

**BUSINESS AFFAIRS AND HUMAN RESOURCES**  
**DECEMBER 7, 2011**

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**SUBJECT**

Performance-Based Funding for the College and Universities

**APPLICABLE STATUTES, RULE OR POLICY**

Idaho State Board of Education Governing Policies & Procedures, Section V.S.  
Idaho Code §33-111

**BACKGROUND / DISCUSSION**

The State's investment in four-year public higher education has gone from \$285.1M in FY 2009 to \$209.8M in FY 2012. At the same time, the demand for postsecondary education is strong; and the need for a postsecondary education in today's global knowledge economy cannot be overstated if we wish to remain competitive among industrialized nations. The reality of this situation requires that we use every dollar to maximize operational efficiencies.

**IMPACT**

Performance-based Funding can be used as a strategic incentive for innovation and creativity in resource allocation to improve desired campus outcomes.

**ATTACHMENTS**

Attachment 1      Performance-based Funding: A Re-Emerging  
Strategy in Public Higher Education Financing      Page 3

**STAFF COMMENTS AND RECOMMENDATIONS**

Staff will give a presentation which will provide background, best practices and a concept proposal.

Attachment 1 is an excellent objective primer on the subject of performance-based funding history, current trends, and pros and cons.

**BOARD ACTION**

This item is for informational purposes only. Any action will be at the Board's discretion.

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## Performance-based Funding: A Re-Emerging Strategy in Public Higher Education Financing

by Thomas L. Harnisch  
Policy Analyst

The transition to a global economy has put an increased value on human capital for individual and collective economic security. Recognizing this, as well as the need to pursue innovation, President Obama has set the ambitious national goal of leading the world in the proportion of college graduates by 2020.<sup>1</sup> The administration hopes to achieve this through a renewed focus on improving the decades-long stagnation in college completion rates.<sup>2</sup> This effort has led to a “completion agenda” matched by initiatives from national higher education associations, state government leaders, policy think tanks and major philanthropic organizations.

At the core of this agenda are public colleges and universities. Public postsecondary institutions, from community colleges to research universities, educate the majority of U.S. students. They provide high-quality, accessible educational opportunities that reflect the needs of communities, regions and states. This place-based, “public purpose” mission is achieved through public-private partnerships, value-added research and skilled graduates.

However, because of reduced state operating support, these very institutions are confronting historic budget cuts and leaving some to question

whether President Obama’s attainment goal can realistically be achieved. Public colleges and universities rely on state budget appropriations, which have declined significantly during the economic downturn. Recent state budget cuts have contributed to higher tuition levels, lower financial aid awards and academic program closures. Enrollment caps have also been implemented in a number of institutions and states. Together, these factors, and many others, could hinder efforts to help more students finish their college degrees.

Boosting college completion rates in an austere funding environment has led to a national productivity agenda for higher education. Led by the Lumina Foundation for Education, the agenda aims to identify, measure and increase institutional effectiveness; share best practices through pilot programs; and explore alternative educational delivery systems.<sup>3</sup> These efforts are aimed at offering more high-quality college opportunities to a greater number of students within existing budgetary constraints.

### Productivity and Performance-based Funding

One component of the productivity agenda involves re-visiting *performance-based funding (PBF)* as a means of improving institutional effectiveness. PBF

is a decades-old higher education finance strategy that links state funding for public colleges and universities with institutional performance.<sup>4</sup> PBF represents a fundamental shift in higher education finance—a shift from state inputs to campus outcomes, and from institutional needs to state priorities.<sup>5</sup>

This finance approach has had a mixed history of success and instability.<sup>6</sup> However, advances in state student data systems and policy refinements acquired from years of state PBF experiments have allowed the postsecondary financing strategy to re-emerge as a core component of the productivity and college completion agendas.<sup>7</sup> The Lumina Foundation, Bill and Melinda Gates Foundation, College Board, National Conference of State Legislatures (NCSL), National Governors Association (NGA), and Education Commission of the States (ECS) have promoted PBF as a policy option for improving campus productivity and boosting college completion. The Obama administration has also recommended that states explore PBF to improve college completion.<sup>8</sup> Together, this has translated to conversations and policy action in state capitols across the nation.

### **PBF Theory and Components**

PBF is an incentive-based policy instrument predicated on *resource dependency theory*.<sup>9</sup> This theory posits that changes in resource availability will threaten organizations and encourage adaptation for continued existence.<sup>10</sup> In this case, because the leaders of public colleges and universities are significantly dependent on state appropriations, the theory postulates that they will take the measures necessary to retain or enhance their institutions' funding. This may involve encouraging more efficient resource allocation, improving program performance and generating degrees that reflect state workforce needs.

