



Contact: Lauren Stewart  
Policy Analyst, 202-624-5332  
October 18, 2010

## State Government Redesign Efforts 2009 and 2010

### Executive Summary

States have experienced record budget shortfalls over the past several years due to sharp declines in state revenues. In response, governors have taken record measures to downsize and redesign state governments during the 2009 and 2010 state fiscal years. Such efforts likely will continue over the near future. Economists predict that state revenues (in real terms) may not reach 2008 levels until late fiscal 2012 or early fiscal 2013. At the same time, the costs of government services will continue to rise, as will ongoing liabilities related to health care, pensions, and other benefits. States also will have to deal with many long-term investments that have been deferred. Thus, state budgets may not recover until the end of the decade.

The NGA Center for Best Practices (NGA Center) has been tracking states' efforts to downsize and redesign government. In FY 2009 and 2010, a broad range of budget cuts and programmatic changes were enacted; some of the changes are temporary but most reflect a "new normal" for state government in the long term. At least 15 states conducted government wide efficiency reviews to identify areas of state government that can be made more efficient and less costly; at least 18 states have reorganized agencies; and more than 20 states have altered employee compensation, including enacting pension reforms.

This Issue Brief examines these actions and others that governors have been taking to deal with the austere budget reality. The actions include the following policy areas:

- **Corrections.** Many states have found that the best opportunity for savings in corrections is to stop building or even close prisons. To do so, states have moved forward with efforts to safely reduce prison populations through sentencing reform, improved reentry programs, and enhanced community parole and probation oversight.
- **K–12 Education.** Governors have tried not to reduce funding for K–12 education and tried instead to achieve greater efficiency with existing resources. Recent efforts include policies to encourage district consolidation, allowing class size to increase, and cutting noncore programs.
- **Higher Education.** States are making cuts to higher education funding, while urging their university systems to become more efficient and raise the percentage of students that graduate. Many states are beginning to employ performance funding that ties a portion of the state's subsidy to the number of degrees awarded instead of just to enrollment. States also are requiring colleges to produce more measures that report degree completion and value to the student.

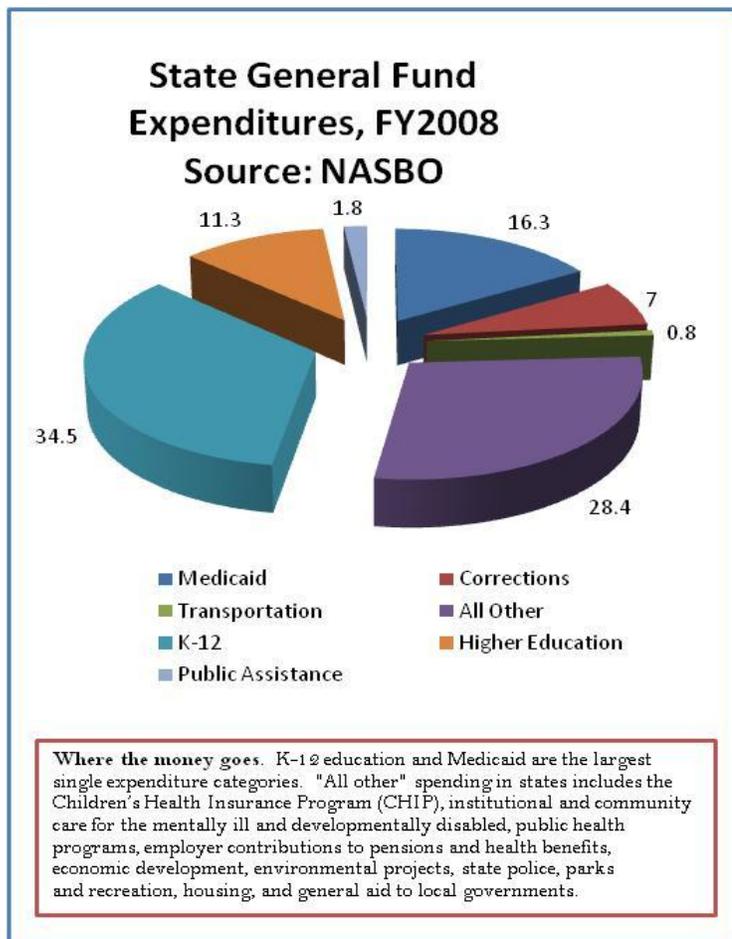
- **Employee Costs.** States have acted to achieve short-term reductions, such as furloughs, layoffs, and other adjustments, but also realize that long-term solutions are necessary. At least 18 states reformed some aspect of their pension systems during 2009–2010, including reducing benefits for future employees.
- **Shared Services and Agency Consolidation.** States are consolidating agencies, sharing services across departments, and in some cases eliminating programs and entities that are nonessential. For example, **Massachusetts** consolidated five separate agencies into one transportation agency; **Washington** eliminated 74 boards and commissions in 2009 and another 69 in 2010.
- **Privatization and Asset Sales.** States are increasingly looking toward privatization and asset sales to raise cash and keep unnecessary ongoing expenses off state books for good. Recent actions taken or under consideration include privatizing state-run liquor stores and selling unneeded state property.
- **Tax Expenditures.** Many states have looked at ways to recover revenues forgone through tax expenditures. **Oregon**, for example, proposed temporary rules in July 2010 that would decrease the impact of the residential energy tax credit program on the state’s general fund.

These activities reflect states’ efforts to downsize and redesign to survive during tough budget times and to emerge competitive after the recession.

### Background

States have experienced unprecedented budget shortfalls over the past several years. In FY 2008, state general revenue expenditures totaled \$687.3 billion. In FY 2010, they fell to \$612.9 billion. Expenditures are forecast to rise only to \$635.3 billion in FY 2011, still \$52 billion lower than in 2008. To accommodate these lower spending levels, governors have enacted a broad range of budget cuts and programmatic changes, some of which are temporary but many of which reflect a “new normal” for state government in the long term.

The need to restrain state spending will continue. The long climb to fiscal recovery may begin in FY 2011, but the return to state fiscal health will take many years. State revenues are not likely to return to 2008 levels until late



in 2012 to early in 2013 (in real terms), and state budgets may not fully recover until near the end of the decade because of deferred investments and the higher costs of delivering services. Thus, governors will face budget challenges for the foreseeable future and must consider long-term solutions to reduce the cost of government.

