

# The Dillon Prescription for Public Sector Healthcare Reform

How consolidating healthcare plans  
can save the State of Michigan  
\$900M a year.



OPPORTUNITIES TO SAVE COST ON PUBLIC SECTOR HEALTH CARE BENEFITS  
PRELIMINARY/DRAFT

**SUMMARY**

**Background**

The State of Michigan faces a 2010 fiscal year deficit of more than \$1.7 billion. Structural changes in public sector active and retiree health care benefits provide an opportunity to help the state address this budget deficit by reducing costs by an estimated **\$700 to \$900 million per year**.

**Proposals**

- Consolidate the planning, delivery and administration of health care benefits, including negotiations and purchasing, for public sector employees and retirees in Michigan \*
  - The state, counties, cities, school districts and other municipalities spend thousands of hours to individually negotiate and administer hundreds of unique health care plans for Michigan's public sector employees and retirees; consolidation of these activities will simplify the process and generate an estimated **\$65 - \$75 million in annual savings** across Michigan's public sector
  - Economies of scale will ensure that Michigan's public sector has access to the most efficient and cost-effective health care plans available, generating an estimated **\$100 - \$200 million in annual savings**
  - The combined size and scale of the state's public sector can be leveraged to explore opportunities to pay doctors, hospitals and other medical providers for the holistic treatment of a patient's medical condition instead of the current fee-for-service model that encourages overtreatment and duplicate medical testing, and to make medical cost and quality information available to patients, which will generate additional savings
- Standardize the health care coverage offered to Michigan public sector employees and retirees to ensure fair, uniform benefits at a lower cost to taxpayers with estimated expected savings of **\$400 to \$600 million annually** \*
  - All public sector employees, from the local school bus driver to the Governor and other elected officials, should be able to choose from the same portfolio of health care plans.
  - The health care benefits offered to Michigan public sector employees and retirees should be similar to
    - those offered to public sector employees and retirees in other states
    - those offered to private sector employees and retirees in Michigan
  - The average costs paid by Michigan public sector employees and retirees for their health care benefits should be consistent with the average cost paid by
    - public sector employees and retirees in other states (subject to means testing on income)
    - private sector employees and retirees in Michigan (subject to means testing on income)
  - Establish a mechanism to ensure that the health care delivered in Michigan conforms to recognized best medical practices. This is important, and the savings could be substantial, as studies show that it often takes seventeen years for best practice treatments to be fully adopted by the medical community. As a result, patients do not get the correct diagnosis for their medical conditions up to 20% of the time and, even when the diagnosis is correct, patients do not receive the best course of care up to 60% of the time, which increases the cost of health care.

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**Recommended Immediate Action:**

- Governor to appoint “Director” to design the vision and an action plan for adoption of a uniform, public sector health benefits program for the State of Michigan
  - Vision to be completed no later than September 30, 2009
  - Action plan to be completed no later than October 31, 2009
  - Approvals to be completed no later than December 31, 2009
  - Implementation to begin in January 2010

**Goals**

- Implement fundamental changes in the planning, delivery and administration of health care benefits for Michigan’s public sector employees in order to create substantial savings for the state
- Provide competitive, affordable health care benefits to the state’s public sector employees
  - Plans should be similar in design and average cost share as the health care benefit plans offered to public employees and retirees in other states, and
  - Plans should be similar in design and average cost share as the health care benefit plans offered to the majority of the state’s private sector employees and retirees
- Use the combined size of Michigan’s public sector to ensure access to the most efficient and cost-effective health care plans available
- Preserve patient choice
- Sustain collective bargaining rights
- Aim to optimize the health of public sector employees, retirees and their families, by investing in prevention and wellness, rewarding healthy behaviors and encouraging individuals to actively participate in the management of their own health
- Establish a mechanism to ensure that the health care delivered in Michigan conforms to recognized best medical practices
- Once the infrastructure to administer health care benefits for Michigan’s public sector employees and retirees is in place and standardized health care benefits programs are operational, the state should offer its health care benefit plans as an option to all residents and businesses in Michigan
- Reposition Michigan as the preferred place to do business

\* Any government units that offer lower cost plans to their employees would be exempted from participation in the state plan

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**DETAILED REPORT**

**Background**

The State of Michigan faces a 2010 fiscal year deficit of more than \$1.7 billion. Structural changes are needed in order to address this deficit. Changes in public sector active and retiree health care benefits provide an opportunity to help the state reduce costs; specifically, changes that would centralize the oversight and administration of health care benefits, standardize benefits for all public sector employees, leverage an increased purchasing scale and position the state to have a stronger voice in ensuring that all residents receive medical care that conforms to recognized best practices.