This approach to higher education finance has three main components: *goals*, *measurements* and *incentives*. For the system to be effective, these components must be aligned and complimentary. The goals generally consist of state or institutional

priorities, such as increasing the number of college graduates and improving outcomes for low-income students.

The measurement component tracks campus outputs and progress towards these goals. Measurements typically reflect state priorities and campus mission. The U.S. Department of Education's *College Completion Tool Kit* categorizes these measurements as:

- General outcome indicators (graduation rates, certificates conferred, etc.)
- Subgroup outcome indicators (Pell Grant recipients, nontraditional students, etc.)
- High-need subject outcome indicators (STEM fields, nursing, etc.)
- Progress indicators (course completion, transfer, credit milestones, etc.)

The incentives, which can be financial or regulatory, are rewards given to spur urgency and action on improving measurements to meet state goals. Often these incentives are in the form of state appropriations, but they can also consist of changes in campus autonomy, such as greater tuition-setting authority.

### **PBF Delivery Models**

Three PBF models that directly link state funding and campus outcomes are *output-based funding*, *performance contracts* and *performance set-asides*.<sup>11</sup> Within these models are a number of programmatic arrangements, which can encapsulate the entire state higher education budget or only a small share of funding.

**Output-based systems** (or payment for results) are funding formulas linking state funding and outputs, such as the number of students meeting credit milestones and completing college. The formula can be weighted according to campus mission, with preferences given for low-income and at-risk students. This approach incentivizes campuses to seek better performance on key metrics in order to generate additional state funding.

**Performance contracts** are negotiated agreements between states and institutions to achieve results. The contracts are regulatory documents representing customized, campus-centric approaches to improving performance. In exchange for a funding allocation, institutions come to an agreement with the state regarding benchmarks and goals.

**Performance set-asides** are a separate portion of state funding designed to improve campus performance. This may be a “bonus” fund or a separate portion of a regular state appropriation. Campuses compete in order to receive money from this account.

This paper will explore PBF’s mixed history, illustrate a number of programs operating across the nation, present arguments on both sides of this approach, outline best practices and provide an update on PBF state policy proposals. All told, PBF can be viewed as a historically popular approach to higher education finance, but one with a mixed record of success. The policy is re-emerging in many states, with a number of them having integrated the most impactful elements of past programs. If successful, these efforts may spur changes that result in greater institutional productivity and improved progress toward meeting state and national educational attainment goals.

## Observations

### **PBF has had mixed success over the last 30 years.**

PBF has been a popular yet unstable approach to higher education finance. Between 1979 and 2007, 26 states enacted performance funding, while 14 abandoned their programs (two states, however, re-established programs).<sup>12</sup> PBF was especially popular during the 1990s economic boom, when flush state coffers provided performance funds for colleges and universities. As state revenues declined during the early half of the 2000s, many PBF systems that were considered “add-ons” were eliminated in state budgets.<sup>13</sup> Only a handful of states have performance funding, many of which link only a small portion of state funding to performance.<sup>14</sup>

A number of program hazards have in the past prevented PBF from becoming a mainstay in higher education finance. Several programs have been abandoned because program designers failed to correctly align campus measurements and state goals or did not account for campus missions. Other issues—such as state funding cuts, crude data measurement and lack of sustained support from political and campus leaders—have contributed to program abandonment over the past three decades.<sup>15</sup> Many states have reverted to simply reporting their performance instead of linking it directly to state appropriations.<sup>16</sup>

Some have noted PBF success at the campus level. Research performed on community colleges by Columbia University’s Community College Research Center, for example, indicates that campus officials garnered a greater awareness of state priorities and institutional performance due to PBF systems. This incentivized colleges to make changes to reflect performance indicators, such as improving remediation efforts. However, program success at community colleges continues to be hampered by poor program design, unstable funding and inequalities in institutional capacity.<sup>17</sup>

Some states with PBF have observed success with their programs, including:

**Ohio:** From FY 1999 to FY 2003, Ohio cut the median time to degree for bachelor’s degrees from 4.7 to 4.3 years, a measure that remained at this level until 2007 (performance-based funding began in 1998).<sup>18</sup>

**Pennsylvania:** The Pennsylvania State System of Higher Education (PASSHE) has been cited by the Lumina Foundation for Education as a national leader in performance-based funding. During the past ten years, PASSHE has experienced significant changes in its campuses’ attitudes toward performance, with gains cited in student retention and graduation rates, campus diversity, program quality and faculty productivity. The average number of credits at graduation has decreased, while retention and graduation rates have increased. PASSHE officials were recently given credit during

their annual hearings before the Pennsylvania House and Senate Appropriations Committees for their leadership role. Despite historic budget cuts proposed by the state's governor, PASSHE remains committed to its PBF principles and will continue its performance-based approach.