This fiscal reality presents not only a challenge but also an opportunity for governors. The current situation has revealed many aspects of state government that have become unsustainable and that cannot be addressed by short-term budget fixes alone. This realization has prompted governors to reexamine the core structures of their state government, with the hope of emerging from the Great Recession functioning better and smarter than before.

Many states have already taken action to redesign state government by consolidating some services and privatizing others, reforming employee compensation and pensions, and adopting smarter policies in the areas of corrections and education to “do more with less.” This Issue Brief outlines specific examples of such efforts undertaken by states during 2009–2010.

Although states are examining all government functions for potential savings, most of the activity has been concentrated in the following areas:

- Corrections
- K–12 education
- Higher education
- Employee costs
- Shared services
- Privatization and asset sales
- Tax expenditures

One major budget category that continues to be a substantial cost for states but offers little opportunity for near-term savings is Medicaid. Health care costs have continued to rise, and Medicaid rolls have grown each year because of the recession. The new federal health care law will expand Medicaid eligibility in 2014, putting additional upward pressure on state Medicaid costs.

### **Corrections**

In 2009 and 2010, a total of 40 states have made program area cuts to corrections.<sup>1</sup> This area is a major target for savings because other than Medicaid, the corrections system is the fastest-growing category in state budgets.<sup>2</sup> As a result, many states want to find ways to safely reduce the prison populations and close state prisons. That can be achieved through sentencing reform to reduce the nonviolent prison population and enhance community parole and probation oversight. Health care for prisoners is another area in which states have found opportunities for reducing costs. These steps, combined with closing inefficient facilities, can yield substantial returns for state budgets.

### *Prison Closures*

The high cost of state prisons, made higher because many of the nation's prisons are aging and inefficient, has prompted many states to take policy actions that will allow them to close prison facilities. States such as **Colorado, Connecticut, Michigan, Nevada, New York,** and **Washington** have recommended prison closures as a response to budget shortfalls.

For example, **Washington** Governor Chris Gregoire has directed the department of corrections to take several measures to reduce the number of prison beds in the system. Actions include closing two facilities and downsizing two others, for a savings of \$49 million.<sup>3</sup> **Michigan** has decided to convert one of its maximum security prisons into a federal facility. The county inspector valued the building at more than \$18 million and the 100-plus acres of land around it at more than \$200,000.<sup>4</sup>

Resistance from corrections unions can be a challenge for states because state prisons often create jobs in isolated areas. For example, **Nevada's** government efficiency commission, the Nevada Spending and Government Efficiency (SAGE) Commission, recommended immediate closure of the Nevada State Prison (NSP) back in 2008. In June 2010, after almost two years of conflict with the Nevada's labor unions, Governor Jim Gibbons approved plans to phase out operations at NSP.<sup>5</sup> The gradual phase-out plan, created by the director of the state's department of corrections, will address staffing concerns by transferring inmates and staff to other facilities and implementing furloughs once a month beginning in July 2010, saving the state \$3 million. At least 31 other states have reduced staff, instituted hiring freezes, reduced salaries or benefits, or eliminated pay increases for corrections workers.<sup>6</sup>

### *Sentencing Reform*

To help enable prison closures, states have begun reforming their corrections policies to lower the number of nonviolent offenders going to prison. **California,** for example, was advised by a panel of federal judges to release up to 57,000 nonviolent inmates from the overcrowded system to help save \$800 million. **New York** has eliminated mandatory minimum sentencing for certain classifications of nonviolent felons and expanded drug treatment programs and other alternatives to incarceration. As of February 2010, more than 200 offenders had been resentenced, and 1,500 were resentenced retroactively.<sup>7</sup>

Such changes often take longer to yield savings, but the savings can be sustained over time. **South Carolina,** for example, approved a sentencing reform package in June 2010 designed to save the state \$400 million over the next five years by reducing incarceration of nonviolent offenders and more closely supervising released inmates to reduce recidivism. The measure is expected to reduce the states future prison population enough to eliminate the need for a new prison.<sup>8</sup>

*According to a recent report, nonviolent offenders make up over 60 percent of the prison and jail population. Nonviolent drug offenders now account for about one-fourth of all offenders behind bars, up from less than 10 percent in 1980.*

Source: "The High Budgetary Cost of Incarceration," Center for Economic and Policy Research, Washington, DC., June 2010.

States such as **Colorado**, **Virginia**, **Vermont** and **Washington** have introduced graduated sentencing policies to help shrink the population of nonviolent offenders. For example, **Vermont** enacted legislation in 2010 that creates a home confinement alternative for certain nonviolent offenders who would otherwise have been sentenced to prison. **Washington** created a parenting sentencing alternative, which became effective in June 2010. To participate, an offender must be placed on electronic monitoring and must comply with other program requirements. Sexual and violent offenders are not eligible.<sup>9</sup>

**Ohio** is considering a policy that would reduce a prisoner's sentence by seven days during every month that the prisoner attends treatment or other programs.<sup>10</sup> The Seven Day Earned Credit policy could save the state over \$11 million annually, according to analysis by the Ohio Office of Management and Budget.<sup>11</sup> When **Nevada** increased the amount of time an inmate could earn through substance abuse education, the state freed an estimated 51 prison beds in fiscal year 2008.<sup>12</sup>

A review by the National Council on Crime and Delinquency of state "accelerated release" policies over a 23-year period found no statistically significant increase in rates of recidivism among offenders whose periods of incarceration were reduced. In fact, an evaluation of **Wisconsin's** earned time policy found a decrease: 17 percent of inmates released early returned to prison after the first year, compared to 28 percent of those freed on their mandated release date.<sup>13</sup> Wisconsin will save an estimated \$30 million in 2011 through its early release program and other sentencing reforms, such as allowing inmates to serve reduced sentences for good behavior and early discharge from probation.<sup>14</sup>

