a marketplace or utility enterprise.

- Adjust or create systems (accounting, financial management, HR, IT, etc.) to support entrepreneurial way of doing business in the enterprises.
- Establish Customer Councils to oversee utility services
- Equip managers, employees as well as customer/users with the training, tools and support they need to operate effectively in an entrepreneurial environment.
- Use communication constantly and consistently to support the transformation.
- Investment: $500,000 - $1 million over 2 years
- Savings: 10 percent of the cost of each enterprise per year, for three years, for a total of 30 percent.

Issues to consider

- Legislation may not be required, but legislative branch must be brought in.
- Accrual accounting will be needed to produce accurate and meaningful balance sheets for the enterprises.
- Huge culture change requires top-to-bottom training and financial management support for the enterprises.

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Performance Contracting

Description

The purpose of performance contracting is to align incentives in order to improve results. It is a method to focus contractors on supporting the strategy and goals of the contracting organization. Performance contracts can be written for many relationships: Governor's office with secretaries, secretaries with departments, department heads with managers, state government with local government, and government with its suppliers.

Performance contracting with suppliers would focus on changing the relationship from one based on paying for inputs or meeting specifications to one based on producing outcomes important to the state. This relationship should be accompanied by simplification of reporting and less red tape.

Opportunities to employ performance contacting exist in all aspects of state government. Major opportunities include:

- Human services
- Health care
- Transportation construction and maintenance

Example

The Illinois Department of Children and Family Services dramatically turned around the performance of its foster care program by using performance contracting with their out-of-home placement providers. By paying providers for kids' outcomes (successful long term placement, adoptions, etc.) instead of days of care, the Department changed the incentives for providers, saved money, and improved outcomes for children. In 2000 the Department won the Innovations in American Government Award for its success.

Implementation/ Requirements

- Leaders of a delivery system that want to change the dynamics
- Agreement on results to be achieved
- Ability to measure results
- Investment in personnel (training, assignment) to track results
- Willingness to risk giving contractors discretion in how they achieve outcomes
- Investment: $500k - $1 M
- Savings: undefined but significant

Issues to consider

- Needn't be 100% of pay. In fact where margins are tight, 5% - 10% of contract value may be plenty to make performance consequential.
- Measurement is going to be an issue. Care has to be taken to incent the right things. Must become skilled in measurement and reporting results.

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Competitive Contracting

Description

Competitive contracting opens up service delivery decisions to the power of competition. The most obvious method is simply outsourcing to the private sector through a bidding process open to for profit and/or non-profit bidders. Outsourcing has issues and limits, but it has successfully produced greater value for services that were once considered to be only in the public domain. Contracting out should not be used when it would a) jeopardize important public goal like safeguarding rights, b) create a private monopoly, c) be used for critical public capabilities, like emergency services, or d) violate strongly held values.

Competitive contracting can also be achieved using only a pool of public bidders (internal bidders or bidders from other public organizations), or a combination of pubic and private bidders. The state can ask it's own agencies, or other public agencies (cities, parishes, separate authorities) to bid on public services – ensuring that the service will ultimately be provided by some public entity. Perhaps the IT division of one department can do a better job of providing technology services to other departments. Or state leaders can ask agencies to bid against private competition. (To do so, it must ensure that there's a "level playing field" among private and public bids.)

Competitive contracting typically yields 20-30% savings on the first iteration, no matter who wins. If a full contracting process is not possible, the effect of outside competition can be simulated using a 'bid to goal' process that uses external benchmarking to set a target for internal or public sector-only bids. If bids meet the goal, the contract proceeds. If not, a second round invites outside bidders.

Example

Indianapolis, under the leadership of then mayor Steven Goldsmith, used managed competition for more than 30 services to achieve almost 30% cost savings while maintaining or improving quality.

