ISSUE GUIDE

MICHIGAN'S DEFINING MOMENT

ACTION GROUP • MAY 13, 2009

GOVERNMENT COLLABORATION & ACCOUNTABILITY

THE CENTER FOR MICHIGAN

www.thecenterformichigan.net

INTRODUCTION

Michigan's public purse is torn wide open. State officials are struggling to close a more than $1 billion budget deficit this year. The state is on pace to spend $10 billion more than it collects in taxes a few short years from now. Local property tax revenues are dropping quickly due to foreclosures and falling home values. In short, Michigan's public sector must change the way it does the public's business. The choice is simple – raise taxes, cut costs, or do both.

Michigan raised taxes two years ago to solve the last state budget crisis. Soon thereafter, Governor Jennifer Granholm said she would never again pursue a tax hike. There is almost constant buzz in Lansing about tax cuts and tax increases. But taxes are not the focus of this morning's discussion. This town hall meeting will address one big question…

In the toughest economic conditions since the Great Depression, how does Michigan's public sector – at most reasonably efficient cost –support the kinds of vibrant, high-quality communities where people want to live and work and companies want to do business?

We will discuss 10 possible public sector reform choices across three broad topics: **Collaboration**, **Efficiency**, and **Personnel**. These are, by no means, the only possible "reforms" out there. But they are among the most top-of-mind ideas under discussion in Lansing and at local city council and school board tables. By the widest estimations, the reform proposals we'll discuss today could amount to **more than $5.5 billion in savings** to state and local government and schools. But such savings come with many trade-offs, like lower wages and benefits for public workers and loss of local control for municipalities and school districts.

This Issue Guide offers one-page summaries – including possible savings and pro/con arguments for each of the 10 reform choices we'll consider this morning. Also at your table you have color-coded slides prepared by experts who will lead us in this morning's discussion:

- Mike Flanagan, Michigan Superintendent of Public Instruction (video presentation only)
- Eric Scorsone, Co-Director, State and Local Government Program, Michigan State University Extension Service
- Paul Tait, Executive Director, Southeast Michigan Council of Governments
- Kurt Kimball, City Manager Emeritus, Grand Rapids
- Kevin Prokop, Co-Chair, Michigan Legislative Commission on Government Efficiency
- Doug Roberts, Director, Institute for Public Policy & Social Research, Michigan State University.
- Cynthia Williams, Executive Director, Michigan Education Special Services Association (MESSA)

This issues guide was written by Center for Michigan Executive Director John Bebow and reviewed before publication by today's panel members.

We'll cover a lot of territory quickly this morning. John Bebow and Public Sector Consultants Senior Vice President Peter Pratt will review the reform choices in a question & answer exchange with the expert panel. Participants will vote on the reform choices using the digital clickers at your tables. There will be open discussion between participants and the experts. Finally, volunteer work groups will be formed to continue work here in Lansing on the reform topics that gain the most momentum throughout this interactive morning. **A detailed agenda is on the next page**.

PROGRAM AGENDA

8:00 a.m. – Grab a cup of coffee and pick a seat

8: 15 – Opening remarks, introduction of panelists – Phil Power, President, Center for Michigan

8:30 – Expert Discussion on **Collaboration Reform Choices**

- Intensified School Consolidation & Service Sharing
- Intensified Local Government Consolidation & Service Sharing
- Reform of Act 312 (binding arbitration)
- Reform of Urban Cooperation Act (wage & benefit barriers to collaboration)

9:00 – Town Hall Q & A Between Participants and Experts on Collaboration Reforms

9:30 – Digital Voting (with instant results) on Collaboration Reforms

9:40 – Expert Discussion on **Efficiency Reform Choices**

- Benchmarking Best Practices
- New State Revenue Sharing Formula Reform

10:10 – Town Hall Q & A on Efficiency Reforms

10:40 – Digital Voting (with instant results) on Efficiency Reforms

10:50 – Expert Discussion on **Personnel Reform Choices**

- Wage Cuts & Layoffs
- Retirement Benefits
- Health Care Co-Pays
- Pooling of Public Sector Insurance Plans

11:20 – Town Hall Q & A on Personnel Reforms

11:50 – Digital Voting (with instant results) on Personnel Reforms

Noon – Reform Action Group Activity Signups. Lunch. Have a nice day.