**Colorado** has also revised its sentencing policies to reward good behavior. Starting in 2009, the department of corrections began allowing deduction of up to 60 days from the sentence of a nonviolent inmate for good behavior. The revisions will yield an estimated savings of \$12 million over the next three years, which will be appropriated to recidivism reduction programs.<sup>15</sup> In 2010, Colorado also enacted legislation to lower classification levels for drug possession, including reclassifying possession of small amounts from a felony to a misdemeanor. According to the bill's fiscal impact statement, the changes will save more than \$1.4 million in FY 2010–2011 and more than \$6 million in FY 2011–2012.<sup>16</sup>

Many other states have looked at sentencing reforms as part of efforts to improve efficiency. For example, **Missouri** is now providing judges with assessments of the cost to taxpayers for each particular sentence given. The data derive from a set formula, are specific to each defendant, and include an estimate of the likelihood that the individual will reoffend.<sup>17</sup>

**Vermont's** government redesign initiative, Challenges for Change, recommended additional corrections reforms that could save the state as much as \$7 million, including alternative sentencing options, such as home incarceration (24/7 at home) and home confinement. These sentencing policies allow offenders to participate in employment, treatment, and community service programs that could help return productive citizens to society.<sup>18</sup> Likewise, **Utah's** Advisory Commission to Optimize State Government recommended that the state reduce recidivism through adoption of evidence-based practices in sentencing and increased commitment to education and treatment programs.<sup>19</sup>

### *Parole and Probation Reform*

Reducing prison populations must be combined with investment in strong supervision for offenders to maintain public safety. According to the Pew Center on the States, it costs states \$78.95 per day to house a prisoner, compared to \$3.42 per day to fund a probation program.<sup>20</sup> Options for states include moving low-level offenders and probation and parole violators out of state prisons, while bolstering community supervision programs, and accelerating the release of nonviolent inmates who complete risk reduction programs.<sup>21</sup> For example, **Kansas** has shifted from a traditionally enforcement-oriented corrections system to a focus on surveillance. Beginning in 2009, probation officers started helping offenders find work, health care, housing, counseling, transportation, and child care.

Many of the improved probation programs follow **Hawaii's** HOPE program model, launched in 2004. The program, Hawaii's Opportunity Probation with Enforcement (HOPE), reformed the state's policy so that probation violations resulted in immediate but graduated sentences. Before the reform, offenders had to commit many infractions before facing consequences, but the consequences were expensive and often disproportionate to the infraction.<sup>22</sup>

Under the HOPE program, technical infractions (such as a missed drug test) result in jail terms that occur in the same week as the violation but usually last only a few days. Sentence length increases for successive violations. In 2010, findings from a one-year, randomized controlled trial of the program were released, showing that HOPE probationers were 55 percent less likely to be arrested for a new crime, 72 percent less likely to use drugs, 61 percent less likely to skip appointments with their supervisory officer, and 53 percent less likely to have their probation revoked. Importantly, the offenders served an average of 48 percent fewer days of incarceration than the control group. The program was expanded in April 2010 because of its success.<sup>23</sup>

In 2010, **Alabama** enacted legislation authorizing graduated sanctions for technical probation violations, including participation in intensive probation supervision or other sorts of community corrections programs, provided that the offender is nonviolent and has maintained compliance for six consecutive months. The legislation defines a "technical violation" of probation as any violation other than the commission of a new offense.<sup>24</sup>

States are also providing incentives for local governments to do a better job. In 2010, **California** enacted legislation to improve the state's probation programs by rewarding county probation programs for success in reducing recidivism and revocations among felony probationers. The California Legislative Analyst's Office has calculated that the state spends roughly \$50,000 in marginal additional prison and parole costs for each probationer sentenced to prison. Specifically, the law establishes community corrections programs to carry out probation supervision, and each county is eligible to receive up to 45 cents of every dollar in state savings resulting from successful reductions.<sup>25</sup>

**Arizona** enacted a similar law in 2008, awarding counties 40 cents on every dollar saved.<sup>26</sup> Counties can use the funds to improve community supervision.<sup>27</sup> In 2009, **Illinois** established performance incentive funding through the Crime Reduction Act. The law provides funds to counties that pledge a 25 percent reduction in the number of eligible nonviolent offenders committed to state prison facilities, through increased success in probation and parole.<sup>28</sup>

### *Health Care for Prisoners*

Health care for prisoners also accounts for a significant proportion of states' corrections costs—about 10 percent of total spending.<sup>29</sup> A review of the **California** Department of Corrections (DOC) in 2009 found that “a significant portion of the cost of housing inmates is for providing health care, which includes contracted specialty health care.”<sup>30</sup> Moreover, 32 percent of all overtime costs in the California DOC during 2007–2008 was related to health care guarding and transportation.<sup>31</sup> Many states have found similar, unsustainable costs associated with health care for their prisoners. In response, several states have acted during 2009 and 2010 to control those costs, the effort to reduce corrections spending to sustainable levels.

The **Idaho** Department of Correction is saving more than \$525,000 on a new medical contract for state prison inmates that focuses on preventive care, reducing the cost per inmate from \$12.45 per day to \$12.15 per day. The savings come from catching medical problems early, before specialists or trips to a hospital are needed.<sup>32</sup>

Similarly, **Michigan's** recommendations for its 2011 budget includes \$4.6 million in expected savings from a recommended drug formulary review and changes in prescribing practices. **New York** expanded the eligibility requirements of its medical parole policy for a projected annual cost savings of \$2 million.

### *Geriatric Care*

That the nation's prison population is aging rapidly is another source of rising health care costs. The number of people 55 or older in state and federal prisons grew 76.9 percent between 1999 and 2007.<sup>33</sup> The over-50 population is expected to grow to one-third in 2010.<sup>34</sup> Older prisoners cost states much more—\$70,000 per year compared to \$23,876 for an average state inmate.<sup>35</sup>

In 2008 and 2009 several states, including **Alabama**, **North Carolina**, and **Washington**, enacted policy reforms that would allow some older inmates to serve the remainder of their sentences in the community. In **Virginia**, a study for the appropriations committee of the House of Delegates estimated that the department of corrections could save up to \$6.6 million if 62 individuals—15 percent of the population eligible for geriatric release—were released in 2010.<sup>36</sup>

## **K–12 Education**

K–12 education is an area that is usually immune from state budget cuts, but the severity of the recession has resulted in lower K–12 funding in many states. Budget cuts have resulted in larger class sizes and a shorter school year in some cases. In others, states have eliminated programs, moved to consolidate school districts, and adjusted teacher compensation to find savings. Many of these changes reflect a trend to concentrate resources on core curriculum and away from expansions that occurred over the past several years. Most of the decisions on how to respond to reduced state aid are left to local school districts.