Implementation/ Requirements

- Commitment to getting value through competition
- Clarity about expected outcomes and required service restrictions
- Ability to measure results
- Investment in training public managers to bid services and monitor contract performance
- Willingness to risk giving contractors discretion in how they achieve outcomes
- Investment: Six months and $300-500K
- Savings: 20-30 percent of the cost of services contracted

Issues to consider

- Set criteria for when private (profit or non-profit) provision of services is appropriate.
- Ensure a level playing field in the bidding process (accounting for hidden subsidies, etc.).
- Provide assistance to public managers who have no experience in how to bid services.

Winning Compliance – Regulatory Reform

Description

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

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

All of this makes enforcement a blunt instrument. As public leaders recognize its limitations, governments around the world are shifting to cheaper, more effective options. They keep enforcement as a last resort, but they turn first to other tools. They build public support for community standards. They create partnerships with those who must comply: businesses, local governments, and communities. They educate compliers about what is necessary and how to comply. They make it easier to comply, by streamlining processes like permitting and inspections or adding services that assist compliers. They shift from requiring specific actions to requiring specific results -- allowing compliers to figure out the best and cheapest way to produce those results. And they create market incentives to spur compliance.

Through the application of winning compliance strategies, states can achieve high levels of voluntary compliance and reduce the cost of compliance.

Example

In the late 1980's, the State of Minnesota applied a winning compliance approach to its sales tax system. The State reengineered the system into one that would customize to the conditions of the taxpayer, making it substantially easier to pay the right amount of tax and easing the "compliance burden." As a result, collections increased substantially while the cost to the state and to taxpayers went down.

These same approaches have been applied to everything from environmental regulation to OSHA, child support enforcement, and police work.

Implementation/ Requirements

- ID highest cost/ lowest compliance activities.
- Educate leaders of compliance functions about winning compliance strategies.
- Make overall compliance a key results measure for these agencies.
- Data and information management systems must be able to track compliance and differentiate among compliers.
- Investment: $500,000 - $1,000,000 annually in redesigning/ reengineering
- Savings in staff time and citizens' time, but hard to quantify cost savings; potential for greater tax collections if used in revenue agency.

Issues to consider

- Elected officials often have a hard time seeing beyond enforcement or punishment.
- Middle managers and frontline staff will need training and coaching support to move away from the "gotcha" paradigm of enforcement.

Fix Business Processes – Lower Costs and Improve Services

Description

A small set of government processes inflict a lot of high-profile pain on citizens – think of the Department of Motor Vehicles in many states. By identifying and fixing them, states can improve citizen satisfaction with government services and save money. Bring all the tools to the table: quality management, reengineering, customer accountability, and technology. Score high profile wins as a signal to all departments and to citizens.

The quality movement peaked in the early ‘90s, and while much was accomplished, too often improvement teams met for months with little to show for it. Better methodologies are now available, based on the same Deming principles. Generally known as “lean” or “lean six sigma,” these tools offer dramatic improvements in processing times, error rates, and customer satisfaction. Public-sector adaptations known as “Kaizen” and “Zoom” yield extraordinary results in very short time frames. They also unlock resources for other unmet needs.

Start with processes that inflict the greatest pain on the most people. Look for backlogs and complaints. Ask the business community. Permitting, licensing, and payment processes are usually good candidates. Then use Kaizen or Zoom processes to reduce the pain. Once done, set customer service standards and redress policies for the new processes to build in accountability to the customer.

Examples

Starting in 2004, as part of their Reinvention Partnership, the State of Iowa began using Zoom and Kaizen to redesign business processes to get better results and save money. To date they have redesigned 95 processes throughout the state – at first with outside consultant help, and since 2007 through their own Office of Lean Enterprise within state government. Learn more about Iowa’s business process success at **http://lean.iowa.gov/resources.html**

When this was begun in one permitting process at the Iowa Department of Natural Resources, the organization issued around 2,000 permits per year. Before the kaizen process took place, it took an average of 62 days to get a new permit approved. The kaizen team reduced the time down to six days, without changing any regulatory or compliance requirements, and eliminated a 600-application backlog over the next six months.

Through other process redesign efforts, many behind-the-scene steps, handoffs, and delays have been eliminated. Permits of all types are processed faster today. Arson cases are being investigated more effectively. Employee grievances are resolved more quickly.