**Expected savings range from an estimated \$700 to \$900 million per year.**

**Current Status**

- **Complexity**

The State of Michigan, through the Civil Service Commission, manages and purchases health care benefits for most state employees and retirees. The state's counties, cities, other municipalities, and schools are responsible for providing and administering benefits for their own employees and retirees. Due to the challenges and complexities involved in establishing and managing health care benefits, many public sector communities, local governments and school districts use a third party administrator (TPA) to perform these tasks. For example, the Michigan Education Special Services Association (MESSA) is a TPA that provides health care benefits to more than three quarters of the state's public schools and universities, covering more than fifty percent of teachers. The American Federation of State, County and Municipal Employees (AFSCME) through MEBS, the Michigan Public School Employees Retirement System (MPERS), the State Employee Retirees Association (MI-SERA), the Michigan Municipal League (MML) and the Municipal Employees' Retirement System of Michigan (MERS) are other examples of organizations with a voice in health care benefit programs for public sector employees and retirees in Michigan.

Thousands of hours are spent annually on multiple levels to manage and administer health care benefits for Michigan's public sector employees and retirees who participate in the benefit plans offered by the state and its vast number of counties, cities, schools, other municipalities and local units of government. To give this some perspective, Michigan has:

- 83 counties
- More than 630 cities and 1,250 townships
- 839 school districts and intermediate school districts (with about 1,200 bargaining locals)
- Numerous other local units of government such as courts, libraries, road commissions and community health agencies
- Each of these units may negotiate benefit contracts with **multiple** unions representing active employees and **multiple** unions representing retired workers

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- **The Cost of Health Care for Michigan's State Employees and Retirees**

According to House Fiscal Agency, the state incurred \$551.7 million to provide health care coverage to 48,529 active employees and their families in 2008. This was an average cost per contract (a contract is an employee and his/her dependents) of \$11,368. The state also paid \$360.9 million in 2008 to cover 45,551 retirees and their families, which was an average cost of \$7,923 per retiree contract. House Fiscal estimates that the state will save \$100 million in health care costs in 2009 due to increases in premium sharing (from five to ten percent) and point-of-service costs (e.g., deductibles and copayments) for state employees. The increases went into effective on October 5, 2008.

Although state employees recently assumed a larger portion of overall health care costs, data show that they continue to pay less in premiums (on both an absolute and percentage basis) than the amount paid on average by their counterparts in Michigan's private sector. For example, the total 2009 cost of coverage for a family enrolled in the state's health care program ranges from generally just under \$16,000 for an HMO to just over \$17,000 for the state's PPO plan. State employees pay between \$800 and \$1,500 annually, or five to eight percent, of the HMO premium and \$1,700 annually, or ten percent, of the PPO premium. Conversely, the average 2009 annual total premium for family coverage provided in Michigan's private sector for businesses with more than 50 employees is estimated to range from \$13,000 to \$14,000, with private sector employees paying on average 18%, or \$2,300 to \$2,500, of the total premium. This means that private sector employers pay on average \$10,700 to \$11,500 for family coverage after deducting the employee premium share, compared to just over \$15,000 paid by the state.

The total 2009 annual premium for individual coverage under the state's PPO plan is \$6,190 with employees paying ten percent or \$619 of that premium. Under the available HMO plans, the total 2009 annual premium for individual coverage ranges from \$3,774 to \$6,111, with employee premiums ranging from five to eight percent, or \$189 to \$540 per year. The total average premium for individuals enrolled in all plan types is \$5,176 in Michigan's private sector with the individual paying 15% (\$772) of the premium.