### *Changes to School Aid*

As many as 39 states made broad program area cuts in K–12 in fiscal years 2009 and 2010.<sup>37</sup> Most involved allowing class size to increase (by raising student-to-teacher ratios in funding formulas), reducing administrative staff allocations, and cutting funds for staff training. **Texas**, for example, formed a special House-Senate committee on school finance that is looking at class

size and other education costs in advance of the 2011 legislative session. Specifically, the committee is looking at increasing class size, which has been capped at 22 pupils for more than 30 years. This school year, 144 districts received waivers from the state that allowed larger classes at 544 elementary schools.<sup>38</sup> In **Florida**, a resolution to ease its constitutional cap on class size will be on the November 2010 ballot.<sup>39</sup> **Virginia** cut funding for reduction of class sizes in kindergarten through third grade.<sup>40</sup>

Some states have reduced costs by altering the formula for state aid to local schools. In June 2010 **Rhode Island** enacted a new education funding formula developed by the state department of education and education experts at Brown University. Under the new formula, money will follow each student, with annual aid allocations shifting along with changes in enrollment patterns and community wealth. The key factors used to determine state aid to schools will include a new state share ratio that considers the capacity of each district to generate revenue and the concentration of at-risk students.<sup>41</sup>

#### *School District Consolidation and Shared Services*

Governors have another option to reduce costs related to K–12 education in school district consolidations. Back in 2008, **Maine** consolidated 260 school districts into 80, to save \$36.5 million. Many states have looked at consolidation in 2009–2010. For example, a study released in August 2010 by Michigan State University researchers found that **Michigan** could save \$612 million a year by consolidating public school districts and eliminating current district boundaries along county lines. The savings would equal roughly 4 percent of total school budgets.<sup>42</sup>

Similarly, in **Massachusetts**, the department of education found that the state's smaller districts, those with fewer than 1,500 students, spent about \$1,000 more per student than districts with between 1,500 and 3,000 students. More than one-third of the state's school districts have fewer than 1,500 students. Since 2008, the state has reimbursed districts that merge more generously for school construction and renovation costs.<sup>43</sup>

In **Mississippi**, Governor Haley Barbour created the Commission on Educational Structure by executive order in 2010 to examine school district consolidation. The commission's initial recommendations identified 18 school districts that could be consolidated, for expected savings between \$12.5 million and \$13.5 million in the 2011 fiscal year. The commission's final recommendations to the governor, released in September 2010, included a suggested time line for consolidating selected school districts by July 1, 2011.<sup>44</sup> Other recommendations include using a data-driven model to select school districts, moving to combine procurement statewide for items common to all school districts (such as buses, copy paper, and janitorial supplies), and enacting new legislation to allow school districts in multiple counties to use a centralized system to share services and back-office operations.<sup>45</sup>

Sharing services among school districts can reduce costs. **Oregon's** Reset Commission Report, released in June 2010, recommended that the state legislate a shared services model for all school districts by July 1, 2012. The commission estimated that by mandating the consolidation of certain services, such as accounting and information technology, the state could save more than \$40 million per year.<sup>46</sup>

In August 2010, **Texas** Governor Rick Perry proposed offering grants to school districts that share services and cut administrative costs. Each district would receive a grant worth 10 percent of the total savings earned during the first year.<sup>47</sup>

#### *Teacher and Administrator Compensation*

A number of states have moved to reform teacher compensation in order to reduce costs. **Georgia's** State Budget Task Force recommended several cost-saving strategies for K–12 education, including increasing teachers' contribution to their retirement plan. The task force reported that a 6 percent increase in the employees' contribution could save the state \$39 million in fiscal 2011. It also recommended freezing automatic raises and switching to a pay raise system based on merit, and offering online classes.<sup>48</sup> **New Jersey** Governor Chris Christie proposed a plan to cap superintendent pay and offer annual stipends based on performance. The plan is predicted to save almost \$9.8 million.<sup>49</sup>

**Vermont** reached accord between the legislature, the state treasurer, and the state's largest public employee union that will result in most teachers' working additional years and making greater contributions to their pension fund but receiving a larger pension check on retirement. The state will initially save \$15 million a year, or about 10 percent of Vermont's current budget shortfall.<sup>50</sup>

**Indiana** found that its public schools and universities could realize at least \$450 million in savings annually by transitioning into the state employee health insurance program, according to a recently released report commissioned by the Indiana General Assembly in 2009.<sup>51</sup>

#### *Changes to K–12 Programs and Policies*

Virtual learning and digital textbooks have gained increased attention for their ability to reduce costs and preserve quality. **Georgia's** State Budget Task Force found that if 1 percent of students enrolled in two online K–12 courses, the state would save more than \$4.5 million.<sup>52</sup>

Other states have had the same idea for maximizing efficiency of K–12 budget resources. In August 2010, **Utah's** Advisory Commission to Optimize State Government made final recommendations to the governor, several of which emphasized online technology in education. Specifically, the commission's final report advised expanding online courses, using online textbooks, and establishing online guidance counseling for high school students transitioning to college.<sup>53</sup> In July 2010 **Texas** Governor Perry called for the creation of a Texas virtual high schools system.<sup>54</sup> The governor also proposed, in April 2010, that Texas abandon the use of traditional textbooks in public schools and replace them with computer technology by 2014.<sup>55</sup> Both proposals were still pending at this writing.

