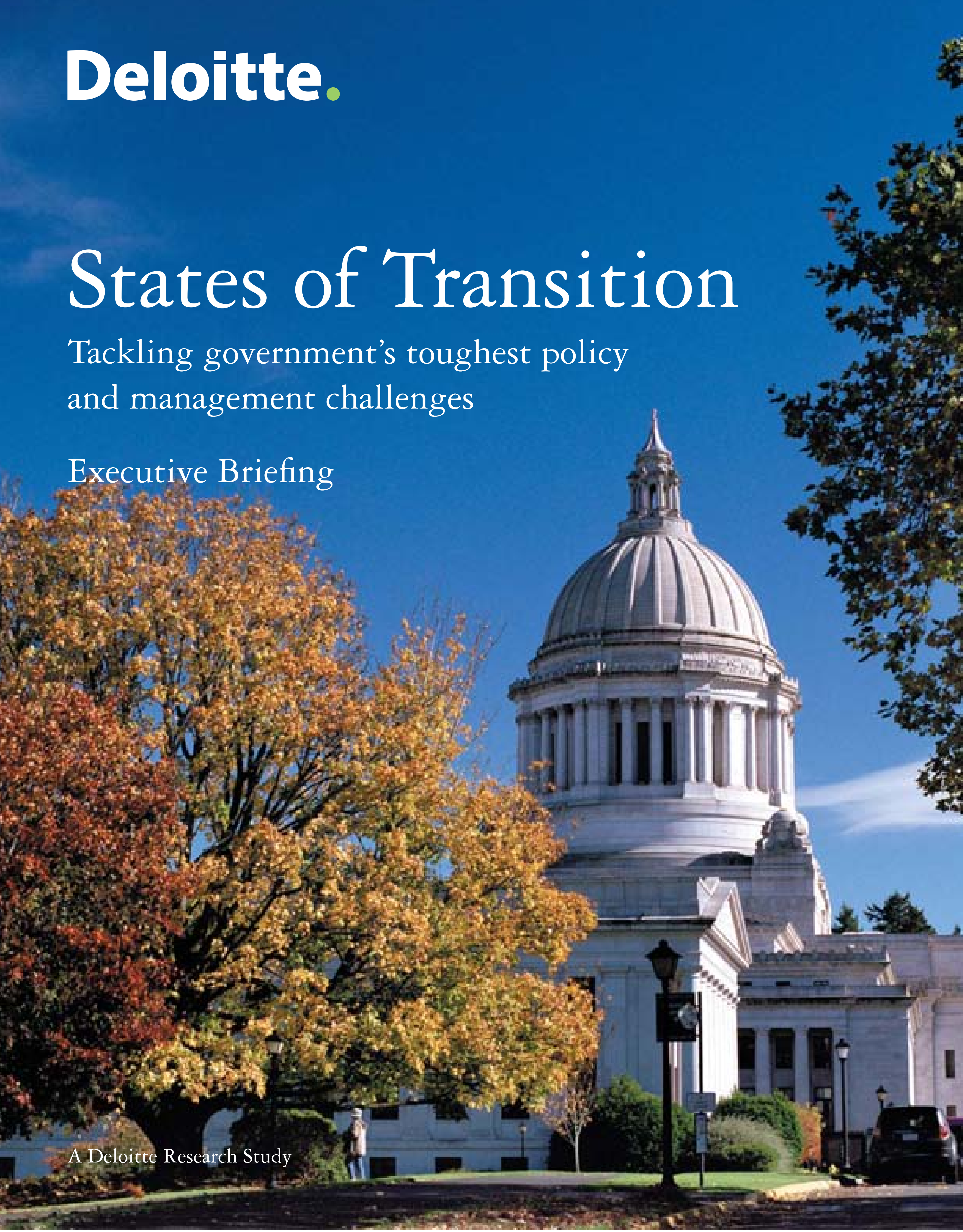
States of Transition

Tackling government's toughest policy and management challenges

Executive Briefing



A Deloitte Research Study

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About Deloitte Research

Deloitte Research, a part of Deloitte Services LP, identifies, analyzes, and explains the major issues driving today's business dynamics and shaping tomorrow's global marketplace. From provocative points of view about strategy and organizational change to straight talk about economics, regulation and technology, Deloitte Research delivers innovative, practical insights companies can use to improve their bottom-line performance. Operating through a network of dedicated research professionals, senior consulting practitioners of the various member firms of Deloitte Touche Tohmatsu, academics and technology specialists, Deloitte Research exhibits deep industry knowledge, functional understanding, and commitment to thought leadership. In boardrooms and business journals, Deloitte Research is known for bringing new perspective to real-world concerns.

Foreword

Governors hold the best political jobs in the nation. State leaders today wield unrivaled potential for improving Americans' lives and implementing positive change. Perhaps uniquely to U.S. politics, your state programs directly impact huge segments of society — and in many cases, shape national policies. You enjoy wide latitude to innovate and have enough influence over state operations to translate your ideas into reality.

Taxpayers have placed immense responsibility in your hands. This executive briefing of the new book *States of Transition* delivers insights into solving some of the most vexing challenges facing state government leaders, including issues that already top your own to-do lists. You'll find strategies for improving public education by driving more money into classrooms. You'll find solutions for fixing a broken Medicaid system, which now consumes approximately one quarter of total state budgets. And you'll find techniques for using technology to cut the cost of programs throughout government, while improving services to citizens whose expectations are higher than they ever have been.

For newly elected state officials, we offer advice that can help your administration get off to a quick and effective start. *States of Transition* will help you to face head-on the challenges of state governance — which soon will be landing on your desk at an overwhelming and intimidating pace. For those returning to office, these pages contain fresh ideas for implementing reforms that deliver lasting improvement. There is no simple recipe for transformation. I recommend that you consider the concepts presented here and apply them in ways that fit the unique requirements of your state.

Our nation is starved for problem solvers. Fortunately, today's state policy-makers hold office during a time of relative prosperity. After years of fiscal hardship and relentless budget cutting, state conditions have rebounded. For the first time in recent memory, state leaders enjoy some financial breathing room, which affords them the ability to invest in reforms that bring dramatic improvement to government operations and to the lives of citizens.

All of you — governors, cabinet secretaries, senior staff members and state legislators — face awesome responsibility, and yet you also have unlimited opportunity. It's all part of what makes your jobs among the most challenging and rewarding positions anywhere on Earth. Clearly, implementing meaningful changes carries significant risk and it demands courage. Be confident. Think big. Much of this nation's history was written by state leaders. Now this opportunity is yours.

Tom Ridge

The Honorable Tom Ridge,
former governor,
Commonwealth of Pennsylvania
Senior Advisor to Deloitte & Touche USA LLP

Window of Opportunity

Retrofitting government for 21st century governance

Americans expect more from government in a post 9-11/Katrina world, but they trust it less.[1] This credibility gap between government institutions and Americans presents a big challenge for today's state leaders. States, after all, are directly responsible for many of the most important services and programs government provides. Often in partnership with local governments, states provide education, build and maintain the roads that enable commerce, enforce the law and house criminals, fund social services, deliver Medicaid, organize disaster responses and undertake a host of other critical activities which directly affect people's lives. Citizens see long-standing problems in some of these areas—runaway Medicaid costs, poor education, inadequate and under-maintained infrastructure—and wonder why improvement seems so slow in coming.

Low expectations, however, may set the stage for a great opportunity—one that state leaders are particularly well positioned to capitalize on. States are more agile than the federal government—both in terms of their ability to experiment with new solutions and to overcome partisan hurdles. States remain the laboratories of democracy—the place where the boldest policy innovations occur. They are also the place where voters tend to put problem solving abilities ahead of partisanship and ideology—especially when they pick their governors (a phenomenon illustrated by the presence of so many Democratic governors in "red" states and Republican governors in "blue" states).[2]

In short, states are incubators for the great ideas and future leaders of American government at a time when citizens are seeking both—but are skeptical about whether government institutions can deliver either.