(Note: The State of Michigan pays 90% of the total health care premium for its PPO plans, and 95% of the total premium for the same coverage code as the State Health Plan PPO. Accordingly, state employees pay ten percent of the total premium for PPO coverage and between five and eight percent for HMO coverage. This calls into question the incentive or motivation for HMO plans to price their products at levels below ninety-five percent of the PPO premium.)

The report "Civil Service Salary and Benefit Comparisons," published by House Fiscal Agency in November 2008 shows that, as a result of the new contract agreements that went into effect in October 2008, Michigan's state employees will pay \$142.37 per month for family health care coverage. The report goes on to state that this amount is higher than the average paid by private/public sector employees surveyed in 2007.

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The \$142.37 per month premium reflects coverage under the PPO plan, the most expensive plan option available, whereas monthly premiums for the HMO plans range from \$42 to \$124 for family coverage. When health care inflation is added to the average premium cost paid by private sector employees, the new premium paid by state employees for family coverage continues to be lower. Per the House Fiscal report, the average premium for family coverage paid by private sector employees in Michigan was \$138.15 as of June 2007. This increases to \$152 per month (or \$10 more than the maximum paid by state employees) when compounded for two-years of inflationary increases at five percent, which is a conservative yet fair increase as the Joint Economic Committee of the U.S. Congress reported that health care inflation was 8.8 percent in 2007 and other sources have quoted increases of five percent for 2008.

While the premiums paid by state employees for family coverage continue to be less than those paid by private sector employees, state employee health care premiums far outpace those paid by other employees in the public sector. In 2007, the average monthly premium paid by Michigan's public sector employees for family coverage was \$62.01. Compounded at 5 percent per year for two years, this would increase to \$68.37, or \$74 per month less than the maximum premium paid by state employees for family coverage.

- **The Cost of Health Care for Michigan's Active and Retired School Employees**

(Note: The analysis presented in this section focuses primarily on active school employees covered through MESSA.)

For the 2008 fiscal year, House Fiscal Agency reports that the school share of cost for all insurance provided to active school employees was \$1,989.5 million. This equates to about \$1,727 million for health care costs when adjusted for life insurance and disability (a total of about three and one-half percent) and dental and vision (about seven to ten percent). The school share of cost for retiree insurance was \$734.5 million (health, dental and vision), or about \$660 million for health care only.

The Michigan Education Special Services Association (MESSA) is affiliated with the Michigan Education Association (MEA) and provides health care coverage to about three quarters of Michigan's school districts and more than fifty percent of the state's teachers. Notably, some large districts such as the Detroit Public School (DPS) system are self insured and therefore are not part of MESSA. MESSA covers active teachers through a Voluntary Employees Beneficiary Association (VEBA), where the association develops health care plans and programs, offers them to various school districts and then administers the benefit programs. Specific cost information on the state's self-insured schools is not available.

The benefits provided through MESSA are comprehensive and considered by some to be more generous than the benefits offered to state employees and in the private sector. For example, MESSA plans have covered massage therapy without a prescription or referral from a physician. This type of benefit is generally not covered by other insurance carriers, sometimes even with a physician referral.

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MESSA offers a variety of health care plans with a range of deductibles and other copayments. While there is an increasing trend in the number of school districts where employees pay premiums, many pay no premiums or very small premiums for their health care benefits, and several services performed by in-network providers are not subject to deductibles, copays and/or coinsurance.

Per the House Fiscal Agency, the average cost to a school district per employee for insurance benefits offered through MESSA is \$15,000 per year. About three and one-half percent of this cost represents life insurance and disability coverage, while it's estimated that approximately another seven to ten percent is for dental and vision coverage. Therefore, assuming that the average cost of a benefit plan is \$15,000 per year, the net average cost per employee for health care benefits is approximately \$13,000 per year. House Fiscal also notes that the costs of a MESSA benefit package vary from district to district and that the costs would be higher if not sold as part of a package (a typical MESSA PAK includes health care, dental, vision, life insurance and disability).