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New legislation in **Virginia**, which took effect in July 2010, establishes the groundwork for “virtual school” programs. It directs the state superintendent to set up approval criteria for online

courses and virtual school programs and will allow local school boards to enter into contracts with approved private or nonprofit organizations to provide such courses and programs.<sup>56</sup>

The budget shortfalls have required many states to cut newer programs that they can no longer afford. Often the first to go are programs that were established while economic times were good in an effort to enhance K–12 education. Now many states want to channel every resource they have left into maintaining a high-quality core curriculum. For example, **New Jersey** has reduced funding for after-school programs. **Maryland** had to cut gifted-and-talented summer centers and certain math and science initiatives that had been introduced in recent years. **Illinois** has eliminated the state writing exam for elementary and junior high students, to save \$3.5 million. Only the 11th grade writing test may still be preserved because some universities require a writing exam for applicants.<sup>57</sup>

Because states' K–12 core curriculum begins with kindergarten, many of the forced spending reductions have affected early childhood education. **Arizona's** proposed FY 2011 budget eliminates its Early Childhood Block Grant program and all-day kindergarten.<sup>58</sup> **California** is considering a proposal to increase the age for children entering kindergarten to five years, to save a projected \$700 million annually. The bill was still pending at this writing.<sup>59</sup> Half of the savings would go to expanding public preschool programs. **Hawaii** has decided to end junior kindergarten, a program that began in 2006 for children born too late in the year to qualify for regular kindergarten. The law that ends the program was approved during the 2009 legislative session; it requires children entering kindergarten in 2013 to be at least five years old by Aug. 1. Ending the program will save \$30 million a year.<sup>60</sup>

## Higher Education

Postsecondary education is the third-largest expenditure in most state budgets. A total of 39 states have cut higher education budgets in 2009 and 2010.<sup>61</sup> States are conducting comprehensive reviews of their higher education systems to find efficiencies, making reductions to employee costs, and encouraging better performance through changes to funding formulas or elimination of redundant programs.

### *Reviewing State Higher Education Systems*

States such as **Kentucky**, **Louisiana**, **Maine**, **Virginia**, and **Washington** have formed commissions to find cost savings. **Kentucky** created the Higher Education Work Group to find ways to reduce college costs and to improve efficiency in such areas as student aid, remediation, and graduation rates, as well as produce general cost saving ideas. Initial recommendations include fundamentally restructuring financial aid programs to lower costs and helping more students to graduate in four years.<sup>62</sup>

**Louisiana** also created a commission to review all aspects of postsecondary education and report its findings to the legislature in 2010. The university system board of trustees in **Maine** conducted a study to address budget shortfalls and recommended changes to course offerings, campus missions, and administrative policies.<sup>63</sup> Similarly, **Virginia** established the Commission on Higher Education Reform, Innovation and Investment to help the state increase the university system's attainment while pursuing cost-saving reform strategies and finding new ways to make higher education system accessible and affordable.<sup>64</sup> Over the past decade, tuition and fees have

nearly doubled, as state support for higher education has fallen by almost half, according to a report by the State Council of Higher Education for Virginia.<sup>65</sup>

**Washington** has formed a higher education funding task force to advise the governor on how to increase Washington's annual degree production by 30 percent over the next decade, while addressing state budget shortfalls. The recommendations of the task force will inform the governor's 2011 legislative agenda.<sup>66</sup>

#### *Reducing Employee Costs*

State budget cuts to higher education have led to administrative cuts, furloughs, layoffs, and other actions. In July 2010, **Connecticut** Governor M. Jodi Rell wrote a letter to the board of trustees of Connecticut's three public higher education institutions urging them not to approve pay increases for nonunion managers.<sup>67</sup> In response, the chancellor and board chairman of the Connecticut State University system have recommended a salary freeze for management and nonunion unclassified personnel at the University of Connecticut, at community colleges, and in the Connecticut State University system.<sup>68</sup> The Connecticut State University trustees also rescinded 3 percent equity raises for 63 managers and certain other employees, for a total savings of \$275,000.<sup>69</sup>

**Arizona's** board of regents will require all three state universities to implement a 2.75 percent reduction in state-funded salary spending. The reductions will be reached through hiring fewer tenure-eligible faculty and eliminating some positions altogether, among other actions. **Colorado** will start requiring higher employee contributions to health and retirement benefits in the University of Colorado system.<sup>70</sup>

#### *Increasing Performance*

Although many states will continue to cut or freeze higher education spending, to remain competitive it will be critical to continue providing quality and affordable higher education. A report by the Georgetown University Center on Education and Workforce found that 22 million new college degrees are needed by 2018, representing a 10 percent increase annually, to meet the rising employer demand for skilled workers.<sup>71</sup> Thus, states will need to find a way to increase college completion, without increasing resources, by making their systems more productive.

Many states are starting to demand greater results for state dollars and to shift from funding based on enrollment to funding based on degree attainment. **Tennessee** recently approved performance funding for higher education through the state's Complete College of Tennessee Act of 2010, which includes a provision for an outcomes-based funding formula.<sup>72</sup>

In 2009, **Indiana's** legislature worked with the Indiana Commission for Higher Education to link base funding to performance. In 2010, 90 percent of Indiana's higher education enrollment funds will be based on attempted credit hours, and 10 percent on completed hours. This ratio will shift to 100 percent on completed hours by the end of 2014, under the plan. In addition to the enrollment component, institutions are funded based on five other priorities, including increase in number of degrees awarded, increase in students graduating on time, degree completion by low-income students, and increase in students transferring from two-year to four-year schools.<sup>73</sup>

**Oregon**'s Reset Cabinet recommends increasing the weight given to degrees in the state's funding formulas, rather than basing them solely on enrollment.<sup>74</sup> The report also recommends maintaining accountability by requiring multiyear plans built around clear performance expectations. States such as **Colorado, Georgia, and Louisiana** are moving to give their higher education institutions greater autonomy—and authorization to raise tuition—if the institutions can show improved achievement, including higher completion rates.