Implementation/ Requirements

- Requires that teams be fully authorized to make changes during improvement events.
- Unions can support, but they need to be brought in early and continue to be part of the process.

- Outside, expert consulting assistance is required to start.
- Set clear expectations from the start for cost savings, time savings and/or outcome improvement.
- Investment: $100,000 to prove the value in state government; more depending on how many high-pain processes are addressed
- Savings: significant potential

Issues to consider

- Be careful not to improve processes that should not be done in the first place.
- If pursued fully, part of the strategy will include developing internal capacity to eventually take over from outside consultants.
- Stakeholders who will benefit from the improvement can be asked to help pay for the improvement events, but check on potential ethics rule restrictions.

Make Agencies Manage Capital Assets More Efficiently

Description

In most jurisdictions, capital dollars are budgeted separately from the operating budget. Further, the debt service, maintenance and operating costs are often not paid by the department or agency consuming the capital. The result is that capital looks 'free' and departments want as much as they can get. However, a state could require departments to pay their own debt service, operating and maintenance costs out of their annual budgets, while also giving them the flexibility to reallocate resources to support their capital/ investment needs. Or, the state could charge the departments a set asset fee (for example, 1.5 percent of the asset value per year) to cover some of these costs.

This will:

- Make capital costs transparent, and make departments accountable for them.
- Reduce capital requests as departments realize their true costs.
- Give departments easier access to the capital they really need by allowing them to decide when and how to allocate resources in their budget for capital purposes.
- More effectively align capital and operating resources in pursuit of statewide and departmental strategies.
- Incent departments to sell unused and low value assets. Departments should be allowed to keep -- or at least share -- proceeds from the sales.

Example

Both New Zealand and the United Kingdom have implemented asset fees successfully.

Minnesota: In 1990 the state's collection of higher education institutions requested approximately $2 billion in bonding. Both the Governor and Legislature struggled to prioritize their requests along with the additional $2 billion of requests form other agencies and fit them all into a budget that allowed for only $500 million of bonding. At the conclusion of a very frustrating process the legislature and Governor agreed to insert a provision into the statutes that required higher education institutions to pay 1/3 of the debt service for bonds from their own operating budgets. The impact was swift and significant. In the next round of bonding, requests from the higher education institutions were only half what they had been – and the institutions listed them in priority order.

Implementation/ Requirements

- Ability to assign and account for capital, operating and maintenance costs by department or program.
- Investment: $50,000 - $100,000 plus staff time
- Savings: significant

Issues to consider

- Include other unassigned costs – health, pension, overhead?

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Health Care: Coverage, Cost and Quality

Description

Most governors are already working to save money on Medicaid, and Congress is working on health care reform. But no matter what Congress does, rising health care costs will continue to imperil public institutions (and many businesses and nonprofits). Major opportunities remain to both reduce cost and improve quality. The highest leverage opportunities include the following.

1. Make behavior matter.

One way of describing America's health care problem is that we experience too much care and not enough health. Our most important goal, after all, is not *health care,* but *health.* And the biggest obstacle to good health for many Americans is not a lack of care; it is their own behavior. Nevertheless, we spend 88 percent of our health resources on treatment, but only 4 percent on changing personal behavior. We are still paying for smoking, the epidemic of the 20th century. We are just beginning to pay for obesity, the epidemic of the 21st century. If we want better health, behavior has to change. That means:

a. Changing minds. Launch sustained public campaigns on obesity, exercise, diet, smoking, drugs, alcohol, etc.
b. Changing habits. Require and/or provide vaccinations, dental care, and eye exams for students.
c. Changing prices. Require health plans to give premium discounts based on healthy behavior, body mass index, and the like. Tax cigarettes, alcohol and junk food to reflect their true health care costs.

2. Replace fee-for-service payments for procedures with prepayment of annual fees for patient care. Use competition between integrated, managed-care systems to get the best combination of quality and price.