**Tennessee:** Tennessee developed the first PBF system and has remained a leader in this field for decades. Their performance-based system has yielded positive learning outcomes.<sup>19</sup> In 2010, the state overhauled its financing structure for higher education, changing a primarily enrollment-driven higher education finance system to an output-based approach. The model is one of the most intricate and innovative approaches to higher education financing in the nation. The change has led campuses to bring in extra student advisers, increase tutoring and remedial classes, fast-track majors and develop extra courses between semesters.<sup>20</sup>

**Washington:** Washington community and technical colleges have increased performance across all student measurement categories since their "Achievement Points" PBF plan began in 2006. The changes led institutions to link PBF priorities to strategic planning and accreditation activities, and to focus on improving instruction, tutoring, assessment and advising.<sup>21</sup> According to a recent report, one-third of the increase in institutional outputs in Washington has been tied to enrollment increases, with the remaining majority attributed to greater student achievement.<sup>22</sup>

**There are a number of different PBF approaches currently in operation.** State leaders have developed numerous systems linking institutional performance and state appropriations. Some of the programs developed in the last five years include:

**Indiana:** Indiana's 2007 *Reaching Higher: Strategic Directions for Higher Education* initiative launched a *performance set-aside* system for the state. The program seeks to adjust institutional funding based on a series of benchmarks shared by all state institutions.<sup>23</sup> However, leaders of high-performing

state research universities have questioned the approach, believing it neither adequately accounts for current levels of excellence nor the distinctive research missions of some campuses.<sup>24</sup> The Indiana Commission for Higher Education (CHE) has recommended a performance set-aside of 5 percent in the 2011–2013 budget. CHE outlined the following measurements in January 2011:

- **Total Degree Attainment Improvement: 60 percent**
  - Change in overall degree attainment: 30 percent
  - Change in on-time degree attainment: 15 percent
  - Change in low-income degree attainment change: 15 percent
- **Total Credit Hour Completion Improvement: 25 percent**
  - Successful completion of credit hours: 18.7 percent
  - Successful completion of dual-credit credit hours: 5.5 percent
  - Successful completion of "early college" credit hours: .8 percent
- **Total Improvement in University Research: 15 percent**

**Louisiana:** In 2010, Louisiana established a *performance agreement* system (the GRAD Act) that will comprise 25 percent of institutional operating budgets when fully implemented. The contract allows institutions to annually increase tuition by up to 10 percent in exchange for meeting performance targets.<sup>25</sup>

The four performance objectives in the GRAD Act are:<sup>26</sup>

- Student Success;
- Articulation and Transfer;
- Workforce and Economic Development; and
- Institutional Efficiency and Accountability

Each performance objective is comprised of a series of "elements" or sub-goals. Housed under each element is a series of quantitative measures (see *Figure 1 for a sample of targeted elements at Louisiana Tech*. In total, this agreement has 4

objectives, 16 elements and 56 measures of campus productivity). These measurements are categorized as:

- **Targeted:** Specific short- and long-term measures. Institutions must have baseline data, annual benchmarks and six-year targets. Institutions report annual progress on measures.
- **Tracked:** Measurements requiring baseline and actual data must be reported in the first two years. These will be converted in “targeted” measures in years three through six.
- **Descriptive:** These measures do not require annual benchmarks and targets. However, institutions are required to submit baseline and actual data via annual reports.

**Ohio:** Ohio’s *output-based* system was developed in coordination with the state’s ten-year strategic plan for higher education in 2008. The program includes a decreasing number of “stopgap” measures for its first few years to ensure program stability; as conceived, the state will eventually base its entire appropriations allotment on outputs. The programs are divided by type of institution and are weighted to account for at-risk student populations.<sup>27</sup>

- **University main campuses:**
  - Course and degree completion
  - Campus/mission-specific contributions
  - Funding for graduate/medical education
- **University regional campuses:**
  - Course and degree completion
  - Campus/mission-specific contributions