States have also started reviewing their university system curriculums and performance to increase effectiveness. States can improve overall efficiency by eliminating nonproductive majors, for example. In 2010, the **Pennsylvania** State System of Higher Education placed 71 degree programs with low enrollment in moratorium, discontinuing 15 and incorporating others into other programs.<sup>75</sup> **South Dakota** ordered a review of the state's six public universities in 2009. The board of regents will consider the resulting recommendations, which include ending 37 programs and 109 specializations within majors, as well as consolidating other programs.<sup>76</sup>

States can also reduce costs by relying more heavily on their community college systems. **North Carolina**, for example, increased funding to community colleges by nearly 9 percent in 2009–2010, the community college system's largest-ever single-year increase.<sup>77</sup> **Tennessee** will eliminate remedial education classes at public universities, shifting the courses to community colleges as part of the state's Complete College Tennessee Act, signed by Governor Phil Bredesen in 2010.<sup>78</sup>

**Georgia**'s State Budget Task Force recommended encouraging the state's four-year colleges to partner with two-year colleges to offer remedial courses at a discounted formula funding rate.<sup>79</sup> **Missouri** revised its need-based scholarship program to increase scholarships for community college students from the current \$1,000 to a maximum \$1,300 a year and cut the maximum amount for four-year colleges, both public and private, in half, to \$2,850 a year starting in 2014–2015.<sup>80</sup>

**Florida** has experienced a significant increase in four-year degree offerings by its community colleges since the enactment in 2008 of a law allowing them to offer four-year degrees in certain fields. Now, 18 of the state's 28 community colleges are offering a variety of four-year degrees. In July 2010, the law was updated to allow community colleges with successful four-year degree programs to petition the state for autonomy in establishing additional four-year courses.<sup>81</sup>

### State Employee Costs

Employee compensation, including payments for state retiree health care and pension benefits, represents 20 percent to 30 percent of total state expenditures. States are looking for ways to reduce these workforce-related costs. Initial steps by many states have been to make cuts that

*States are working to improve the overall efficiency of the higher education system. The United States used to lead the world in the number of 25-to-34-year-olds with college degrees but has now dropped to 12th among 36 developed nations.*

Source: "Education Pays 2010," The College Board. September 2010.

yield immediate savings to fill budget gaps. Throughout fiscal years 2009 and 2010, 29 states have used layoffs; 26 states have imposed furlough days; 13 states have reduced employee benefits; and 15 states have issued salary reductions, all as parts of an overall strategy to reduce or eliminate budget gaps.<sup>82</sup>

After their initial actions, many states found that these kinds of cuts do not shift the cost curve sufficiently to deal with the fiscal realities of the “new normal.” Many temporary cuts have therefore been supplemented with longer-term reductions that can help permanently shift the cost curve for states, including wage and pension actions.

#### *Furloughs and Layoffs*

Virtually every state made temporary cuts as an initial reaction to the recession. The Pew Center for the States estimates that nearly all states have instituted hiring freezes, at least 75 percent have eliminated vacant positions, and more than half have laid off and furloughed workers since the recession began in December 2007.<sup>83</sup>

A total of 26 states have instituted furlough days to close budget gaps in fiscal years 2009 and 2010.<sup>84</sup> **Illinois** Governor Pat Quinn required his top managers and policy staff to take 24 unpaid days off to save an estimated \$18 million this year.<sup>85</sup> **Kentucky** has decided to continue furloughs through 2011, to save an estimated \$24 million this fiscal year and avoid laying off an estimated 413 state workers.<sup>86</sup>

**Hawaii** furloughed teachers for 17 days in 2010,<sup>87</sup> and **Washington** will temporarily lay off state employees to achieve a FY 2011 budget savings of \$73 million. Thus far, more than 22,000 state employees have been affected.<sup>88</sup>

Many states chose to make straightforward reductions, such as layoffs, rather than developing furlough plans. **Iowa**, for example, has reduced its state workforce to the lowest level since 1994—a total of 2,071 fewer jobs in 2010 than in 2009. The reduction is largely due to its early retirement incentive, which is expected to save an estimated \$89 million even after about 1,000 of the positions are refilled.<sup>89</sup> **Wisconsin** expects to make a 2 percent to 3 percent reduction in the public workforce in 2011.<sup>90</sup>

**Louisiana**’s proposed budget could result in an estimated 1,000 state employee layoffs in FY 2011.<sup>91</sup> The Louisiana Streamlining Government Commission has recommended that all state agencies reduce permanent staff positions by five employees each year for the next three years. It also recommended that each statewide elected official eliminate approximately 50 percent of unfilled staff positions during 2010 and return the funds to the state.<sup>92</sup>

#### *Wage Actions*

As many as 15 states have made salary reductions in fiscal years 2009 and 2010.<sup>93</sup> **New York**, for example, sought a 4 percent wage rollback for most state employees in 2010, but the effort

*Indiana is currently operating at staffing levels below those that existed in 1975. Since 2005, the number of full-time employees has decreased by more than 6,000, a reduction of nearly 18 percent.*

was not successful.<sup>94</sup> **New Jersey** has placed a permanent 2 percent limit on annual raises for public workers, including police, firefighters, and teachers, and will allow towns to discard civil service rules governing employee hiring and firing.<sup>95</sup>

**Utah**'s Advisory Commission to Optimize State Government released its final recommendations to the governor in August 2010. They included making systematic changes to the mix between state employee salary and benefits to better reflect private sector practices. Specifically, the commission recommended reducing benefits and increasing salaries and requiring direct contributions to pensions.<sup>96</sup>

#### *Retirement Benefits*

Given the rising costs of benefits, states are moving to address future state retiree costs. Thirteen states made cuts to state employee benefits in 2009 and 2010, and at least 18 reformed some aspect of their pension systems, including reducing benefits for future employees.<sup>97</sup> States such as **Arizona, Colorado, Iowa, Minnesota, Mississippi, Montana, New York, Pennsylvania, Vermont,** and **Wyoming** increased contribution rates to the state retirement system for all or some current employees. In **Wyoming** employees will have to contribute for the first time.<sup>98</sup> **Utah** has closed its defined benefit plan to new workers entirely.<sup>99</sup>

**Arizona, Illinois, Missouri, New York, and Pennsylvania** have raised the requirements for current employees to retire. In **Illinois** and **Missouri** the retirement age is now 67. **Vermont** raised its retirement age from 62 to 65; employees may also retire if their age and their years of experience total 90.<sup>100</sup>

**Missouri**'s pension overhaul, enacted in July 2010, is expected to save the state \$662 million over the next 10 years. Changes include requiring new state employees hired after 2011 to contribute to their pension benefits, which is not mandatory under previous law; increasing the minimum work experience to qualify for a pension from five years to 10; and raising the minimum retirement age from 62 to 67 for full benefits from the state.<sup>101</sup>