COLOR-CODED SLIDE GUIDE

GOLD: Mike Flanagan on school accountability and service sharing
PINK: Paul Tait on consolidation, collaboration, and possible efficiencies
GREEN: Eric Scorsone on consolidation, collaboration, and benchmarking
BLUE: Kurt Kimball on collaboration success, Act 312, and Urban Cooperation Act
YELLOW: Kevin Prokop on revenue sharing and benefits pooling
ORANGE: Doug Roberts on retirement benefits
LAVENDER: Cynthia Williams on benefits pooling

COLLABORATION REFORM CHOICES

CHOICE 1: INTENSIFIED SCHOOL CONSOLIDATION & SERVICE SHARING

CONCEPT: Michigan has more than 500 local public school districts. Combining various district operations – from busing to back-office administration functions like purchasing and payroll – may result in economies of scale, especially in rural areas, while allowing districts to maintain their local identities. A legislative efficiency commission has floated the idea of giving the state school superintendent the power to consolidate neighboring districts if budget savings of 5 percent can be realized. Another approach would be to mandate shared services at the county-wide Intermediate School District level.

POSSIBLE SAVINGS: Recent rigorous statewide estimates of the savings implications of school district mergers and shared services were unavailable for this guide. A couple points of reference… If two neighboring districts each received $8,000 per pupil in state funding, and a 5 percent savings could be achieved through service sharing or consolidation, the districts would save **$400 per student per year**. A Deloitte study last year suggested schools could save $9 billion nationwide through service sharing.[1] Michigan's very rough share of that $9 billion estimate would be **$300 million**, based on population. $300 million is about 2.5 percent of total state spending on local schools.[2]

PROS: Money-saving consolidations and service sharing could lead to less investment in school bureaucracy and more on classroom education. Putting the responsibility – and heat – for school consolidations on the state education boss would insulate local officials from often- heated local arguments over school closures and program changes.

CONS: Loss of local control over local schools. Service sharing programs elsewhere have produced mixed results, according to the American Association of School Administrators.[3]

COLLABORATION REFORM CHOICES

CHOICE 2: INTENSIFIED LOCAL GOVERNMENT CONSOLIDATION & SERVICE SHARING

CONCEPT: Michigan has more than 1,800 units of local government. Conventional wisdom suggests that consolidating some of those governments could result in money-saving staffing efficiencies and economies of scale in such things as purchasing. In practice, there has been only one such consolidation in Michigan in recent years – three small towns that formed the new city of Iron River in the 1990s[4]. Larger consolidation pitches – such as an idea to combine Farmington and Farmington Hills – have not won local political support. However, local governments across the state have found hundreds of money-saving ways of working together. In west Michigan, Grand Rapids and surrounding cities have joined forces on 109 different services, including such things as community service work crews, police cadet training, emergency dispatch, waste disposal, transit, recreation, and public works equipment sharing[5]. In metro Detroit, the Southeast Michigan Council of Governments lists 250 such collaboration examples[6]. Yet four years ago, a detailed statewide survey of hundreds of governmental units by the Citizens Research Council of Michigan found the vast majority of governments were not cooperating on such things as accounting, payroll, purchasing, printing, building security, janitorial services, cemetery maintenance, fleet services, permitting and code enforcement, community planning and development, and parking lot/structure management.[7] Governor Jennifer Granholm and other political leaders have discussed requiring greater consolidation and collaboration but have not provided funding mechanisms that would either incentivize or force action.

POSSIBLE SAVINGS: In Iron River, the consolidation led to local government savings of **10 percent**.[8] A proposed consolidation of Farmington-Farmington Hills was projected to save about **$3.7 million** per year – a savings of $250-400 for each Farmington household and $40 for each Farmington Hills household.[9] Greater consolidation of fire and emergency response services could save an estimated 15 percent (or **$100 million**) per year statewide.[10]

PROS: Intensified consolidation and service sharing could save significant money, funnel more resources directly into top-priority services, and encourage greater regional planning, cooperation, and economic development.

CONS: Possible loss of local control and possible erosion of traditional town identities. A funding model to incentivize or force consolidations and service sharing would be complex and the push for long-term savings could result in initial, short-term upheaval.

COLLABORATION REFORM CHOICES

CHOICE 3: REFORM OF ACT 312

CONCEPT: This four-decade-old law prevents police and firefighters from going on strike by requiring labor disputes to go to binding, third-party arbitration far removed from local city council tables. Public safety costs amount to as much as half of an average city budget. Economic studies suggest that binding arbitration drives up local government costs by 3-5 percent.[11] City administrators also argue Act 312: 1) Stymies money-saving consolidation of neighboring police and fire departments; 2) Can result in budget-breaking back pay awards; 3) Can drive up pension benefits to the point where, in some cases, retirement incomes are greater than wages when officers are still on the job.[12]

POTENTIAL SAVINGS: Based on economists' published estimates, removing binding arbitration could, over time, result in a 3-5 percent reduction in local government expenditures. Local governments in Michigan spent $2 billion on public safety in 2006[13], the last year for which full data is available. A four percent reduction would amount to annual savings of **<u>$80 million</u>** statewide.