States today have a unique window of opportunity to regain public trust by tackling some of the toughest policy issues, those that have proven vexing for a generation, while also positioning themselves to address the new challenges of the 21st century.

Major 21st Century Governance Challenges

Aging populations	The graying of America will have far-reaching consequences for virtually everything: revenues, recruitment, state spending and the needs and expectations of citizens.
Budget busters	Several line items in state budgets, from spiraling Medicaid costs to underfunded pension systems, are currently on unsustainable trajectories.
Perplexing and changing federal-state relationship	On one hand, the federal government is giving states more freedom to innovate in areas like health and human services and transportation. On the other hand, you don't have to look far to see evidence of greater centralization or what some state policymakers see as a return of unfunded mandates in areas like education and homeland security.
High citizen expectations	The unprecedented level of customization, ease and convenience that 21st century "on demand" consumers have grown used to in the private sector now also drives standards in the public sector, sending citizens' expectations of government to an all time high.
Rise in uncertainty	Uncertainty is a given in today's world. Terrorism is no longer limited to the Middle East, and no one knows what form it will take next. The same goes for killer storms, biological threats and disease pandemics. They require federal, state and local governments to coordinate efforts to deal rapidly and effectively with threats that cannot be defined years in advance.
Globalization	Globalization leads to lower prices, a wider variety of goods and services, improved competitiveness and government policies that are tempered by market discipline, however lost manufacturing jobs have been a bitter pill to swallow for some advanced economies—a trend being repeated in the service sector through offshoring. States are being forced to view competition through a new lens.

Source: Deloitte Research

Shedding 20th century shackles

Moving beyond legacy thinking

As state governments struggle to respond to these imperatives for change, many find themselves shackled by the old ways of governing: hierarchical organizational structures that use a narrow, siloed approach to tackle complex problems; personnel practices and pension systems designed for an age when lifetime employment was the rule, not the exception; service models driven by government bureaucracy, instead of citizen needs and preferences; budgets that measure results based on how much is spent, not what is achieved; and tax systems designed around manufacturing, physical goods and localized markets—rather than services, information and a seamless global economy. Some of these legacy problems are systemic, reflecting the failure to update Industrial Age processes and business models. Others are structural—rooted in statutes and state constitutions from a bygone era.

Given the huge gap between past practices and current and future needs, incremental change won't be enough. Obsolete, century-old systems need to be replaced with new models that better speak to the needs of the 21st century. This transformation will require new ways of doing business for every aspect of government, from organizational structures and operating practices to personnel systems and service delivery models. These changes won't be easy, but they are necessary. Moreover, they are now possible—states have new tools and, for the time being, a favorable environment to make them.

The federal government in recent years has given states greater latitude to innovate and experiment. Governors today also have tools and technologies, unavailable in the past, to take advantage of these flexibilities, manage a state on an enterprise basis and approach citizen service in an integrated way. A large group of freshmen governors is entering office, which history shows tends to bode well for reform. And with the strong economy of recent years most states have found some fiscal breathing room, giving today's governors an opportunity that hasn't existed for at least a decade to strategically address some of the longer-term and structural issues they face and create a meaningful legacy for their own administration.

The following pages examine these challenges and outline strategies for reform.

Legacy Issues	Emerging Issues of the 21st Century
Medicaid cost management	Advancing health care outcomes
High education administrative costs	Improving education performance
Underfunded pension systems	Protecting the homeland
Infrastructure gap	Boosting emergency response capabilities
Outmoded state hiring practices	Attracting Gen Y to state government
Service delivery maze	Tax policy modernization
Management of state as a loose-knit confederation of agencies, boards, commissions and programs	Restructuring services to serve an aging population

Source: Deloitte Research

Serving the Aging Citizen

The impact of the graying population on government services

The number of Americans aged 65 and older will nearly double in many states across the country by 2030 and then continue to grow for decades to come (see figure 1). As the population and workforce ages in America, governments at all levels will have to address the challenge of how to deliver retirement and medical benefits to a surging number of aging citizens. Many of the key issues—including extending retirement ages and reducing benefits—have been probed in depth.

A less thoroughly explored, but equally critical, issue is how the growing ranks of the elderly will affect the way government agencies will organize to serve this population and the services they deliver: the design and mix of services they offer; the delivery channels they use; the funding sources they rely upon; and the way the aging citizen will affect civic participation.

State revenue could become a significant issue as the number of elderly increases and a declining percentage of individuals assume the bulk of the tax burden. California, for example, will face a growing service burden at both ends of the demographic spectrum because of rapid growth in population ages 0-17 and 65+. Meanwhile, the number of taxpayers in a key high-earning demographic of age 30–49 will decline.

Government agencies will need to expand services for the elderly in the face of potentially declining revenues and determine how to allocate scarce resources across competing demands from various age groups.

Reform Strategies

Explore alternative revenue models

User fees, public-private partnerships and other models can help to finance new and existing services.

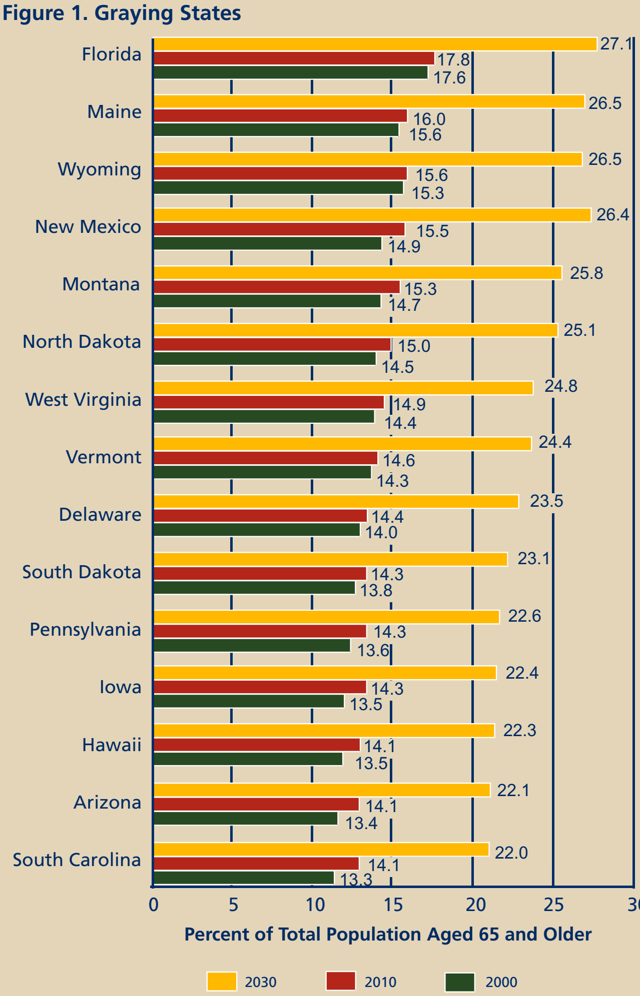
Develop clicks and mortars solutions

State governments can use technology to transform traditional physical channels into "clicks and mortars" services that offer some of the personal interaction many seniors want while using technology to reduce costs.

Establish "channel" partnerships

In some cases, it will make sense for governments to "piggyback" on the investments that private firms and nonprofit organizations have made in service lines and delivery channels to meet the needs and preferences of aging citizens.