**New Hampshire** is considering a new model of pension reform, retiree medical trusts, as recommended by the Commission to Propose a Retiree Health Care Benefits Funding Model. The plan would allow government workers to make tax-free contributions from their paychecks to pooled investment accounts managed by their unions. The accounts will cover retiree health care costs, saving state and local governments \$60 million per year in health care subsidies currently paid to retirees. Implementation of this reform was still in progress as this Issue Brief was being written.<sup>102</sup>

States are also closing loopholes in their current systems. In 2010, the **Mississippi** Senate passed a bill that aims to prevent “double-dipping” by state employees who retire and then return as part-time or contract workers for the government. It also requires employees to increase their contributions to public retirement systems.<sup>103</sup>

#### **Shared Services and Agency Consolidation**

A number of states have taken steps to shrink state government by eliminating or combining agencies. Since 2009, at least 17 states have consolidated or eliminated agencies that have been

identified as duplicative or nonessential. For example, **Massachusetts** consolidated five separate agencies into one transportation agency in 2009.<sup>104</sup> Strategies that states can use to guide this process include

- Identifying entities and programs that are mandated by law,
- Singling out those that are new this decade and asking why, and
- Locating activities that have duplicative or similar functions that could be shared.

Many states have already acted. For example, the **Iowa** Department of Human Services consolidated from 99 full-time county offices to 42 during 2010.<sup>105</sup> **Washington** eliminated 73 boards and commission by administrative action and another 62 through legislation. The state also merged eight separate land use and environmental hearing boards into three.<sup>106</sup> In 2010 **New Jersey** Governor Chris Christie eliminated 60 nonessential boards by executive order, as part of the state's drive to increase government efficiency.<sup>107</sup>

In September 2010, the **Virginia** Governor's Commission on Government Reform and Restructuring voted to streamline state government functions by converting forms from paper to online and setting up "one-stop centers" for citizens. The commission also agreed to consolidate accounting and payroll systems and recommended criteria for eliminating state boards and commissions.<sup>108</sup>

Similarly, **Missouri** created the Joint Interim Committee on Reducing the Size of State Government to conduct its efficiency review, due by December 31, 2010.<sup>109</sup> A total of 18 states have reorganized agencies since the start of 2009, and at least as many have formed similar commissions to review their state governments and find opportunities to reduce costs. Their recommendations result in the consolidation or elimination of some state agencies, as well as the sharing of services across agencies to reduce costs.

In 2009 **Michigan** Governor Jennifer Granholm presented a vision of a redesigned state government in which the state's 18 agencies would decrease to eight. Following review of feedback from the public and other stakeholder groups, formal recommendations for streamlining state government were presented to the governor in early 2010.<sup>110</sup> In March 2010 the governor issued an executive order to begin the streamlining process. Actions will include consolidating the state's management and budget agency and its information technology (IT) agency into one entity, to be renamed the "Department of Technology, Management and Budget."<sup>111</sup>

#### *Shared Services*

Several states are combining services in IT and back-office functions to save money. IT consolidation is a promising area to realize savings and improve efficiency in state government. For example, **Washington's** statewide efficiency review, Opportunities for Washington, identified between \$6.6 million and \$9.7 million in savings on IT infrastructure spending at the five agencies that participated in the review.<sup>112</sup> Subsequently, the governor signed a bill requiring the office of financial management, with the assistance of the department of information services, to identify \$15 million in savings and to perform a statewide review of information technology best practices and governance. The bill, Creating Efficiencies in the Use of Technologies in State Government, became effective in June 2010.<sup>113</sup>

Other states have also taken action. **California** Governor Arnold Schwarzenegger issued an executive order in February 2010 to implement an IT reorganization plan for an estimated \$1.4 billion in savings over five years.<sup>114</sup> **Iowa** Governor Chet Culver signed legislation to consolidate the state's IT functions, for \$125 million in taxpayer savings.<sup>115</sup> The bill puts one state agency in charge of both purchasing and servicing technology systems for all state agencies.

In one case, two states considered sharing services across state borders: **Minnesota** and **Wisconsin** have looked into a partnership to share the costs of certain services across the two state governments.<sup>116</sup>

### **Privatization and Asset Sales**

Many states are looking to outsource or privatize state services to lower costs. In some cases, states are also selling assets to obtain cash windfalls.

#### *Outsourcing State Services*

States can reduce certain costs by outsourcing. **Illinois**, for example, is considering letting a private firm run the state's lottery in an effort to save money by putting one firm in charge of business operations that are spread among dozens of individual outfits. The state would retain control of major business decisions.<sup>117</sup> The **Georgia** Department of Transportation in July 2010 announced plans to seek a private partner to help manage the state's 17 highway rest areas and nine welcome centers.<sup>118</sup> The **New Jersey** Department of Environmental Protection and Governor Chris Christie's administration are in discussions about having private vendors, rather than state personnel, manage state forests and parks.<sup>119</sup> Other states, such as **Georgia** and **Virginia**, have engaged corporate sponsors to help support state parks. In return for corporate donations to state parks departments, the states can offer promotional opportunities and advertising. For example, Georgia recognizes corporate partner Verizon Wireless on the state Department of Natural Resources Web site. Virginia recognizes its corporate partner, The North Face, by putting the company's logo on state park trail signs.<sup>120</sup>

**Louisiana's** Streamlining Government Commission recommended several opportunities to outsource state services. For example, the commission recommended that the department of public safety and corrections outsource all aspects of food services, background checks, pharmaceutical services, and the collection of probation and parole fees. The commission also made recommendations to other agencies, including advising the department of environmental quality to outsource its lab services and the department of transportation and development to outsource its maintenance operations and sell all production equipment except that for emergencies.<sup>121</sup>

Similarly, **Georgia's** State Budget Task Force final report suggested that budget savings could be realized in K–12 education, without decreasing quality, by outsourcing such functions as accounting, human resources, maintenance, and transportation.<sup>122</sup>

#### *Privatizing State Functions*

Many states have moved to privatize functions to increase efficiency. In 2010, **Louisiana's** Streamlining State Government Commission, for example, recommended that the state create a

privatization and outsourcing unit within the division of administration to serve as a resource for all departments and agencies considering or implementing privatization or outsourcing.<sup>123</sup>