**Table 1 – Average Cost of Health Care through MESSA**

Total Average Insurance Cost	Adjustment for Life and Disability @ 3.5%	Adjustment % for Dental and Vision	Adjustment \$ for Dental and Vision	Net Average Health Care Insurance Cost
\$15,000	(\$525)	7%	(\$1,050)	\$13,425
\$15,000	(\$525)	10%	(\$1,500)	\$12,975

While the premium cost per plan type for MESSA coverage is not specifically available, Table 2 below shows an estimated range of premium costs based on projected enrollment in each coverage type and using the \$13,000 average cost per contract. Assuming enrollment in family coverage of forty-five to fifty percent, the family premium for health care costs could range from \$15,600 to \$16,300. Due to the law of averages, the cost of a single/individual premium, as well as the enrollment rates across the various plans, will drive the premium cost for family coverage.

**Table 2 – Estimated Ranges of Premium Cost for MESSA Health Care Plan by Type of Coverage**

Type of Coverage	Enrollment	Cost		Enrollment	Cost	
Single/Individual	20%	\$6,500	\$7,000	15%	\$6,500	\$7,000
Two Party	30%	\$13,000	\$12,000	40%	\$12,000	\$11,500
Family	50%	\$15,600	\$16,000	45%	\$16,150	\$16,300
Average	100%	\$13,000	\$13,000	100%	\$13,000	\$13,000

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MESSA reports that it has controlled health care cost increases at levels below national averages and individual school districts would pay far more for health care coverage outside of the MESSA plans. The Michigan Education Association (MEA) has said that due to the size and scale of MESSA, the only way a consolidated plan for state employees would save money is by reducing health care benefits for teachers.

There are examples of school districts leaving MESSA only to find that their premiums skyrocketed in the following year, as well as examples where school districts achieved cost savings when they moved from MESSA coverage to another carrier. There are a number of reasons why a school district that leaves MESSA coverage may experience an increase in health care costs, but this is primarily because:

- o MESSA is able to leverage its size and scale to purchase health care services more efficiently than many school districts can do independently or as part of a smaller scale collaborative;
- o The size and number of participants in MESSA plans create larger pools that help spread the risk so that an individual school district is not severely penalized for large claims; and
- o MESSA offers health management tools such as chronic disease support, medical case management and wellness information.

Previously, it was more difficult for a school district to accurately compare its cost for MESSA coverage against prices offered by other carriers. The state now requires MESSA to provide details on claim data by specific school district as this information is needed to enable the districts to seek bids from other carriers.

- **The total cost of health care for other public sector employees (counties, cities, townships, and other governmental units) is not readily available, however this cost can be estimated by the following methods:**

1. **Extrapolated from Other Data:** The cost of health care benefits as of May 2007 was estimated at \$880 million for 69 of 83 Michigan counties; 559 cities, villages and townships of over 1,800 statewide; and nearly 250 other local units of government.
  - Assuming that the estimate of \$880 million represents 75% of the total health care costs incurred by all counties, cities, villages, townships and other local government units, then their total annual health care costs would approximate \$1,170 million
  - If the estimate of \$880 million represents 50% of total health care costs incurred by all counties, cities, villages, townships and other local other local government units, then their total annual health care costs would approximate \$1,750 million
  - This yields a total cost range of \$1,170 to \$1,750 million per year

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2. **As a Percentage of Health Care Premium Cost for State and School District Employees and Retirees:** The following table shows the expected total cost of health care benefits provided to public sector employees and retirees covered by county, municipal, city, township and other government units if those costs approximate 35%-50% of the total amount spent for state employees and active and retired school employees.

**Table 3: Estimated Cost of Health Care Benefits for Cities, Counties and Other Local Governments**

Type of Health Care Coverage	2008 Total Annual Cost Paid by State or Schools \$(millions)	Other Public Sector @ 35% \$(millions)	Other Public Sector @ 50% \$(millions)
Active State	\$552		
Retired State	\$361		
Active Teacher	\$1,727		
Retired Teacher	\$660		
Total	\$3,300	\$1,150	\$1,650
Range For All	\$3,300	\$4,450	\$4,950

- (Note: the total costs shown in this chart for all local governments range from \$1,150 to \$1,650, which is fairly consistent with the range calculated under Method 1 above.)