Figure 1. Graying States



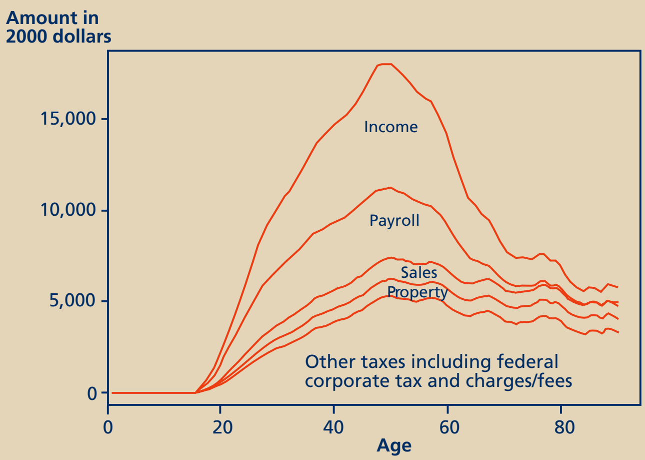
Source: U.S. Census Bureau, State Interim Population Projections 2004-2030

Examples

New revenue sources for elderly programs
Pennsylvania, faced with the problem of "premature graying," implemented in 1972 the only state lottery to date that dedicates all proceeds to senior programs. The state has spent nearly $15 billion on elderly assistance programs.

Using technology to foster independence
The Sunshine Network Veterans Health Administration in Florida deploys high-tech, user-friendly tele-health computer devices to allow many elderly citizens to lead more independent lives.

Figure 2. Tax Revenues by Program and Age, US



Source: Ronald Lee and Ryan Edwards, "The Fiscal Effects of Population Aging in the U.S.: Assessing the Uncertainties," in James M. Poterba, ed., Tax Policy and Economy, Volume 16. MIT Press for National Bureau of Economic Research, June 2002, pp. 141-81.

Next Steps

1. **Understand how the aging population will impact your state.** Require state agencies to produce a plan detailing how they will cope with the impact of the aging population.
2. **Make it easier.** Pay special attention to the design of information prepared for older users. Age-related disabilities (vision loss, hearing loss, memory problems and mobility loss) are common among elderly citizens. For documents, this means making sure that they are clearly written and printed in easy-to-see type. For online information, it means making sure that material is visually and substantively coherent and easy to navigate.
3. **Segment customers** to predict changes in customer characteristics, needs and desires and use the information to allocate resources across services and delivery channels.

Bending the Talent Curve

Revamping workforce systems

The U.S. workforce demographic will change considerably in the next 10 to 15 years with the retirement of the Baby Boom generation (those born between 1946 and 1964). State governments will face significant challenges because their workforces are significantly older on average than the private sector workforce.

While Generation Y (those born between 1979 and 2000) is comparable in size to the Baby Boom generation, its members lack the experience necessary to replace senior-level employees, creating serious succession challenges.

The most vivid way to portray the talent gap barreling toward states is to plot the rising demand for public sector employees against the declining supply. The result is two curves bending away from each other, leaving a gap that will grow ever wider over the next decade and a half unless states take immediate steps to develop strategies and programs to "bend the curves" to help close this gap (see figure 4).

With that said, the gap also creates a significant opportunity to fundamentally change the way government employees perform their mission and state human resources are managed.

Reform Strategies

Bend the curves

State governments need to evaluate the future demand for skilled state employees against the likely supply and aim to bend the supply and demand curves toward each other (see figure 4).

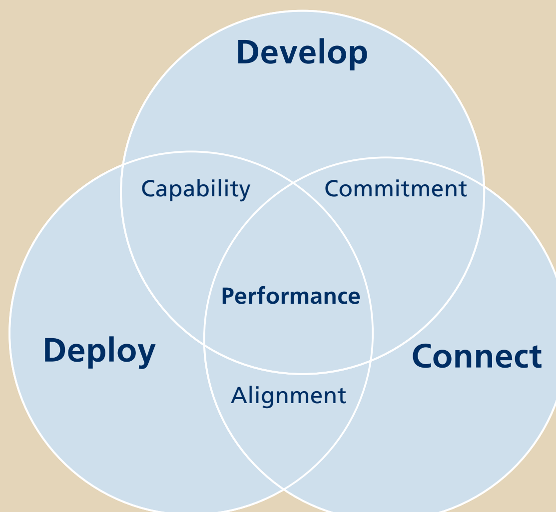
Fast-tracking critical talent

Once critical talent has been successfully hired, state agencies must work to ensure that top talent is on a fast-track, with increasing responsibility and opportunities for professional development. By fast-tracking top talent, states can address gaps in succession planning and capability transfer.

"Develop-Deploy-Connect"

This model represents an integrated management strategy in which employees receive relevant experience and guidance, are aligned in the appropriate position for their skills and interests, and develop the proper connections to advance within the organization (see figure 3).

Figure 3. The Develop-Deploy-Connect Model



The Develop-Deploy-Connect model should be at the core of an organization's talent strategy. By focusing on these three elements, organizations can generate capability, commitment, and alignment in key workforce segments, which in turn improve business performance. When this happens, the attraction and retention of skilled talent largely take care of themselves.

"Develop" means providing the real-life learning that employees need to master a job. This doesn't mean just traditional classroom or online education. As important, are the "trial-by-fire" experiences that stretch their capabilities and the lessons they learn from peers, mentors, and others.

"Deploy" means working with key individuals to (a) identify their deep-rooted skills, interests, and knowledge, (b) find their best fit in the organization, and (c) craft the job design and conditions that help them to perform.

"Connect" means providing critical employees with the tools and guidance they need to (a) build networks that enhance individual and organizational performance, and (b) improve the quality of their interactions with others.

Source: Deloitte Research

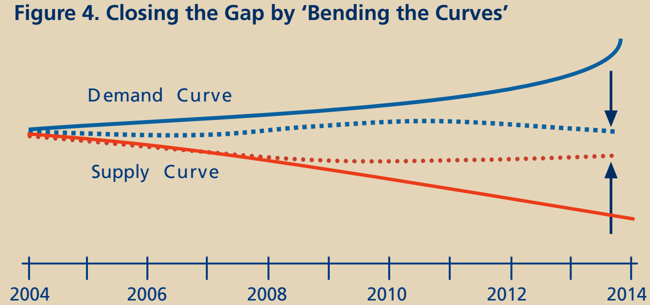
Examples

Expediting the application process
In 2003 the San Jose, California, Employment Services Department (ESD) adopted a decentralized, position-based hiring process, which cut hiring time nearly in half.

Accelerated recognition and advancement for top talent
Presidential Management Fellows (PMF) Program, sponsored by the Office of Personnel Management, targets students who are completing graduate degrees. The 2005 PMF class consisted of 643 fellows from 200 colleges and universities. Once accepted, fellows develop a two-year strategic plan to help focus their learning, development and career advancement.

Customized career paths
Illinois's Upward Mobility program provides state employees with personalized guidance and training to advance to new and more challenging positions. Almost 13,000 state employees have been through the program.

Figure 4. Closing the Gap by 'Bending the Curves'



Next Steps

1. **Modernize and e-enable outdated hiring practices.** States must update hiring practices so that the process is faster and more efficient.

2. **Identify and target critical workforce segments.** State agencies should determine segments of their workforce that contribute disproportionately to the success of their organizations. Agencies should then use campus recruiting initiatives, outreach programs and internships to attract employees for those segments.

3. **Adopt innovative recruiting strategies.** To change the negative perception of working in the public sector, states must include marketing and educational efforts as part of their recruiting practices. States should develop relationships with local graduate programs and offer competitive, Gen Y–tailored employment packages.

4. **Upgrade technology.** Process automation and self-service e-government solutions increase productivity and reduce the required number of positions.

5. **Assess organizational structure.** States should review their organizational structures for consolidation and/or sourcing opportunities.

Solving the Pension Crisis

Making good on promises

State officials must face up to the problem of huge unfunded pension and retiree health care obligations or face voter backlash when the bill hits the taxpayers in the pocketbook. More than one-third of state and local pension plans have a funded ratio below 80 percent.