PROS: Savings on labor costs and returning control of those costs to local elected officials rather than distant arbitrators. Simplified labor negotiations, since many workplace issues beyond pay and benefits are now argued for many months in arbitration cases.

CONS: A renewed threat of police and firefighter strikes or "sickouts" if Act 312 is fully repealed. Likelihood of intense morale problems among public safety workers. Complications from a statewide "solution" to a problem affecting a small minority of municipalities, according to labor leaders.

COLLABORATION REFORM CHOICES

CHOICE 4: REFORM OF URBAN COOPERATION ACT OF 1967

THE CONCEPT: If two or more cities want to formally consolidate or merge departments, the highest wages and benefits offered by any of the cities involved in the merger would become the rule for the employees of all the merged operations. That's a key concept of the Urban Cooperation Act. Local government leaders say it is a huge impediment to further government consolidation, service sharing, and cost savings. "We can talk about consolidation in Lansing until we're blue in the face," the Michigan Municipal League recently stated. "Local units of government are even open to the idea. But without changes to the Urban Cooperation Act and Public Act 312, it's nothing but talk."[14]

POSSIBLE SAVINGS: We have not found a calculation for detailed cost savings from reform of the Urban Cooperation Act. But experts say this reform is a precursor to many of the consolidation and service sharing cost savings estimates listed earlier in this document.

PROS: Removing the highest wages and benefits provision in the law would help open the door to cost-saving consolidations, service-sharing agreements, and potentially greater regional cooperation and planning.

CONS: Potential loss of local control and potential reductions in pay and benefits for some workers.

EFFICIENCY REFORM CHOICES

CHOICE 5: BENCHMARKING BEST PRACTICES

CONCEPT: The Internet and modern database techniques make it possible to gather reams of data on a wide range of public sector services. Local governments can use such benchmarking data to compare themselves against peer governments, and identify and implement “best in class” practices. Cost efficiencies in many areas – like road maintenance costs per mile, crimes solved per police officer, or costs of vehicle maintenance, prisoner meals, utilities, and health care plans – can be identified and leveraged.

POSSIBLE SAVINGS: A consortium of local governments in North Carolina has seen substantial savings through a benchmarking program launched in 1995. Local anecdotes include municipalities that reduced refuse hauling expenses by 30 percent, recycling expenses by 60 percent, and fire service costs per response by 44 percent.[15] Potential savings for Michigan’s public sector could be in the range of 2.5 percent of spending on a periodic basis.[16] Local government savings of 2.5 percent across Michigan would amount to about **$100 million** per year.[17]

PROS: Savings through benchmarking efficiencies could help maximize service levels in an era of very limited revenues. In addition to savings, benchmarking provides greater accountability across governmental units and creates an annual scorecard on which the public sector can measure annual performance. For example, the state of Oregon annually holds itself accountable for roughly 100 benchmark performance measures[18]. Michigan has no such system despite repeated pleas by budget and public policy experts to create one.

CONS: Full, state-mandated local government benchmarking would add unknown costs to each local government. A pilot program at Michigan State University involving 40 units of government costs $60,000 per year. Administering the program for all 1,800 units of local government across Michigan would cost an estimated $500,000-$700,000 per year.[19]

EFFICIENCY REFORM CHOICES

CHOICE 6: NEW STATE REVENUE SHARING FORMULA

CONCEPT: Michigan's more than 1,800 units of local government will receive $1.1 billion in revenue sharing payments from the state this year[20]. About 60 percent of that money comes from a constitutionally guaranteed portion of state sales tax revenues and the rest is provided under other state budget-related law[21]. Each city, county, village, and township gets revenue sharing based on population. A legislative efficiency commission has suggested "a constitutional amendment that establishes a level of payment to local governments and counties that follows services and not the unit of government."[22]

POSSIBLE SAVINGS: The legislative efficiency commission estimates that a new revenue sharing formula that leads to greater local government efficiency could save $250 million or more per year.[23] A new revenue-sharing formula could, conceivably, allow the governor and legislature to impose specific cost savings measures on local governments. For example, the Southeast Michigan Council of Governments lists the following potential Deficit Reduction Opportunities[24]:

- Apply a four-day, 32-hour work week to save up to 20 percent of labor costs.
- Reduce or eliminate least important services to save 10 percent.
- Rebid all purchases to save 10 percent.
- Privatize non-critical services to save 15 percent.
- Consolidate departments and organization structure to save 15 percent.
- Reduce non-competitive overhead and administration costs by 30 percent.
- Re-open union contracts to reduce benefits costs by 30 percent.
- Sell revenue-producing assets for a one-time cash infusion.
- Restructure debt.
- Collaborate with neighbors to save 30 percent.