**How Michigan’s Public Sector Compares**

Total premiums spent to provide health care benefits to Michigan public sector employees continue to outpace total premiums paid for health care benefits for public sector employees in other states. Using 2006 data, the National Council of State Legislators (NCSL), which is referenced in the report “Budget Action Plan: Restructuring Options to the State Legislature for Transforming Michigan’s Budget,” prepared by Public Sector Consultants for Detroit Renaissance and released on September 17, 2008, compared Michigan’s state employee benefits to other states. The reports state that “Michigan’s total monthly premium costs for family health care coverage were \$1,249.76, compared to the average cost of all 50 states of \$1,012.67. State of Michigan employees paid five percent (in 2008 and earlier) of their premiums, compared to a 19 percent average across all 50 states.”

Said another way and considering the recent increase in premium contributions, the premiums paid by Michigan’s state employees are nine percentage points lower than those paid by their counterparts in other states. Further, the report “Fiscal Year 2008 Liabilities of the State Employees’ Group Insurance Program,” published in March 2007 by the State of Illinois Commission on Government Forecasting and Accountability, reported that Michigan’s average 2006 family health care premium of \$1,249.76 ranked eighth highest of all states.

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These conclusions are supported by information published by the Kaiser Family Foundation “Employer Health Benefits 2007 Annual Survey.” The survey reports that “state and local government workers in the United States pay an average of 13 percent of their health insurance premium if they have single coverage and 22 percent for family coverage. For employees of all public and private sector employers included in the survey, these proportions are sixteen percent and twenty-eight percent respectively. The average total monthly premium cost for family PPO health coverage was \$1,037.”

Per the Kaiser Family Foundation “Employer Health Benefits 2008 Annual Survey,” the average health care costs for family coverage across all employers was \$12,680, with employees paying on average twenty-seven percent of that cost. (Note: twenty percent of workers with single coverage pay no premium and seven percent of workers with family coverage pay no premium.)

Certainly, recent increases in premium contributions for Michigan’s state employees have closed the gap with percent of premium paid by their counterparts in other states. However, it continues to be the case that Michigan’s total premium costs are higher than the total premium costs paid for public sector employees in other states. Total premiums for family coverage provided by the State of Michigan are between \$16,000 (HMO) and \$17,000 (PPO). The state pays about \$15,200 and employees contribute \$800 to \$1,700 (five to ten percent). While the total premium cost of a family plan is not specifically available for MESSA health care coverage, it is estimated at about \$16,000 per year; the premium contribution paid by Michigan’s public school employees is not available. Premium costs are also not available for Michigan’s other public sector units.

**Table 4 – Comparisons of Michigan’s Public Sector Premium Costs**

	Annual Premiums for Individual Coverage				Annual Premiums for Family Coverage			
	Total	Employer	Employee	EE %	Total	Employer	Employee	EE %
National Average <sup>a</sup>	\$4,940	\$4,160	\$780	16%	\$13,300	\$9,750	\$3,550	27%
Average Public Sector - All States <sup>b</sup>	tbd	tbd	tbd	13%	\$14,000	\$10,900	\$3,100	22%
Private Sector – Michigan <sup>c</sup>	\$5,176	\$4,400	\$776	15%	\$13,000 - \$14,000	\$10,700 - \$11,500	\$2,300 - \$2,500	18%
MI State Employees <sup>d</sup>	\$3,774 - \$6,190	\$3,585 - \$5,571	\$189 - \$619	5% - 10%	\$16,000 - \$17,000	\$15,200 - \$15,300	\$800 - \$1,700	5% - 10%
MI School Employees <sup>ee</sup>	\$6,000 - \$7,000	n/a	n/a	n/a	\$15,000 \$16,500	n/a	n/a	n/a

<sup>a</sup> Kaiser Foundation 2008 average premium cost marked up for five percent inflation: single of \$4,704 becomes \$4,940; family of \$12,680 becomes \$13,300; national average includes both public and private sectors

<sup>b</sup> US average public sector premiums, including Michigan, using 2006 annual premium cost of \$12,150 for family coverage with three years of compounded inflation at five percent per year