To be sure, not all state and local retirement plans are in trouble. The Florida Retirement System, for example, is 107 percent funded, with assets of $112 billion and liabilities of $104 billion. In addition to Florida, 10 other state retirement plans also had funded ratios in excess of 100 percent. The real problem is with the 33 percent of plans that had a funded ratio below 80 percent (see figure 5). Unfortunately, these plans have a total unfunded liability of $188 billion. Even worse, the unfunded liability of plans with a funded ratio below 90 percent totals $326 billion.

As if the pension issues were not challenging enough, state and local governments also face the daunting task of figuring out how to pay for huge unfunded retiree health care liabilities that soon could approach $1 trillion.[3]

The bottom line is that public sector retirement costs, excelerated by the aging workforce, pose a serious threat to many state and local governments—making pension reform a key factor in both future economic success for communities and quality of life for constituents.

Figure 5. Funded Status of State and Local Public Pensions

Funded Ratio	Number of Plans	Percent of Plans	Unfunded Liability (in $000)
<70%	20	17.1	111,933,655
70 – 79%	19	16.2	76,182,085
80 – 89%	38	32.5	137,909,272
90 – 99%	29	24.8	23,908,976
100%+	11	9.4	(13,598,723)
Total	117	100.0	$336,335,265

Source: National Association of State Retirement Administrators and the National Council on Teacher Retirement

Reform Strategies

Close loopholes

Options for reform include tightening the practice of granting large pay raises in the years immediately before retirement (which can allow employees to spike final earnings amounts and increase retirement benefits) and narrowing eligibility for high-cost public safety pension benefits.

Two-tier retirement programs

Extremely common in the private sector, these programs reduce retirement and health benefits for employees hired after a specific date, while maintaining agreed-upon benefit packages for existing workers.

Phase in retirement

This strategy is designed to keep older employees in the workforce longer and therefore preserve intellectual capital while delaying the onset of full pension benefits. North Carolina kicked off a program in 2006 under which state employees can start receiving partial pension benefits at age 59 while they continue to work flexible hours.

Four Myths of Public Pension Reform

Myth #1: Defined contribution plans will fix the problem sometime soon. Though it might be the right thing to do in the long run, transitioning to defined contribution plans that do not promise a specific amount of benefits at retirement likely will do little to resolve near- or medium-term pension fiscal problems. Governments must phase in defined contribution pension plans gradually as new workers enter the system, meaning they may not see significant relief for 20 to 30 years.

Myth #2: Plans just need to invest more in equities to get their returns up. Investment policies must balance income potential with risk. Plans opting for higher-yield investment strategies must understand the higher risks involved and ensure they can afford the potential losses.

Myth #3: All employees cost the same. Defined benefit pension costs for younger workers are typically significantly less from an actuarial standpoint than pension costs for older workers who have spent long careers in the public sector.

Myth #4: Deferring costs can lessen the fiscal pressures. Deferring pension costs may offer a quick fix for spiraling pension expenses, but the practice usually results in serious, long-term consequences.

Examples

Understanding the magnitude of the gap

New Jersey's state and local public retirement systems are underfunded by as much as $35 billion—a shortfall that will have to be made up by investment gains, tax increases or service cuts.

Putting a spotlight on underfunded pensions

The Texas Pension Review Board placed an unprecedented 18 public retirement plans on its watch list, a warning that the plans have insufficient funds to meet future obligations. Among them are the state's largest pension systems—the Teacher Retirement System of Texas and the Employees Retirement System of Texas.

Getting a handle on liabilities

Illinois has initiated a series of strategies to reduce its unfunded liability including curtailing loopholes and abuses; mandating that all future benefit enhancements will expire after five years (unless they are renewed by the governor and the state legislature); and requiring every future benefit increase to have a dedicated revenue source.

Next Steps

1. **Assess the problem.** Conduct an in-depth analysis of current public pension funds and retirement benefits in your state to ascertain the size of the problem and its causes.

2. **Stop the financial bleeding.** Ensure that current contributions at least cover current liabilities. This step entails a combination of cost-cutting and revenue-enhancing changes.

3. **Scale back generous early retirement programs.** These provisions are proving to be extremely expensive and poorly designed as a huge number of aging Baby-Boomers near retirement age.

4. **Involve Stakeholders.** Involving political officials, business leaders, labor unions and other stakeholders helps build recognition of the challenge and support for these initiatives.

Fixing Medicaid

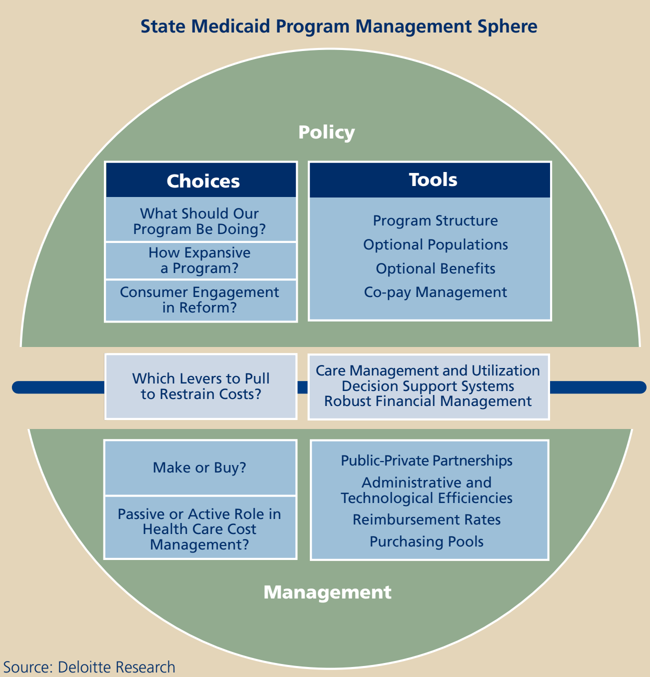
Making tough choices

Medicaid costs have ballooned to nearly one-third of the annual budget in many states, making it the largest line item in many state budgets. The current fiscal path, if left unchanged, will crowd out other state priorities. Medicaid has so far defied states' attempts to control its costs while having variable impact on the health outcomes of the citizens it serves. While nearly half of the country's Medicaid programs have budgets the size of Fortune 500 companies, most Medicaid administrators lack the management tools needed to transform the sea of program data into useful information to inform decision making or the capacity to invest in leading commercial solutions.

The good news is that across the country, state governments are rethinking their Medicaid programs. The federal Deficit Reduction Act of 2005 (DRA) allows for unprecedented flexibility in how states structure and manage their Medicaid programs. States now have greater flexibility to alter benefits, charge patients for services and expand the role of private insurers.

States can overcome the challenges of reforming Medicaid—provided they have the right approach, the right incentives, the right priorities, and a commitment to actively managing the transformation process. Lasting reform requires first confronting a set of difficult choices that go to the very heart of what kind of Medicaid program a state wants to have (see figure 6). By fully addressing them, states can focus on a long-term strategy that will take their program in the direction they want it to go *without* breaking the state's bank or losing site of the program's mandate to serve individuals in need.

Figure 6. Critical Choices for Medicaid Reform



Source: Deloitte Research

Reform Strategies

Choice-based reform

Personal health accounts and the ability to choose health benefits packages allow health care to be tailored to the specific health care needs of an individual. Establishing a fixed benefit amount allows the state to control its Medicaid costs, while giving individuals the power to decide how those limited dollars are best spent.