Governments are such large players in the health care marketplace that what they do (or don't do) will drive the entire market. We can get better care at a better price if we:

a. Create a large statewide purchasing pool, including public and private employers and encompassing at least 30% of the market. (In the average state, Medicaid, SCHIP, and state and local employees and retirees equal 21% of the market.) Include long-term care.
b. Define a basic package of care.
c. Get competitive proposals from all plans in the state.
d. Rank all proposals into three tiers, based on quality and price.
e. Let people choose the most cost-effective tier at low or no cost, depending upon their status (Medicaid, state employees, etc.), but pay the full difference if they choose a plan in tier 2 or 3. This will ensure choices for citizens but drive health plans to get their costs down and quality up.
f. Give additional points in the ranking system for use of evidence-based medicine and other practices that lead to cost-effective care.

3. **Electronic claims and billing**

In 1993 Utah's health insurers, providers, and the state came together to create the Utah Health Information Network (UHIN). Their goal was to avoid the creation of duplicate systems as each payer moved into electronic processing of claims. In 1995, Executive Director Wayne Nelson estimated that savings could be up to five percent of total health care costs. Today the system includes virtually every payer and provider, and the savings are eye-catching. At Intermountain Health Care, claims processing now costs .1 cent per transaction—a fraction of the three cents per transaction it would pay otherwise. The state should lead the creation of such a system and require it of all providers paid for with public dollars

4. Create state policies to encourage end-of-life planning for everyone.

No one knows how many of our health care dollars go to elderly people in their last year of life, but 25 percent is a good guess. In many cases this serves no rational purpose and pleases no one, including the patient. But doctors and nurses are taught to do everything they can to help patients, and in the absence of specific policies that tell them otherwise, that's what they do.

State leaders should engage the public in a discussion about the benefits of end-of-life planning, including living wills. Then they should alter state policies to encourage the preparation of living wills and adopt a default living will for anyone who has not created their own. The state should make forms readily available with accessible advice for those who need it and provide a health premium discount for those who have such a health directive on file. Talking about end-of-life issues is not easy. Not talking about them will make the dying process more difficult and more costly.

Examples

- United Healthcare, the nation's largest health insurer, recently unveiled a health plan with discounts for people who regularly use an exercise facility, don't smoke, and have healthy weights, based on successful experience with this approach by some employers.
- Wisconsin's insurance program for state employees offers an example of how states can use prepayment to stimulate price competition between health plans. It defines a basic benefit package, asks health plans to submit bids specifying the annual dollar amount they would charge for this package, and then ranks those bids. The Wisconsin program uses price and quality measures to define three tiers. Plans in tier one, which are low in price and high in quality, cost the least for state employees. If they prefer a more expensive plan—because their family physician is not part of a tier-one plan, for instance—they are free to choose it and pay part of the difference. But the vast majority of members choose tier-one plans, and this fact creates an incentive for health plans to lower their prices. (Members can switch plans once a year.)

  Wisconsin put this three-tier approach into effect in 2003. In Dane County, which includes Madison, the state employee plan covers 25-30 percent of the private (non-Medicare and Medicaid) market. By 2006, costs for individual and family plans had fallen 14 percent below the statewide average and 30 percent below the most expensive regions. Wisconsin's experience in Dane County indicates that both patients and doctors can be satisfied in such a system, as long as they have choices. It also demonstrates that a government can restrain costs by including just 30 percent of the market in its managed competition arrangement. This is true because most health plans compete for that 30 percent, and when they make changes to become more efficient and effective to capture that market, those changes affect the rest of their business.

- Most long-term care is provided on a fee-for-service basis, with little coordination. Managed care for fixed prices—in which members can choose their plan and switch annually if they are not happy—provides incentives for health plans to find the most cost-effective setting for each person, whether in their home, a nursing home, a rehabilitation hospital, a chronic long-term care hospital, or a day program. Oregon, Arizona, Florida, Texas, and Wisconsin have already proven that such programs improve quality and cost-effectiveness. Oregon's case-management approach has reduced claims by roughly 50 percent. "Cash and Counseling" programs in several states, which give patients some Medicaid money each month to purchase their own goods and services, also show promise by helping people make choices that keep them out of nursing homes and hospitals.

