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COST SAVINGS IN DHS (DPW) INSTITUTIONAL CLOSURES

This paper posits that savings to the state through institution closure is negligible or nonexistent unless certain conditions are present, and, these conditions are not equally present in all DHS institutions. The paper further embraces as fact net savings cannot exceed net costs. Stated alternatively, the State cannot save any money beyond it's actual or net costs.

Net savings for the state thus becomes the gross cost of keeping an institution open (generally the intended savings from closure), reduced or adjusted by any revenue lost because of actions leading to the intended savings. These adjustments include:

1) Reimbursed expenses - reimbursed expenses are actually revenue unless the reimbursed expenses are not considered as an original expense. Such revenue offsets costs involved in producing the revenue and thus the concept of net cost must be introduced. If, for instance, 55% of the cost of care is reimbursed, revenue equals 55% of cost of care and the net cost to the state is reduced to 45% of the cost of care.

2) State taxes are the primary form of revenue to the state. A portion of the salaries paid to employees in the institutional system is returned to the state as taxes and thus is actually revenue to the state. Loss of this taxation revenue represents a negative savings. For example purposes, this paper will posit that 15% of the gross amount of a typical DHS employees' salary is returned to the state in the form of income taxes, sales taxes, gas taxes, excise taxes, etc.

3) Economic theory tells us that people who work for money save some, pay taxes, and spend the rest. It further tells us that the people who

receive what is spent also save some, pay taxes, and spend the rest, etc.. In this manner, a dollar is spent, a portion is spent again, a portion of that portion is spent again, etc.. This phenomenon is referred to as the "multiplier effect". The multiplier effect also applies to taxes, in that what is spent by person A becomes income for person B. It is not the intent of this paper to address the cash inflow versus cash outflow of Minnesota's economy, but a figure is needed for exemplary purposes. This paper will posit the Minnesota multiplier to be 1.75, or alternately stated, there is a marginal gain caused by taxes on total reexpenditures of income in Minnesota equal to 75% of the taxes paid on the original amount. Using #2 above, 75% of the 15% = 11.25% (which, like #2, is also lost revenue).

The above constraints (less any costs involved in disposal) can be stated in formula form, that is, net savings (S) are equal to State cost (C) minus the sum of reimbursement (R), lost taxes (LT), and multiplier tax loss (MTL) or,

$$S = C - (R+LT+MTL).$$

The formula does not contain any of the costs involved in disposing of the closed facility, any of the costs involved in transferring the residents, nor any of the costs involved in transferring the staff. Perhaps most significantly of all, it does not contain representation of any social costs. (The "costs" involved in disposing of the facility can actually become revenue if the selling price exceeds the net cost of disposal. This revenue could be used to offset the costs of transferring staff and residents. Some "social costs" are also amenable to neutralization -- e.g. unemployment compensation -- but most social costs cannot be addressed in this manner -- e.g. uprooting families or devaluation of

community property, etc. are not readily amenable to dollar costs.)

Given that the formula is valid in its contention that true State savings can only be represented by those costs which are not reimbursed, directly or indirectly, and, since C, R, T and MTL can be predetermined (approximately), a model evolves which can be used to determine the savings involved in closing a DHS institution. That is, as the sum of R+T+MTL approaches the value of C, S approaches zero. For instance, using the tax and multiplier tax figures from #2 and #3 above, we are able to determine that closure of an institution with a reimbursement rate of 73.75% will net no savings to the State, i.e. $S = 100\% - (15\% + 11.25\% + 73.75\%)$, or $S = 100\% - 100\%$, or $S = 0$.

(The above formula [$S = C - (R+LT+MTL)$] is equally true for issues involving the reduction of staff in institutions where "C" equals salary costs.)

The model shows that savings do not occur simply through disuse of State resources. Given that disuse of resources is not an appropriate management tool and presuming the State wishes to trim costs in the institutional system, it behooves the management of the facilities to present viable, alternative methods of cost containment. The author of this paper suggests that true savings can best be accomplished through planned maximization in the utility of the resources (e.g., alternative use of capital, both land and vacant buildings) and long-term planning regarding recapitalization of the facilities. As an example of alternative use of capital, one might consider selling it, i.e. Anoka State Hospital probably has the most saleable capital in the state system -- it certainly seems reasonable that some speculator would purchase the land for development.

A second example might be Brainard State Hospital converted to a corrections facility -- the geographical location and physical layout appear to be adequate for the purpose.

Two questions need to be addressed before closing:

When is it appropriate to close a DHS institution?

When is it appropriate to cut staff?

Generally, the answers depend on restrictions on reimbursement and/or capitalization issues. That is, the amount which can be reimbursed has limits, and, costs in excess of these limits can endanger reimbursements or the expenditures themselves may be non-reimbursable (e.g., recapitalization). As this relates to closing of institutions, when the costs of maintaining the institution are great enough so as to cause the total cost of care to approach the maximum amount acceptable to the reimbursing parties, or when recapitalization of the institution is necessary to maintain reimbursement and equally acceptable accommodations are available elsewhere without recapitalization, the institution should be closed. As the above relates to reducing staff numbers, if staff to resident ratios are established which meet requirements and restrictions for reimbursement, then, as resident numbers reduce, staff reductions relative to the ratio (and acceptable cost) can usually occur without endangering reimbursement.

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