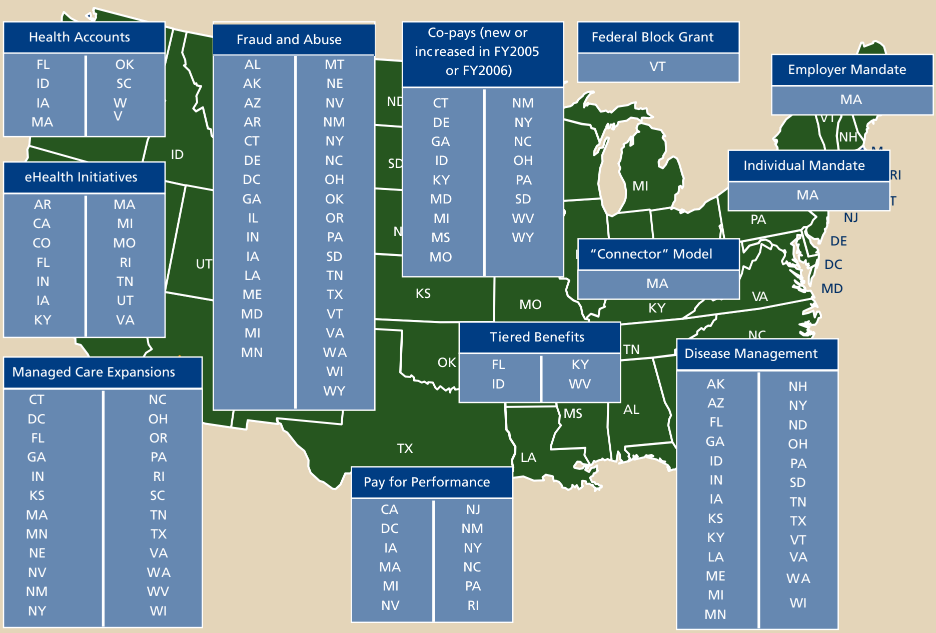
"Connector" model

A "connector" allows individuals to purchase private health insurance coverage at more affordable rates through a state-sponsored exchange.

Tiered benefits

Customized benefits packages allow health care to be targeted to specific populations with different health care needs.

Figure 7. Recent Medicaid Reforms Across the Country



Note: The following categories of reforms reflect actions taken by states in FY2005 and FY2006: fraud and abuse; managed care expansions; new or increased co-pays; disease management.

Sources: The Henry J. Kaiser Family Foundation, Deloitte Research and Deloitte Center for Health Solutions

Examples

Redefining core program functions

Under the Florida Choice program, the state's role has shifted from claims-processing to policy and contract management, which has in turn shifted the risk of cost control to managed care plans.

Taking advantage of increased federal flexibility

Under Vermont's new global commitment waiver the federal government gives the state a lump sum payment for each person enrolled in the state's Medicaid program, leaving the state with greater freedom to manage its program and full responsibility for controlling costs.

Next Steps

1. **Assess the program.** An assessment of current Medicaid outcomes, technology and administration will give policy makers and program administrators enough information about the program and the way it is administered to be able to make informed decisions about the program's strategy and the necessary reforms.

2. **Ask the tough questions.** States must make difficult choices that go to the very heart of what kind of Medicaid program each state wants to have, such as which policy and management levers will be used to reduce or, at a minimum, contain program costs.

3. **Give managers the information they need.** States need to give program managers the management tools they need to turn the immense volume of information that flows through Medicaid and its information systems into meaningful data to increase understanding of what works and inform key decisions.

Integrating Health and Human Services Delivery

Ending the bureaucratic maze

Citizens in need of health and human services face a number of challenges, including a bureaucratic maze that can make it hard to get the assistance they need. For example, someone on public assistance might need a variety of related services, including job training and placement, child care, transportation, health care, food stamps and drug rehabilitation. Navigating the maze places a tremendous time burden on individuals in need—time that could be better spent working toward independence.

While many states are working to integrate siloed HHS agencies, there is a disconnect between what service integration means conceptually and how it actually gets operationalized. One problem is that most people are not sure what "service integration" even means. Some define it as combining related service offerings—for example, combining all state health care programs like Medicaid, the Children's Health Insurance Program (CHIP), and Disability services—into a single offering. Others see it as grouping different departments and agencies under one umbrella organization, that is, integrating health care, nutrition, and public health services as part of health and human services delivery. To many, service integration can be as simple as a common Web portal with links to various agency websites.

The truth is service integration is all of those things—and more. To do it right, three critical elements must be addressed: service offerings, technology, and workforce management (see figure 8).

Reform Strategies

Focus on stakeholders
Look at the problem from the perspective of your major stakeholders (agency workers, third-party providers, advocacy groups and, most important, citizens.) Successful integration strategies generate meaningful benefits for all key players.

Adopt a comprehensive approach
Service integration requires a mix of capabilities across three key dimensions: service offerings, technology and workforce. The ideal mix varies from one organization to the next.

Mix and match
Many organizations will find their best option for service integration is a hybrid of integration and specialization.

Examples

Giving citizens a single entry point
Massachusetts' Virtual Gateway is an online portal that serves as a single front door for health and human services programs. The gateway streamlines the application procedure and reduces the time and effort required to access services.

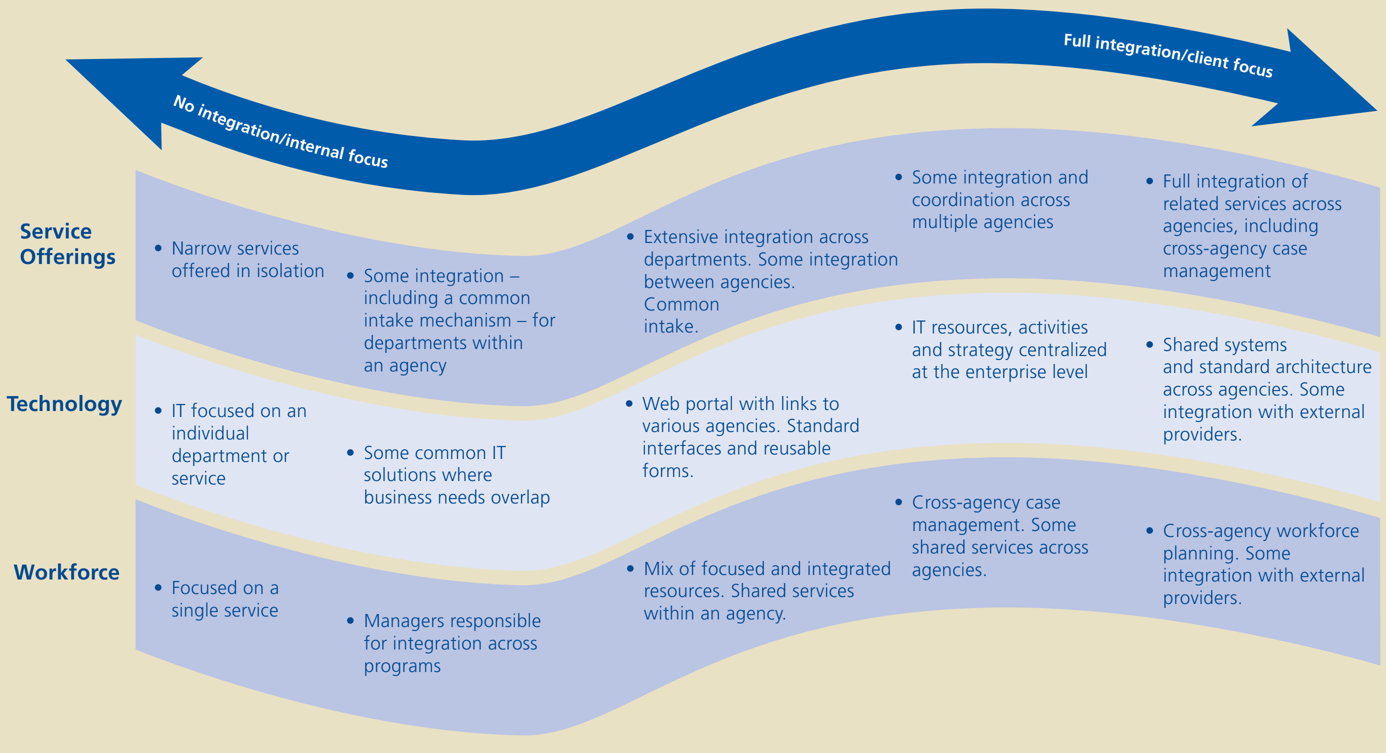
Step by step improvement
Pennsylvania's COMPASS started as a simple online portal for health care applications. It has grown incrementally to a one-stop shop for multiple health and human services programs.