Several states, such as **New Jersey** and **Arizona**, have created task forces to guide privatization efforts. In July 2010, the **New Jersey** Privatization Task Force released its report, identifying more than \$200 million the state could save through privatization.<sup>124</sup> **Arizona** created the Privatization and Efficiency Commission by executive order in January 2010. The Commission is tasked with the mission to examine each state agency, department, board, and commission to determine which functions or entities can be eliminated, streamlined, consolidated, or outsourced for savings. The commission's report to the governor is due by December 31, 2010.<sup>125</sup>

During summer 2010, Arizona also privatized SCF Arizona, the state's workers compensation fund, and in July 2010 the governor issued an executive order to establish a quasi-public commerce authority, headed by private business leaders, to replace the commerce department.<sup>126</sup>

States **Virginia**, **Washington** and **North Carolina** have considered privatizing state-owned liquor stores and state-run liquor sales. In September 2010, **Virginia** Governor Bob McDonnell's office presented an official recommendation for privatization of state-run liquor stores (ABC stores). The administration expects this move to provide as much as \$500 million to the Commonwealth. The recommendation calls for auctioning 1,000 retail licenses to the highest bidders and selling the ABC warehouse in Richmond and 19 state-owned outlets. The Commonwealth would maintain health, safety, law enforcement, and marketing regulatory authority over private distilled spirits sales and distribution. The proposed plan would also increase the number of ABC enforcement agents by 25 percent. All money realized from the privatization would be placed in a Virginia Transportation Infrastructure Bank, to be used for new transportation funding.<sup>127</sup>

**Washington** is considering two initiatives to privatize liquor sales, both of which will be on the November 2010 ballot for voter approval. The change would allow private outlets to sell liquor, ending the state's monopoly.<sup>128</sup> **North Carolina** has also considered privatizing its state liquor sales and in 2010 named a budget reform panel to examine the state-run liquor system.<sup>129</sup>

### **Asset Sales**

Asset sales can yield sustained savings over time by eliminating maintenance expenses and other liabilities related to ownership. States are selling surplus property, office buildings, and other excess equipment as part of overall budget strategies in 2009 and 2010.

For example, **Connecticut's** executive budget calls for raising \$15 million in FY 2010 and another \$45 million in FY 2011 through asset sales. Its office of policy management maintains an ongoing list of assets for sale.<sup>130</sup>

**California** enacted legislation in July 2009 to authorize the sale and lease back of 11 state properties.<sup>131</sup> The sales are expected to yield \$598 million for the state's general fund over three years.<sup>132</sup> Similarly, **Missouri** sold 23 unneeded properties to fund bridge and road repairs in 2009.<sup>133</sup>

#### *Real Estate Management*

States often have opportunities to save through better management of properties they continue to maintain. **Georgia's** State Budget Task Force, for example, found an estimated \$230,000 in savings through real estate management.<sup>134</sup> **Delaware** has already saved \$1.1 million through better real estate management between 2009 and 2011.<sup>135</sup> Specifically the state has negotiated rent reductions, consolidated some office space, and moved some employees from offices that were leased to buildings that the state owns. That effort was led by the Office of Management and Budget. As mentioned earlier, the **Louisiana** Streamlining Government Commission recommended that the state sell all production equipment except for emergency equipment.<sup>136</sup>

#### **Tax Expenditures**

Tax expenditures represent revenue forgone for state coffers in the form of tax credits, deductions, and exemptions. Several states are looking to revise their tax expenditures to help balance their budgets. For example, a proposal in **Hawaii** would repeal tax exemptions for nonprofit organizations to raise \$500 million to \$750 million in new revenue, helping to close a budget shortfall of \$1.2 billion by January 2011.<sup>137</sup>

In his 2010 state of the state address, **Missouri** Governor Jay Nixon proposed scaling back and consolidating Missouri's tax credits as a way to save money. On July 15, 2010, the governor appointed a 25-member committee to review the state's 61 tax credit programs.<sup>138</sup>

**California** is considering a plan to delay corporate tax breaks in 2011.<sup>139</sup> **Georgia** state legislators did not renew the back-to-school tax break weekend, in effect since 2002, to save \$12 million in forgone revenue.<sup>140</sup> In July 2010 **Oregon** proposed temporary rules that would decrease the impact of the residential energy tax credit program on the state's general fund. The rule changes are effective for 180 days. The agency plans a public hearing later this year to decide whether to make this and other changes permanent.<sup>141</sup> **Pennsylvania** Governor Ed Rendell has proposed eliminating a provision in the state's tax code that gives large vendors, such as Wal-Mart or Home Depot, a 1 percent discount for remitting their sales tax to the state on time.<sup>142</sup>

**Georgia's** State Budget Task Force presented final recommendations on March 16, 2010, for cutting \$2 billion from the state budget. Among the opportunities for savings identified was \$100 million in forgone tax revenue. To recoup those monies the task force recommended broadening

*Arizona authorized the sale and lease back of state assets as part of the budget solutions enacted for fiscal year 2009-2010. Under this approach, key assets were nominally sold to a bank trustee and leased back to the state for 20-years. The trustee was financed by certificates of participation (similar to bonds) sold to the public. These sales yielded approximately \$735.4 million to the state's general fund as of January 2010.*

the sales tax base to include additional services and conducting a regular review of exemptions and revenue sources. Georgia currently exempts over \$10 billion in state sales and use taxes. Other recommendations included increasing accountability in tax collection through the use of private auditors or partnerships with local governments to identify noncompliant businesses and ensure that all businesses are properly filing taxes. The report found that over 900 businesses are not on the state department of revenue's current sales tax list.<sup>143</sup>

### **Conclusion**

Fiscal pressures will continue to exist in coming years. Governors will face budget challenges for the foreseeable future and must consider long-term solutions to reduce the cost of government. That fiscal reality presents not only a challenge but an opportunity because it has revealed aspects of state government that have become inefficient and unsustainable. This realization has prompted governors to reexamine the core structure of their state governments, with the hope of emerging from the Great Recession functioning better and smarter than before.

Many states have already acted to redesign their operations by consolidating some services and privatizing others, reforming employee compensation and pensions, and adopting smarter policies in the areas of corrections and education to “do more with less”. This Issue Brief has outlined examples of such efforts that states have undertaken during 2010 to do more with less.

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