Implementation/ Requirements

- Set audacious goals: reduce costs 25%, close quality gap by half.
- Create a design team to produce a design for the next legislative session.
- Investment: $1,000,000 - $2,000,000, plus significant staff time.
- Savings: huge potential.

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Liberate Local Governments

Description

Relations between state and local governments are terrible, characterized by mutual mistrust and vilification. The State wants better results, greater efficiency, and improved compliance in return for the money it sends to local governments. Local governments want fewer mandates and greater freedom to meet the needs of their communities. States could strike a new and better deal; less funding for local government in return for relief from state requirements. Freedom from mandates, reporting obligations, and other restrictions would allow local governments to more flexibly manage their own operations. Savings in local allocations would be augmented by savings on red tape at both ends.

Examples

Minnesota's Government Innovation and Cooperation Board, which granted local governments waivers to state rules, was an Innovation in American Government Award Finalist in 2000 (see *The Price of Government,* pp. 242-3). Unfortunately, this experiment fell to Governor Jesse Ventura's budget axe in 2003. In 2005, West Virginia passed the Local Government Flexibility Act, establishing a waiver review process under the Governor for policies, rules, and regulations.

Implementation/ Requirements

- One year
- A consultation process involving local governments and legislative sponsors could design the deal, which must at least minimally meet the needs of both state and local governments.
- Regularly share early successes and lessons among local governments.
- Add an innovation fund to sweeten the deal and enhance results; dollars for the innovation fund can be recovered from reduced local allocations.
- Investment: $250,000-$400,000, which can also be recovered from the lower local allocations.
- Savings: Millions of dollars in lower appropriations for local government.

Issues to consider

Need a way to neutralize special interests who will mobilize to kill proposed flexibilities and authorities.

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Push Hard Against Federal and State Mandates

Description

State governments are loaded with mandates – functions and roles that are imposed externally by the federal government, or by their own state laws or courts. Many states grumble about mandates, but fund them every year without question. The surest way to gain funding for a program is to identify it as a mandate, regardless of its real value and contribution to the results citizens care about. Instead of carefully reviewing what a mandate really requires, leaders go with tradition, "common wisdom", and the interpretation of one or two employees whose current jobs depend on the existence of the mandate.

An aggressive mandate review process would determine 1) whether the mandate really exists, and 2) the minimum required by the mandate – based in law, regulation, and actual practice. The state could certainly decide to exceed minimum requirements, but this should be an active decision to do so, not the unconscious assumption of a required service level.

With limited resources, governments cannot afford to fund mandates that are not providing the maximum value. A mandate review is not designed to avoid mandates, but to avoid paying more for mandates than the state wants to, given its other spending priorities.

Example

In 2004 the Multnomah County board was faced with a major budget crisis and asked all county functions – including the separately elected Sheriff – to go through a rigorous, outcome-based budgeting process to determine which programs to fund. The Sheriff responded – to the board, and in the press -- that his proposed budget had to be fully funded because his office was mandated by state law. On legal review, the statute simply read, "There shall be a Sheriff." The board's only legal mandate was to fund a single job. The Sheriff participated in the process.

Implementation/ Requirements

- Recruit and empower an oversight group to examine mandates.
- Ask them to determine the minimum (spending, service levels, outcomes) that the state must do to fulfill the mandate.
- Do not include people whose jobs are directly connected with the mandates reviewed.
- Understand and accept the risks involved with a conservative interpretation of particular mandates.
- Savings: will depend on what the mandate review uncovers.

Issues to consider

- What function must be performed?
- What level of service must be delivered?
- What amount must be spent?
- What specific outcome must be achieved?

Reform the Administrative Systems: Budget, Accounting, Procurement, HR, Audit

Description

Administrative systems are the keepers of the bureaucratic rules. They are far more powerful than all the pronouncements made by elected officials or department heads. The systems run those who govern, not the other way around. That's why government employees call the organizations that run them "control agencies." In the name of savings, these systems hamstring employees, ignore results, and create colossal waste.