Leveraging new resources to meet increased demand
ACCESS Florida is a web-based application designed to meet the increased demand for public benefits following the 2004 and 2005 hurricane seasons while simultaneously cutting the state's HHS workforce in half. Call centers were set up and community partnerships across the state were leveraged to assist citizens with the new online process for applying for benefits.

Next Steps

1. **Conduct a self-assessment.** This analysis determines the organization's readiness and need for service integration.
2. **Create a roadmap.** The roadmap defines the optimal plan for service integration.
3. **Perform a cost/benefit analysis.** Such an analysis helps determine the point at which the cost of full integration outweighs the benefits.
4. **Remember that the customer is critical to success.** If the needs of the ultimate customer of the integrated system are not included in the initial process and design stages, the effort is likely to fail.

Figure 8. Service integration



Upgrading Emergency Preparedness and Response

Improving disaster response

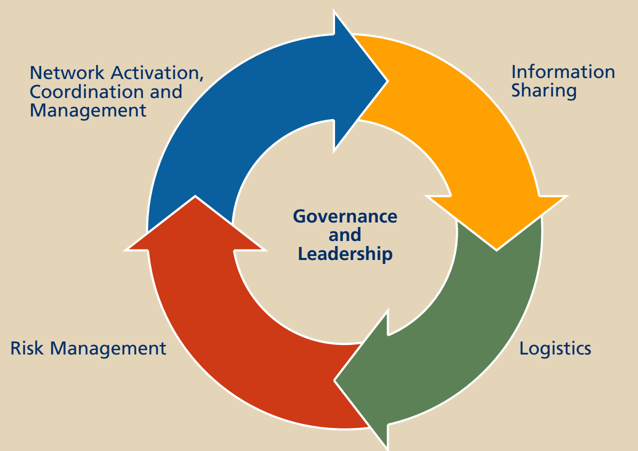
Largely due to the failures of government at all levels to plan, prepare for and respond aggressively to Hurricane Katrina, emergency preparedness policies have been redrawn at the federal level of government. But even as capabilities are built and new, more efficient interfaces with the federal government developed, the long-standing principle that emergency preparedness begins at the lowest possible jurisdictional level probably won’t change. Local and state governments are still “on the hook” for all phases of emergency management—from preparing and planning to response and recovery.

The list of emergencies for which states need to prepare is daunting in size and variety, ranging from floods, tornados, hurricanes and earthquakes to pandemics and potential terrorist attacks.

A governor’s performance in an emergency—and what that performance says about his or her ability to manage—may well shape that governor’s future career. A governor who excels in emergency planning and response is one who has mastered these five key areas (see figure 9):

- Network activation, coordination and management
- Information sharing
- Logistics
- Risk management
- Governance and leadership

Figure 9. Five Key Capabilities for Effective Emergency Response



Source: Deloitte Research

Reform Strategies

Emergency response networks
Effective emergency management and response involves integrating a disparate array of organizations into functioning networks that share information, coordinate activities and synchronize responses.

State-of-the-art logistics
Long before a need emerges for emergency equipment and supplies, leaders must develop strategies for getting the right goods to the right place at the right time.

Creative leadership
This includes being visible and calm, keeping public attention focused on critical issues and articulating a positive vision for the future.

Examples

Developing a robust network

Florida can now move quickly when disaster strikes, either inside its own borders or in neighboring states. Its emergency management plan is based on effective coordination among numerous local and state officials, volunteer organizations, public and private health care organizations and utility companies.

Connecting network participants

Pennsylvania's National Electronic Disease Surveillance System (PA-NEDSS) connects more than 130 hospitals, 120 labs, 450 public health staff and 475 physicians. As a result, public health officials can collect patient case data on a continuing basis over a secure system and communicate public health alerts and advisories immediately.

Thinking through disaster scenarios

Wal-Mart prepared in advance for Hurricane Katrina by anticipating customer demand, replenishing stocks and planning for emergencies like a power outage. It reopened within two weeks all but 15 of the 126 stores it had closed, positioned itself to sell products to storm victims and lent its distribution muscle to relief agencies.

Principles for Developing Effective Information Sharing

- Set clear goals
- Get buy-in at the top
- Create a culture of sharing
- Create a governance model
- Establish communication protocols
- Implement appropriate technology
- Mitigate risks

Next Steps

1. **Integrate existing networks.** Identify effective emergency response networks that already exist as well as needs that are not being met by any existing organization, then devise ways to fill those gaps.

2. **Improve information sharing.** Set clear goals, create a culture of sharing and establish a governance model for information sharing.

3. **Incorporate the private sector into logistics plans.** Private firms can contribute manpower, equipment and much-needed logistics expertise to disaster relief. Establish mechanisms for collaboration to take advantage of this expertise.

4. **Develop a risk governance model.** Assess risks in terms of likelihood and vulnerability, determine how much risk can be tolerated and then develop strategies for managing risk according to that assessment.

Driving More Money into the Classroom

Getting more bang for the education buck

Tight state budgets, surging school enrollment in some districts and falling in others, executive mandates and court rulings put increasing pressure on states and school districts to reduce education costs, particularly for noninstructional services. The 65 percent solution—requiring 65 cents of every educational dollar to be spent on instruction—is now under consideration in numerous legislatures across the country.

How can states and school districts respond to these fiscal pressures without adversely affecting educational performance?

Lacking economies of scale—and often sufficient managerial expertise—many districts find it extraordinarily expensive to provide a full array of support and administrative services in-house. While district consolidation is one option for achieving economies of scale to reduce costs, it can have serious downsides including a negative impact on educational outcomes.

A more promising approach is to reduce noninstructional spending costs through shared services. Arrangements with other school districts, among schools within large school districts, or with outside entities to share services such as transportation, food services, human resources, finances and purchasing can help realize significant cost reductions without negatively affecting student outcomes (see figure 10). States can help identify best practices and drive innovation at a district level.

Figure 10. School Functions Amenable to Shared Services

Capability	Fit for Shared Service	Savings Potential (Comparative)
Direct (Services to Students)		
Transportation	●	●
Food Service and Nutrition	◐	◐
Instructional	◐	◐
Safety and Security	◐	◐
Health Services	◐	○
Indirect (Services to Staff or Infrastructure)		
Purchasing	●	●
Finance and Payroll	●	◐
Facilities & Real Estate	●	●
Human Resources	●	◐
Technology Services	◐	●
Administration	◐	◐

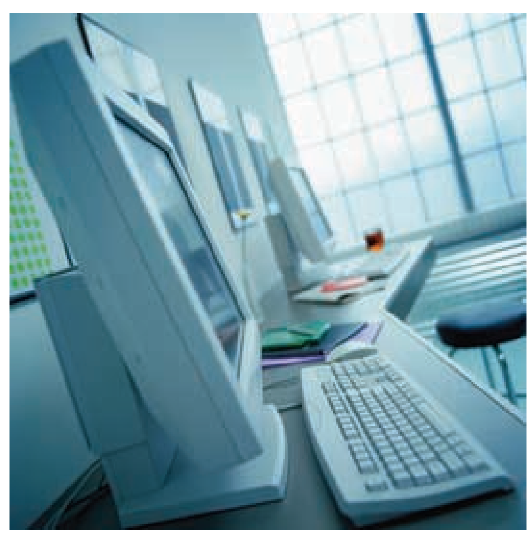
○ ◐ ●
Low → High

Reform Strategies

Functional sharing
Shared services agreements can be used for services across a range of school functions: transportation, food service and nutrition, instruction, safety and security, health services, purchasing, finance and payroll, facilities and real estate, human resources, technology services and administration.