Many local governments have voluntarily pursued such cost-saving strategies. Greater control over revenue sharing could allow the governor and legislature to impose mandatory efficiency strategies.

PROS: Leverage for a "carrot-and-stick" funding approach – financial rewards for best practices and penalties for inefficiencies. Financial rewards for intergovernmental cooperation and penalties for isolationists.

CONS: Loss of local control over government programs. Year-to-year budget uncertainty for local governments. Many challenges in de-politicizing and ensuring fairness in a revenue-sharing system not based on population. Local governments have already endured years of revenue sharing cuts because of legislative acts and lagging state sales tax revenues.

PERSONNEL REFORM CHOICES

CHOICE 7: WAGE CUTS & LAYOFFS

CONCEPT: The annual cost of public sector employees in Michigan is an estimated $33.3 billion (in a $381 billion[25] state economy.) That's about $81,000-$83,000 per worker year. Following the often-used corporate cost-cutting strategy of eliminating jobs, Michigan's public sector could obtain considerable savings. Michigan's state government includes 53,700[26] employees who earn, on average, $54,250[27] in wages and $29,300[28] in benefits each year. Altogether, Michigan's total public sector, including local schools, colleges, universities and local governmental units, had an estimated 411,659[29] full-time employees in 2007 who earned, on average $51,800[30] in wages, $18,616[31] in pension benefits, and $10,400[32] in employer-paid health care annually. Across-the-board staff cuts among Michigan's thousands of individual public sector entities would be impossible to impose, though the governor and legislature could, conceivably, force such reductions with drastic cuts in revenue sharing with local schools and governments.

POSSIBLE SAVINGS: As an example, a 10 percent reduction in state workforce or compensation could save $**450[33] million** per year. A 10 percent reduction in Michigan's total public sector workforce or compensation could save **$3.3 billion** per year. Applying a four-day, 32-hour work week across Michigan's public sector could save up to 20 percent (**$6.6 billion**) per year.[34]

PROS: A shrinking private sector tax base cannot support a static public sector workforce. Job cuts would force government to simplify operations and focus on mission-critical public services in an era of dire economic circumstance.

CONS: Michigan's public sector has already made considerable sacrifices. The state government workforce is down 9,500 workers (or 15 percent) from 2001[35]. Many local governments and schools have also made cuts. Cost cutting has contributed to a shrinking school year in Michigan – more than 40 percent of school districts now hold fewer than 170 days of instruction (two full weeks below the national standard of 180 days[36]. Michigan is already 10 percent below the national average in overall local government and schools staffing levels. The difference is especially acute in key public safety staffing areas: Michigan police staffing (19 percent below national average), fire fighters (37 percent below national average), and water and sewer workers (7 percent below national average).[37] Shortened work weeks and lower staffing levels would naturally lead to lower service levels. And, more job cuts in the public sector will likely lead to less discretionary spending in the general Michigan economy.

PERSONNEL REFORM CHOICES

CHOICE 8: TIGHTEN PENSION ELIGIBILITY & MOVE TO 401K-STYLE RETIREMENT PLANS

CONCEPT: There are more than 130 public employee pension systems in Michigan representing more than 220,000 retirees and more than 500,000 active employees.[38] Altogether, state and local governments, including schools, in Michigan contributed $5.3 billion to pension systems in 2006, the last year for which full data is available.[39]Most notably, the Michigan Public School Employees' Retirement System (MPSERS) represents more than 162,000 retirees and beneficiaries. In 2008, Michigan schools contributed $1.5 billion to fund MPSERS. Over the past five years, increased contributions to MPSERS accounted for 42 percent of all increases in state funding for schools.[40] Tightening pension eligibility and/or moving to 401k plans could reduce annual pension expenditures, allowing some funds to be redirected to other local government services and classroom expenses.

POSSIBLE SAVINGS: Tightened eligibility and benefits changes could result in eventual annual savings of **$87 million**[41] in the educators' retirement system. If tightened eligibility standards and benefits changes could produce 5 percent savings statewide, it would equate to **$265 million** in annual savings.