Bureaucratic administrative systems were designed as an antidote to the corruption and administrative chaos that reigned 60-100 years ago. The first rule of bureaucracy is that people cheat and therefore must be controlled—that's why it often takes as many as nine signatures to release an expense check. It's also why drivers in some states can get a license renewed in 15 minutes, but it can take an employee seven weeks to get reimbursed for a travel expense.

The administrative systems are based on the assumption that compliance with process rules will produce behavior consistent with norms that citizens want—norms such as fairness, equity, lowest cost, and merit-based decisions. But modernized systems can embrace such norms while still delivering value for money. To be successful, reforms should:

Encompass these norms	*While delivering these ends*
Fairness and integrity	Timeliness
Equity	Quality
Decisions based on merit	Effectiveness: results for citizens
Efficiency: lowest cost	Cost effectiveness: value for money
Accountability	Consequences for performance

Budgeting for Outcomes will help create budgets that deliver results citizens want at a price they are willing to pay. But budget creation is only half the job. After the budget is established, it has to be managed, in the face of all the unexpected circumstances governments face every day. Yet most budget offices keep their managers locked in the grip of systems that predate dial telephones. They forbid them to carry over savings from one year to the next and punish them with lower budgets if they don't spend every penny of every line item. They make it difficult to move money from one account to another or change the mix of staff vs. contracts without specific permission. Some budget offices go so far as to review every hiring decision. These restrictions drive many decisions that waste money: decisions to use expensive contractors rather than employees because of FTE ceilings; decisions to keep spending low-value money because it can't be moved to higher-value activities; and, of course, the infamous end-of-the-year spending rush, to make sure no money is left over when the fiscal year runs out.

Most civil service systems are equally wasteful. When they were developed, public employees were not unionized. The courts had not yet outlawed most patronage hiring and firing, nor did they protect most employees from wrongful discharge. Civil service rules were the only protection public employees had from the whims of elected officials—who were in the habit of firing thousands of employees when a new party took power and rewarding political supporters with their jobs.

Today we have three layers of protection, and the result is often gridlock. Managers have trouble hiring the talent they need, because the centralized hiring process is so bureaucratic and slow. Thousands of job classifications divide employees into narrow categories and pay grades, frustrating managers' attempts to move them or reward them with higher pay. Within each classification, pay is determined by longevity, not performance, and when good employees reach the top of their pay grade, further raises are impossible without a promotion. When layoffs occur, employees with seniority can usually "bump" those without, causing a massive game of musical chairs down the organization chart—leaving behind unhappy people in jobs they weren't trained for and don't want. Even firing those who can't perform seems almost impossible. It usually takes so long---and requires such a prolonged battle through multiple appeals—that managers avoid it like the plague. Good managers waste enormous amounts of time circumventing these rules and battling HR offices in a frustrating attempt to get the right people with the right skills into the right jobs.

Examples

See chapter 12 from *The Price of Government* for examples in budgeting, purchasing, human resources, accounting and auditing. Here are a few of the highlights.

Budget reform:

- ***Provide real savings incentives.*** Challenge agencies and departments to save and reward their efforts by making some or all of the savings available for investments in improved performance. The State of Washington created a Savings Incentive Program in 1997, for example. Agencies can keep half of their general fund savings not related to entitlements or other targeted spending authority.
- ***Provide flexibility to reallocate money across budgets in response to changing circumstances.*** The best solution to the problems of budget rigidity is to give managers lump-sum operating budgets without line items and let them allocate resources as they see fit. Great Britain, Australia, and New Zealand have all done this, because they have created systems that hold top managers accountable for agency performance.
- ***Create an Innovation Fund.*** Innovation funds are pots of money organizations can use to invest in efforts to improve service, reduce costs or both. The city of Hampton, Virginia puts 10 percent of annual shared savings into its innovation fund. These funds are most effective when every investment is connected to a specified return—whether financial, so the fund can be repaid, or in terms of service quality.