Cooperative purchasing
Pooling purchasing power can yield substantial savings for school districts and their partners by reducing operating expenses for such items as utilities, equipment, services and supplies.

Tapping underutilized assets
Partnering with businesses can help school districts tap into underutilized assets such as land. For example, in exchange for land, private partners have provided school facilities with fitness centers that are used by students during the day and by private clients outside school hours.



Examples

Applying shared services to instructional services
In the greater Lawrence, Massachusetts area, 10 school districts banded together to provide special education services, saving them approximately $13 million over the next two decades.

Creating new public value through partnering
In Northville, Michigan, the public school district, Northville Township and the city of Northville have partnered to create a joint recreation authority. The city and township have a formula for funding contributions while the school district provides facility assistance and commission members.

Two for the price of one
In Pennsylvania, Cornwall-Lebanon and Northern Lebanon School Districts share the services of a food service director. By sharing the director and increasing the districts' purchasing power, the agreement has saved both districts time and money.

Potential Partners for Shared Services

- Other school districts
- Other schools (especially in large school districts)
- Universities and colleges
- Businesses
- Municipalities
- Nonprofits
- Community health and/or service centers

Next Steps

1. **Make noninstructional school spending more transparent.** Dividing the budget into instructional and noninstructional categories forces more detailed explanations of expenditures.
2. **Eliminate the barriers to shared services.** Examine and, if need be, amend state laws and regulations that limit the ability of school districts to share resources or to engage in partnerships with municipalities and the private sector.
3. **Encourage school districts to share services.** Make shared services more attractive by providing incentives and financial and technical support.

Closing the Infrastructure Gap

Ending the boom and bust spending cycle

Back in the 1960s, California was famous for more than just Hollywood, the Beach Boys and some of the most beautiful scenery in the country. The state was also world renowned for its unparalleled infrastructure building program. Led by former governor Pat Brown, California had one of the world's most extensive infrastructure programs in the late 1950s and early 1960s, paving the way for much of the state's subsequent economic prosperity.

Those times now seem like ancient history in the golden state. These days, annualized state transportation needs amount to around $16 billion, but the state currently only funds about a quarter of that. The result is a huge and growing backlog of projects—$100 billion at last count. California is by no means alone in facing a large infrastructure deficit.

Many states confront huge gaps between their infrastructure needs and their current rate of investment. The American Society of Civil Engineers (ASCE) graded the overall condition of the nation's infrastructure a D—recommending $1.6 trillion of investment in infrastructure over the next five years. The infrastructure deficits, in turn, impose huge costs on society, ranging from lower productivity and reduced competitiveness to an increased number of accidents.

And although the infrastructure gap is most acute in transportation, it is also present in other capital intensive areas of states and localities: education facilities, prisons, hospitals, and water and sewer treatment plants.

In order to bring supply into equilibrium with demand, governments need to look beyond traditional financing and delivery mechanisms and take advantage of new innovative partnership models. By making the best use of the full range of delivery models that are available, the public sector can maximize the likelihood of meeting its infrastructure objectives.

Reform Strategies

Make full use of the wide range of delivery options available
Choosing an appropriate financing and delivery model requires understanding the full range of delivery options available, including new innovative public-private partnership (PPP) models developed to address more complex issues such as proper risk allocation. Any procurement decision should be derived from a robust appraisal of all the options, based on the specific circumstances in which the project is being developed.

Adopt a full life-cycle perspective
Diving head first into anything without a proper understanding of what you're getting into is usually a recipe for disaster. The same is true of entering into new partnerships. Governments need a full life-cycle approach (e.g., a clear framework) for infrastructure partnerships that confers adequate attention to all phases of the project—from policy and planning to the transaction phase, and then, to managing the concession.

Unlock value from underutilized assets
Underutilized state assets can be used as equity to partner with the private sector to create new facilities and develop the existing assets. This not only unlocks value from these assets but also helps to meet critical infrastructure needs.

Examples

Focus on outcomes
Lacking experience in either designing or constructing tunnels, the Florida Department of Transportation opted to utilize an innovative PPP model to develop the Port of Miami Tunnel. The payments will be tied to the availability of the tunnel (meaning its being open for operation and available to users) in addition to quality measures. Supporting revenue will come from container and passenger fees in lieu of tolls.

Turning a physical asset into a financial asset
A fiscal crisis forced the District of Columbia to make a hard decision: shut down the James F. Oyster Bilingual Elementary School or find another way to bring the decrepit old school building up to code. In response, the city divided the 1.67 acres of prime real estate in half to accommodate a new state-of-the-art learning facility and a new apartment building, both built and paid for by the private sector—without spending a single public dollar.

Features of a Legislative Framework Conducive to PPPs

- Afford public entities considerable flexibility in the types of agreements they enter into and the specific procurement process
- Allow contracts to be awarded according to best value, not just low price
- Allow a mix of public and private dollars
- Allow "mixed concessions" (the reconstruction or expansion and long-term operation of existing facilities)
- Allow long-term leases of existing government assets
- Authorize procedures to receive and consider unsolicited proposals
- Avoid provisions that would require any further legislative act for a project to be authorized or financed, franchise agreement executed or toll rates changed

Source: Nossaman, Gunther, Knox, & Elliot

Next Steps

1. Assess the condition of the state's existing infrastructure. Then determine the highest priority development needs.

2. Determine the role of PPPs in solving infrastructure gaps in your state. How can you use innovative financing and delivery models to supplement other delivery tools to help meet infrastructure demands?

3. Establish the necessary legislative and regulatory framework to support a PPP program. A poor legislative and statutory environment will stymie a government's efforts to engage in PPPs. The main features of a legislative framework conducive to PPPs are outlined in the nearby sidebar box.

Transforming State Government

Seeing beyond the silos

The kind of transformational change we recommend doesn't just happen. Even the best policy and management improvement ideas will fail without a sound understanding of current operations, a clear strategic plan, a strong implementation capability and a savvy political and people strategy. How then should a governor organize for transformational change?

Transforming state government, requires a full understanding of the linkages and synergies between programs and functions and business processes of government. How will pension changes affect attempts to upgrade the government workforce? How will Medicaid reforms affect health and human services programs? How will transportation improvements affect economic development?

State leaders need to be able to identify the duplication and overlap across programs, agencies and business processes in areas including financial management, procurement and human resource management. This is fertile ground for realizing cost efficiencies, revenue enhancements and service improvements through shared services, consolidation and other approaches (see figure 11).

State leaders should also look at opportunities for enterprise technology and consistent approaches to business processes.

In short, true transformation becomes possible only when government leaders view government as a single enterprise rather than as a series of discrete agencies separately performing individual functions and services.

Reform Strategies

Budget driver analysis
An analysis should be conducted of the activities that drive state budget growth over time.

Business process review
Review processes that cut across the entire enterprise, such as human resources, procurement and licensing. The goal: to find where duplication of people and processes exist within an organization and also the magnitude of and reasons for that duplication.

Programmatic review
Review specific programs within organizations, usually those with large client populations to determine how services can be produced and delivered more efficiently for the client and at less cost to the government, and thus, the taxpayer.

Examples

Cast a wide net
Minnesota's Drive to Excellence initiative identified numerous business areas ripe for reform, from licensing, regulation and compliance to grants management. Estimated savings: $350 million over six years.