<sup>c</sup> Michigan private sector and schools are estimated at 2009 premiums

<sup>d</sup> Michigan state employees at published 2009 premium rates

<sup>e</sup> The cost of individual coverage for Michigan’s school districts is estimated to run between \$6,000 - \$7,000 for a contract; working within those ranges, the cost for family coverage is calculated at \$15,000 - \$16,500 assuming between 15-20% of enrollees have individual contracts, 30-40% have two-party contracts, and 45-50% have family contracts

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The data shown in the above Table 4 suggest three possible reasons why the total cost of health care premiums in Michigan's public sector are higher than in other states and when compared to private sector employers in Michigan:

- 1) The premium cost of health care benefits for public sector employees in Michigan is generally higher than the premium costs for the benefits provided to public sector employees in other states and in Michigan's private sector, indicating that the benefits may be more generous than those offered by other states to their public sector employees as well as those offered to private sector employees in Michigan
  
- 2) Public sector employees and retirees in Michigan pay a smaller share of health care premiums versus the national averages for public sector employees, the national average for all employees, and the Michigan average for the private sector; additional data show that:
  - State employees have partially closed the gap with their counterparts in terms percent of premium contributions with the changes implemented on October 5, 2008
  - The premiums paid by other public sector employees and retirees in Michigan generally continue to be less than those paid by Michigan's state employees and their counterparts in other states
  - Considering both private and public sector employers, Michigan ranked 45<sup>th</sup> in terms of employee premium contributions for family health care coverage at 19% (with a 2% margin of error) vs. the national average of 25.39%
  - Similarly, for employee premium contributions to individual health care, Michigan ranked 41<sup>st</sup> of all states at 14.5% (with 1.5% margin of error) vs. the national average of 19.14%
  
3. The cost for health care is more expensive in Michigan than in other states
  - This is not a likely conclusion as the per capita health care cost in Michigan ranked 36<sup>th</sup> at \$5,058 vs. the U.S. average of \$5,283 (2004 cost)

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**Opportunities**

There are four broad categories to improve the safety, quality and delivery of health care while reducing costs:

**1) Administrative, Projected Savings estimated at \$65 to \$75 million annually**

**Rationale**

- Consolidation of responsibilities and functions needed to plan and administer benefit programs under the Office of the State Employer would create savings by streamlining the organizational infrastructure and minimizing the costs associated with duplicate processes, staffs and insurance brokers and agents
- Duties of the Office of the State Employer would include, but are not limited to, researching best practices in health care design, negotiating benefit plans, administering benefits, communicating with and educating employees and retirees, managing relationships with health care plans and other providers, and participating in/supporting public forums focused on health care reform

**Support for Savings Projection**

- Various studies have shown the opportunity for savings in the \$70 to \$100 million range would accrue from the consolidation of all public health plans into a state administered self-funded plan. The savings would be most significant for insured groups moving to a self-funded status due to the elimination of commissions and other broker fees and improved efficiency in administration.
- Assuming the costs to administer a state self-funded plan could be in the range of \$15 - \$20 million, net savings would fall between \$65 - \$75 million per year.

**2) Economies of Scale (Leveraged Purchasing Drives Lower Cost), Projected Savings estimated at \$100 - \$200 million annually**

**Rationale**

- Increased enrollment will drive economies of scale in the purchase of certain services and products, such as lower costs for prescription drugs
- All participants in Michigan's public sector would have access to the highest quality and lowest cost health care plans
- This would also better position the state to have a voice in the payment practices for medical services
- With more centralized control of health care benefits, the state will also have a bigger voice in policies and practices designed to improve the health of state residents

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**Support for Savings Projection**

- AFT and IOUE Local 547

The American Federation of Teachers (AFT) and International Union of Operating Engineers (IUOE) Local 547 published a report in 2005 projecting savings of \$156 million annually in the 1<sup>st</sup> year, increasing to \$223 million annually by the 3<sup>rd</sup> year from the consolidation of teacher health care coverage into a single system, increased competition and implementation of programs to encourage improvements in patient health. The estimated savings are based on a system with:

- State-sponsored catastrophic stop loss coverage
- Competitive health care purchasing through coalitions/regional pools
- Transparent health care information for school employers and employees
- Disclosure of hospital and physician performance on measures of quality
- State-of-art programs to improve member health
- Efficient administrative services that leverage industry standards and IT

- Center for Michigan

According to the Center for Michigan, the savings calculated and presented by the AFT and IUOE represents a seven percent savings on the cost of health care for teachers. The Center for Michigan extrapolated this seven percent savings to include local governments and estimated a total savings of \$500 million through mandated health care benefits pooling. The Center for Michigan analysis categorizes all of the savings to be the result of “leverage” although the AFT/IUOE recommendation included savings related to improvements in health care quality and administrative efficiencies. The Center for Michigan savings is based on a total of \$7.1 billion spent on “health insurance benefits” for public sector employees as reported by the U.S. Census for 2005-06. However, further analysis reveals that the \$7.1 billion covered insurance trust expenditures including unemployment compensation, employee retirement and workers’ compensation.

- Savings Quantification

Using data from Table 3 above, estimated annual total health care costs for all employees and retirees in Michigan’s public sector range from \$4,450 to \$4,950. Recognizing that the seven percent savings used by the Center for Michigan includes savings from administrative simplification and other health care reform programs, a more conservative estimate of savings from leveraged purchasing would fall into the two to four percent range, which would yield total savings of **\$100 to \$200 million annually**. Cost reductions from volume discounts on the purchase of prescription drugs could be a substantial percent of this savings.

Accordingly, the leverage gained from consolidation of teacher benefits into a single program would produce savings ranging from \$50 to \$110 million per year, or about thirty to fifty percent of the savings estimated by the AFT and IOUE, with the balance of their savings estimate coming from increased competition, administrative simplification and implementation of programs to encourage improvements in patient health.

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- 3) **Broad use of evidenced-based health care and standardization of employee benefits** present further opportunities for substantial savings, with a total estimated range of **\$400 to \$600 million annually**

**Rationale**

- **Adoption of Best Practices Medicine (also known as Evidenced-based Standards of Care); this will create additional savings**

The use of best medical practices will increase the safety and quality of medical care delivered in Michigan, saving lives and helping to control costs in the long run.

- Across the United States, adult patients receive only about half of the recommended, best-practice care for treatment of their medical conditions (source: McGlynn, et al., "The Quality of Health Care Delivered to Adults in the United States," *The New England Journal of Medicine* (June 26, 2003): 2635-2645).
  - Results of second opinion reviews by Best Doctors show fifteen to twenty percent of patients do not receive a proper diagnosis for their medical condition, and, when a proper diagnosis is received, up to sixty percent of patients do not receive treatment that is consistent with recognized best practices for medical care (source: Best Doctors).
  - The Southern California Schools VEBA introduced a second-opinion program through Best Doctors in 2004. The program produced a 3 to 1 ROI in the first 6 months.
- **Standardization of Employee Benefits** – there is substantial opportunity to save costs by changing benefit design to be more in line with public sector employees and retirees in other states as well as private sector employees and retirees in the state of Michigan and standardizing the type and level of benefits offered across all public sector employees and retirees in the state
    - Studies demonstrate the level of benefits offered to public sector employees and retirees in Michigan are more generous and more expensive than the benefits offered to their counterparts in other states
    - Data show that Michigan's public sector employees and retirees have more generous benefits than individuals employed by private companies in Michigan
    - There are wide differences in the levels of benefits offered to public sector employees and retirees across Michigan
    - There are several ways to modify plan designs that encourage employees and retirees to become better consumers of health care, thereby improving their health status while helping to control costs. For example, state employees now must pay \$50 for use of the emergency room unless they are admitted to the hospital. Also, the use of larger differentials in copayments for generic versus brand drugs would help incentivize members to choose equally effective yet lower-cost generics.