Personnel/HR Reform:

- ***Give managers freedom to manage their people***. Decentralize authority for hiring, firing, and promotion. Take it away from Human Resources and give it to the agencies and departments themselves, along with accountability for performance. Make the HR department primarily a consulting or support resource.
- ***Shift to broad job classifications and pay bands to give agencies flexibility in organizing work.*** Reduce the number of job classifications dramatically—down to a few dozen if

possible. Couple this with a "broadband" pay system, with only three to five broad pay ranges within each job classification. Broadband systems, which have proven themselves in many places by now, allow managers to set salaries at levels required to recruit and keep the talent they need.

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

Implementation/ Requirements

- One to two years per system
- Do one at a time – start with the system that gives the greatest support to the statewide strategy.
- You need a champion in the Governor's office.
- Find entrepreneurial leaders to manage the new system design.
- Investment: $750,000 - $1,500,000 over two years, plus staff time
- Savings: Much greater. The state will be able to deliver better results to citizens with fewer employees.

Issue to consider

- The legislature needs to buy in; work closely with legislators and their staffs.

Finding the Money to Invest in Change

Description

Capturing savings while providing the customer with the same or better results requires changing the way services are delivered, financed, and/or managed. This will often require *one-time* investments.

There will be limited available funds for such investments. So, the best approach is to fund change from the savings generated by the change.

Examples

Federal Student Aid

The US Office of Federal Student Aid (FSA) wanted to transform its relationship with what it called "operating partners." These were several private companies that had very large contracts to deliver services associated with financial aid—originating loans, servicing loans, collecting delinquent debt, answering student questions regarding their loans, etc.

On the one hand, FSA wanted to have a performance based relationship with these operating partners, aimed at reducing the unit cost of administering a student loan. The operating partners, on the other hand, wanted to streamline and simplify the quagmire of red tape involved with federal contracts, and they wanted the flexibility to make more profit. Creating a measurement infrastructure to do performance contracting, reengineering some of the reporting and oversight processes, building a performance based culture in the relationship between FSA and the operating partners, and building new information systems to facilitate all this required one-time expenditures of millions of dollars. FSA had no new money to make such investments.

PSG facilitated a weeklong retreat/negotiation involving high-level executives of the operating partners and FSA's top management. The premise of the retreat was that FSA asked for an across the board 20% decrease in the price charged for services by the operating partners. In return, it offered to discuss any and all issues of concern to the operating partners, including the cap on profits that was fixed at 7%. Over the course of a week of hard negotiations the contracts were converted to performance based agreements, reporting requirements were greatly simplified, multiple levels of red tape were simplified into a single powerful system of oversight, and FSA netted a total price reduction of 22% (more than $100 million annually).

Most of the savings were used to bring down the unit cost of loans. But a few million were set aside to make the investments necessary to deliver better results to student borrowers and better oversight of federal money.

Iowa's "Reinventing Savings" Line Item

For the FY 2004 biennial budget, Democratic Governor Tom Vilsack cut a deal with the Republican-led legislature. He proposed broad opportunities for reinvention that were likely to save money, estimated the savings, and put a negative line item in the budget for ongoing savings of $88.5

million, with a one-time $25 million investment to achieve them. The legislature agreed to make the eventual statute changes necessary to accomplish the reinvention. The savings were taken and the investments promised before the actual program changes were worked out. The Budget Report read as follows:

> ***Initiative***
> *The FY04 general fund budget presented by the Governor includes a "reinvention savings" line item. The Director of the Department of Management is responsible for finding and capturing these savings. The Governor has charged Iowa's Reinvention Partner, The Public Strategies Group (PSG), to work with the DOM in finding opportunities to save money and improving service simultaneously.*
>
> *The Reinvention Partner is in the process of identifying a number of such opportunities. Some may require legislation, others not. In each case, the Reinvention Partner will be held accountable for:*
>
> - *Finding and designing the savings opportunities; and*
> - *Producing a measurable improvement in the service provided.*
>
> *A 100% performance based contract between the State and PSG ties fees PSG may earn entirely to the production of these two results. Most of the initiatives under consideration will produce both savings and service improvements that recur from year to year. PSG fees, however, are tied only to the results it can produce in FY04.*
>
> *The Governor's budget also includes $25 million in one-time funds the Director of the Department of Management may invest, at her discretion, in these reinvention savings initiatives.*