Revisiting government performance on a regular basis
The state's biennial review of Texas state government has resulted in more than $15 billion in savings and gains to state funds since it was launched in 1991.

The payoff from investing in improvement
Illinois' transformation initiative, launched in 2003, aimed at cutting costs, improving results, increasing the transparency of government and improving accountability. The state saved $500 million from an investment of $73 million.

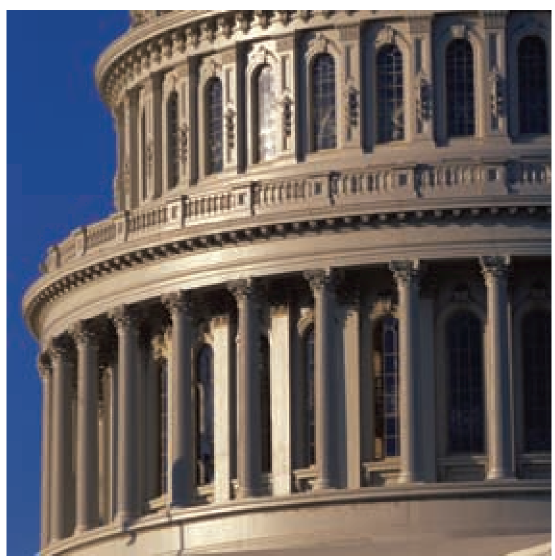
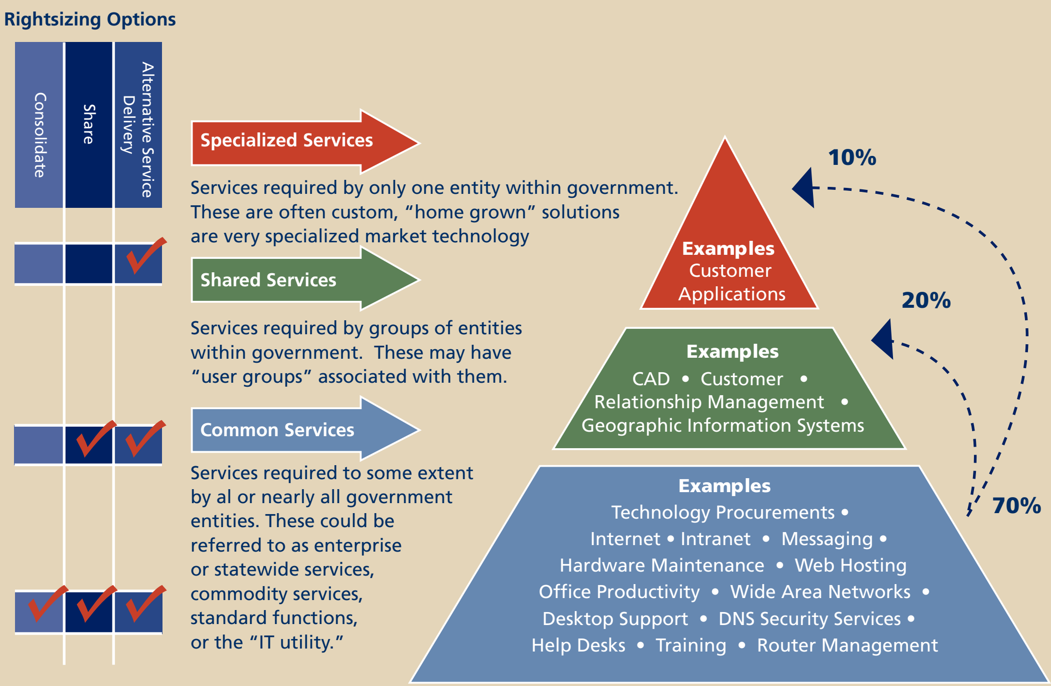


Figure 11. Mapping IT Assets and Sorting out Rightsizing Options



Source: Deloitte Research

Next Steps

1. **Provide executive leadership.** To be successful, a transformation initiative needs the full weight of state leadership behind it. Ensure that the effort has strong and consistent leadership as well as visible support and resources. If the governor is not strongly and consistently leading, the potential will not be realized.

2. **Organize the effort.** States have used various models and combinations of models to transform the way they operate. What tends to work best is an approach that combines top-rate public sector staff (both borrowed and permanent), private sector business executives with relevant transformation experience serving in some kind of advisory role and outside third-party consultant assistance.

3. **Engage lawmakers.** Enterprise transformation initiatives must have legislative support to succeed. There is little point in creating committees and issuing recommendations if you haven't first engaged legislative leaders and worked with them to find common ground.

4. **Target transformation opportunities.** These can be divided into first-wave and second-wave opportunities. First-wave transformations occur at both the agency and enterprise levels, focusing on near term cost savings and customer service improvements. Second-wave opportunities position the delivery of core government services for the future. These reforms rely heavily on new delivery models, innovative partnerships, shared services, advanced technology and related reforms of organizational structure and process design.

5. **Use the business case to drive decision making.** Evaluate development and maintenance costs relative to one time and ongoing benefits.

The Execution Imperative

Translating ideas into action

Tackling the challenges outlined here requires leadership and focused action. States out of necessity have recently entered another age of big policy experiments. These developments are good news. We need more BHAGs (big hairy audacious goals) to meet today's complex challenges. Big, bold ideas can alter the course of history.[4]

But good ideas alone carry you only so far.

"Unless you translate big thoughts into concrete steps for action, they're pointless," wrote Larry Bossidy and Ram Charan, the authors of *Execution: The Discipline of Getting Things Done.* "Without execution, the breakthrough thinking breaks down, learning adds no value, people don't meet their stretch goals, and the revolution stops dead in its tracks. What you get is change for the worse…"[5]

As governors work to improve the way state governments do business—integrating services around the citizen, offering people more choices, providing multiple channels into government, giving citizens a greater say in government and making other admirable reforms—they need to think hard about execution.

This means heeding lessons that emerge time and again: Understand your customers intimately—what services they need and how they prefer to receive them. Drive decisions off hard dollars and cents business cases. Recognize that effective change must encompass business process, technology and human resource components. Use proven practices drawn from the private sector, but tailor them to government's particular needs. Don't try to do everything yourself—collaborate with partners in other jurisdictions, in the nonprofit world and in the private sector. Tackle the easy parts of the problem first, and then apply what you learn to the tougher challenges. Spend a lavish amount of time on managing change—stakeholders must understand the real costs, benefits and rationale.

Big ideas define where we want to be. A detailed strategy for execution—bridging theory and practice—ensures that we get there. If reforms are to be successful, state leaders must devote significant time and attention to both.

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Book Orders

To obtain a copy of the book on which this executive briefing is based, *States of Transition: Tackling Government's Toughest Policy and Management Challenges* (Deloitte Research, 2006), please send an email to publicationcenter@deloitte.com, referencing item 6282.

Endnotes

1 Dan Yankelovich, "Accreditation in a More Demanding World, Presentation to CHEA Annual Conference, January 2006. (http://www.chea.org/Research/2006conf/Yankelovich_Accreditation_in_a_Demanding_World.pdf#search=%22yankelovich%20%20trust%20government%20watergate%202006%22)

2 Prior to the 2006 election, twenty-one of the nation's governors came from the political party that lost the state's presidential vote in 2004. See Josh Goodman, "Against the Grain," Governing.com, October 2006, (http://www.governing.com/articles/10govs.htm).

3 The cost estimated by Stephen T. McElhaney is quoted in Milt Freudenheim and Mary Williams Walsh, "The Next Retirement Time Bomb," New York Times, December 11, 2005.

4 William D. Eggers, "Big, Bold Ideas and the Real World," Governing.com, September 2006.

5 Larry Bossidy and Ram Charan, Execution: The Discipline of Getting Things Done (New York: Crown Books, 2002), p.19.

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