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- **Increased Employee/Retiree Cost Share** – types of cost share include premiums, deductibles, copayments and coinsurance
  - Studies also show that public sector employees and retirees in Michigan pay much less of the cost for their health care benefits than their counterparts in other states as well as private sector employees and retirees in Michigan (as well as other states)
  - The components of employee/retiree cost share are important because they allow the state to structure benefit programs to encourage employees/retirees to participate in health care services that deliver the most value (such as preventive care and annual physicals) instead of more costly services such as unnecessary ER visits, and they give the user some “skin in the game”
  - **Shifting of additional costs to Michigan’s public sector employees needs to be done with some caution, using appropriate means testing of employee income levels**

**Support for Savings Projection**

- Detroit Renaissance report “Budget Action Plan: Restructuring Options to the State Legislature for Transforming Michigan’s Budget” (September 17, 2008)

The Detroit Renaissance report “Budget Action Plan: Restructuring Options to the State Legislature for Transforming Michigan’s Budget,” published on September 17, 2008, suggests an annual savings of \$269 million by increasing premiums and reducing benefits to levels consistent with the plans offered in other states. This savings is ONLY for state employees, state retirees, and public school retirees. It does not address the impact of making similar changes for active teachers and municipal workers. Effective October 2008, benefit changes shifted about \$100 million in cost to state employees and retirees, leaving an additional opportunity of \$169 million.

- Center for Michigan

The Center for Michigan extrapolated the savings presented in the Detroit Renaissance report to include local governments and schools and estimated that “an across-the-board shift of ten percent of health insurance expenses from employer to employee would save an estimated \$700 million per year.” They based this estimate on ten percent of \$7.1 billion spent on “health insurance benefits” for public sector employees as reported by the U.S. Census for 2005-06. However, further analysis reveals that the \$7.1 billion covered insurance trust expenditures including unemployment compensation, employee retirement and workers’ compensation. Regardless, shifting additional cost to employees will generate substantial savings.

Further analysis shows that total health care costs for Michigan’s public sector employees and retirees ranges from \$4,650 to \$4,950 million per year. A ten percent cost shift from the current status quo would deliver cost savings ranging from \$450 to \$500 million. However, the opportunity for real savings may be less as state employees just saw a five percent premium cost shift in October 2008, and income-based means testing should be conducted to ensure any cost shift is equitable.

OPPORTUNITIES TO SAVE COST ON PUBLIC SECTOR HEALTH CARE BENEFITS  
PRELIMINARY/DRAFT

- National Conference of State Legislatures  
Average premiums for health care for public sector employees (active teachers = \$13,000) and retirees in Michigan are higher than national averages (\$12,680 per NCSL), indicating that health care benefits in Michigan are more generous than in other states. Also, the health care benefits provided to public sector employees and retirees in Michigan are more generous than the benefits offered to many private sector employees in Michigan.
  - Changes should be pursued to align the type and level of Michigan's public sector health care benefits with those offered in other states – equalizing Michigan's average public sector premiums with other states would save between **\$200-\$300 million annually**
  - The State of Michigan should take a leadership role in driving reform in payment practices for health care services; movement to value-based health insurance is regarded as a key opportunity to improve the quality of health care, improve health status and lower cost – this will generate additional savings

**Other Positives**

Could garner wide public support – most individuals in the state have seen their benefit levels reduced over the past several years and have had to pay more for the benefits that they have. There is a perception that public sector employees have benefit levels that exceed those available to individuals working in private businesses. Private sector employees who have made sacrifices may support a plan to change the benefit levels of public sector employees to levels that are more aligned with the benefits provided in the private sector.

Standardization of benefit plans and centralization of benefit administration will allow the state to focus on the promotion of wellness and healthier lifestyles. Health care plans may be designed to incentivize individuals to take a more active role in their own health, creating a healthier workforce with lower absenteeism and higher productivity. This will make Michigan a more attractive place to do business.

**Challenges**

**Complexity** – there are thousands of individual plan designs today covering hundreds of thousands public sector employees and retirees at the state level and in thousands of municipalities, school districts, courts, etc., each with multiple local labor contracts with staggered expirations. It will take the UAW more than two years to establish administrative practices and consolidate operations to manage the health care benefits for UAW retirees from Chrysler, Ford and GM. While a complex task, the establishment of the UAW VEBA is not as complicated as the administrative consolidation of the diverse and disparate mix of health care options covering Michigan's public sector employees and retirees.

**Resistance to Change**