Implementation/ Requirements

These are some implementation principles to observe in finding money to invest in change:

- Don't attempt to make significant changes without first setting aside the funds that will be necessary to make those changes. Implementation of these 'game changing' opportunities is not going to be a straight, predictable path (like constructing a new building). Rather, it is going to be an exploration. Successful explorers travel light and carry lots of cash.
- All or most of the necessary investments are ***one time*** in nature. Don't build these expenses into annual operating budgets. Treat them as capital investments.
- For every nickel invested, expect a measurable return. That return may come in the form of savings, a measurable improvement in results delivered, or both. The budget office should act like a bank creating terms that deliver on this expectation.
- Sometimes savings can be "taken off the top" of the budget and thereby captured on day one of the fiscal year. In other cases, it will take more time to capture the savings and/or experience improved results. For this reason, it is wise to develop strategies for financing some of the investments over more than one fiscal year. For instance, some jurisdictions

have used non-dedicated reserves to finance the investments, paying the reserve funds back when the savings are captured.

Issues to consider

- Where will the cash for the investments come from? How will it be repaid?
- What structure will be used to oversee such investments?
- What steps will be taken if some investments fail; that is, the measurable return and/or savings expected from the investment do not materialize?
- Are there existing funds that are suitable for this purpose?
- How will the political, financial and administrative risks of this undertaking be managed?

Transformation Partnerships

One financing strategy that has been extremely successful in PSG's relationship with Federal Student Aid, the New York City Finance Department and the State of Iowa is known as a *transformation partnership.* Similar public/private partnerships are increasingly used to finance and investments in change. For instance, Accenture and other large IT firms have been willing to front-end the cost of expensive government information systems in return for earning a share of the savings from those investments.

The relationship can take many forms. Here's an example of the basic terms of the Reinvention Partnership between the State of Iowa and PSG. Over the four years of its expected life, the Iowa Reinvention Partnership produced more than $50M in documented, captured annual savings and measurable improvements in numerous outcomes, from child protection to environmental control to fleet management to recidivism in state prisons.

These are excerpts from a description of the Iowa Reinvention Partnership.

> **What is a Reinvention Partner?** It is a strategic position in Iowa State government to advise the Legislature, Governor, Lt. Governor and their Cabinet on fundamental changes in the way Iowa delivers services to citizens. Babak Armajani, CEO of the Public Strategies Group has been designated as Iowa's Reinvention Partner and he is supported by a number of his PSG colleagues who will be working with us over the next several years.
>
> **Why have a Reinvention Partner?** The Governor has undertaken the challenge of dramatically reducing state expenditures while simultaneously improving service. Iowa is already a very well managed state with minimal "fat" in its operations. Given the cuts the State has been forced to make, the only way to maintain or even improve service is to fundamentally change the way we do our work. Our Reinvention Partner will guide us over the next several years in making these changes.
>
> **Isn't it dumb to spend money on something like this, when resources are so scarce?** No, we need to invest in change just like any other well-managed organization. Changing the way we work is the key to our future. But here's the good news. The State has negotiated with PSG an innovative funding arrangement. PSG is going to serve its role as Reinvention Partner, provide coaching and consultation to state mangers, conduct certain kinds of training, help strengthen Iowa's performance management systems, and help departments break through barriers to change. The fee for these services will be $ 0.
>
> **What's the catch?** In return for these services, the State has granted PSG the right to enter into performance-based agreements with any state agency. That franchise allows PSG to participate in a variety of specific projects focused on reinventing aspects of Iowa state government. PSG is allowed to enter into share-in-savings, share-in-revenues, and other performance based arrangements with various departments.