PROS: Tightened retirement spending in the public sector would reflect recent trends in the private sector and allow some public funds currently spent on legacy systems to be reinvested directly in acute public services and classroom needs.

CONS: Labor unions contend that switches from pensions to 401k-style retirement plans do not save money and do not provide adequate and secure retirement incomes for public employees.[42] Pension negotiations are highly controversial, subject to collective bargaining, and certain to lead to morale problems among affected public employees. Initial costs of moving from pensions to 401k plans for teachers would amount to more than $100 million in the first year and it would take many years of annual savings to recoup the up-front investment.

PERSONNEL REFORM CHOICES

CHOICE 9: INCREASE HEALTH CARE CO-PAYS

CONCEPT: Widespread cuts to private and public sector benefits are a well-documented trend in recent years. Significant additional public savings could result from cutting public sector health care costs and increasing co-pays for public workers. In 2007, almost 213,000 State of Michigan employees and retirees received health care benefits at a combined cost of $1.45 billion. These benefits costs exceed the national average for other public sector systems and the employee share of premiums is lower on average than in other public and private sector systems.[43]

POSSIBLE SAVINGS: Increasing state employee and retiree health care premium co-pays to match the *nationwide* average for family coverage could save **<u>$269 million</u>** per year. Altogether, state and local governments, including schools, spent $7.1 billion[44] on health insurance benefits in 2005-06, the last year for which full data is available. An across-the-board shift of 10 percent of those expenses from employer to employees would save an estimated **<u>$700 million</u>**.

PROS: Shifting health care costs from employers to employees can be a relatively quick public sector cost cutting mechanism. Such shifts would bring public sector benefits in line with those available in the private sector which pays for the public sector.

CONS: Shifting costs from employers to employees may actually increase long-term health care costs if employees forego needed care and require most expensive care later on. Cost shifting also fails to address the causes of rising health care costs. Benefits changes are complex and highly emotional issues subject to collective bargaining. Further cuts to benefits would negatively impact morale in public workplaces, where workers have been subject to many types of spending and staffing cuts in recent years. Statewide mandates of across-the-board benefits cuts to local government workers would be impossible due to Michigan's tradition of home rule.

PERSONNEL REFORM CHOICES

CHOICE 10: MANDATED HEALTH CARE BENEFITS POOLING

CONCEPT: A statewide insurance pooling system for public employees may save money by consolidating administration, pooling the risk of individual catastrophic claims, and providing power in numbers to negotiate lower rates with insurers. Michigan Public Act 106, passed two years ago, allowed for a smoother creation of such voluntary pools.[45] But, so far, not a single new insurance pool has been created among local governments and schools since the act became law,[46] suggesting that a voluntary pooling law is ineffective or not yet compelling to local governments. State law does not mandate pooling. A legislative reform commission has discussed the creation of a combined statewide system for public employees.[47]

POSSIBLE SAVINGS: Legislative analysts who studied the possible impacts of Public Act 106 of 2007 did not estimate the potential savings. Savings from pooling could be **<u>$156-223 million</u>** per year *for school districts only*, according to a 2005 paper by the American Federation of Teachers and International Union of Operating Engineers.[48] That estimate did not include additional savings for local government. The unions' study estimated pooling could cut 7 percent of school district health care costs. If such pooling savings could be extended across Michigan's full public sector, a 7 percent savings would amount to more than **<u>$500 million</u>** per year.[49]

PROS: Lowering and containing health care costs may allow schools to put more money into classroom education and local governments to spend more on direct public services. The Michigan Education Special Services Association (MESSA) offers the benefits of pooling for more than half of all public school and community college employees in Michigan. MESSA points to more than $500 million in cost savings in the past five years through new benefit plan options.

CONS: Pools could limit health care choices for workers. Results of small regional pools are mixed. One pool of west Michigan schools raised rates by 21.7 percent in 2007-08, while MESSA has kept annual rate increases to an average of less five percent over the last four years.[50] Creation of a statewide pool would be a massive, time-consuming undertaking—involving numerous union contracts—that could possibly result, at least in the near term, in considerable confusion and morale problems among public workers.

SOURCE NOTES

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THE CENTER FOR MICHIGAN

www.thecenterformichigan.net

4100 North Dixboro Road
Ann Arbor, MI 58105
734-769-4625 office
734-769-4703 fax

John Bebow, Executive Director
jbebow@thecenterformichigan.net

Kim Johnson, Southeast Michigan Outreach
248-321-8635
kjohnson@thecenterformichigan.net

Nancy Short, Central Michigan Outreach
202-390-5766
nshort@thecenterformichigan.net