**Figure 1. GRAD Act Example: Louisiana Tech University**

| Measure  | Baseline Year/Term   | Baseline Data            | Year 1        | Year 2        | Year 3        | Year 4        | Year 5       | Year 6       |
|--|--|--------------------------|---------------|---------------|---------------|---------------|--------------|--------------|
| 1 <sup>st</sup> to 2 <sup>nd</sup> Year Retention (targeted) | Fall 2008 to 2009<br># in Fall 2008 Cohort<br># retained in Fall 2009                  | 74.2%<br>1,506<br>1,118  | 76.0%         | 76.2%         | 76.4%         | 76.6%         | 76.8%        | 77%          |
| 1 <sup>st</sup> to 3 <sup>rd</sup> Year Retention (targeted) | Fall 2007 Cohort<br># in Fall 2007 Cohort<br># retained in Fall 2009                   | 61.6%<br>1,522<br>938    | 64%           | 64.2%         | 64.4%         | 64.6%         | 64.8%        | 65.0%        |
| Same Institution Graduation Rates (targeted)                 | 2008 Grad Rate Survey<br>Fall Revised Cohort (total)<br>completers <= 150% of the time | 47.3%<br>1,936<br>916    | 47.5%         | 48.0%         | 48.3%         | 48.7%         | 49.0%        | 50.0%        |
| Statewide Graduation Rate (targeted optional)                | Fall 2002 Cohort<br># of Fall 02 FTF (cohort)<br>completers <= 150% of the time        | 53.07%<br>1,969<br>1,045 | 55.1%         | 55.2%         | 55.4%         | 55.6%         | 55.8%        | 56.0%        |
| Percent Change in Program Completers                         |  |                          |               |               |               |               |              |              |
| Baccalaureate  | 2008–2009 AY   | 1,306                    | -3.4%<br>1262 | -3.1%<br>1266 | -2.3%<br>1276 | -1.0%<br>1293 | 0.0%<br>1306 | 2.0%<br>1332 |
| Post-Baccalaureate   | 2008–2009 AY   | 19                       | 31.5%<br>25   | 56.0%<br>30   | 68.0%<br>32   | 76.0%<br>33   | 85.0%<br>35  | 85.0%<br>35  |
| Master’s   |  | 352                      | 16.7%<br>411  | 16.0%<br>408  | 16.0%<br>408  | 18.0%<br>415  | 18.0%<br>415 | 20.0%<br>422 |
| Doctoral   |  | 37                       | -2.7%<br>36   | -0.7%<br>37   | 1.0%<br>37    | 1.0%<br>37    | 1.0%<br>37   | 2.0%<br>38   |

Source: Louisiana Board of Regents, 2010



• **Community colleges:**

- Enrollment (95 percent)
- Success points (5 percent)
  - Developmental education success
  - Number of students earning 15 credits
  - Number of students earning 30 credits
  - Number of students earning at least one associate degree
  - Number of students who completed 15 credits and enrolled in a four-year college or university

**Pennsylvania:** In early 2011, the Pennsylvania State System of Higher Education approved a new PBF system, thus replacing the performance structure that had been in place since 2000. The new system will be based on the core values of student success, access and institutional stewardship. Following a transitional year, all PASSHE institutions will be evaluated on five common indicators—two in student success, two in access and one pertaining to institutional stewardship—and five additional indicators, chosen by the institutions themselves (at least one must be stewardship). The performance-based funding plan is projected to be 2.4 percent of PASSHE’s state appropriation (*see Figure 2 for a more detailed outline of the PBF formula*).

**Tennessee:** Tennessee lawmakers passed the *Complete College Tennessee Act* in 2010, which shifts higher education funding from an enrollment-based to an *output-based performance system*. There are two basic formulas, one for community colleges and one for four-year state colleges and universities. The two formulas account for differences in institutional missions. The system, which will be phased in over the next four years, bases funding on outputs and does not have specific targets or goals. Institutions receive funding based on factors such as the number of students reaching credit milestones, college completion, graduation rates and research funding. The formula weighs institutional mission and provides a premium for the success of low-income and non-traditional students.<sup>28</sup>

**Washington:** The Washington State Board for Community and Technical Colleges (SBCTC)

has developed a *performance set-aside* system called “Achievement Points” under its *Student Achievement Initiative* program. Campuses receive funding based on accumulation of achievement points.<sup>29</sup> Achievement points are acquired through the following:

- Building toward college-level skills (basic skill gains, passing pre-college writing or math)
- First-year college retention (earning 15 or 30 college credits)
- Completing college-level math (passing necessary college math courses)
- Completion (earning a certificate, two-year degree or apprenticeship)

**The principles behind PBF remain controversial.**

The concept of linking institutional performance with state appropriations has been met with praise and skepticism from stakeholders in higher education.

Key *advantages* of PBF may include:

- **Greater awareness of campus performance.** PBF can lead to a greater awareness of performance of college campuses. This can spur discussions about resource allocation, mission and priorities. Greater visibility and state emphasis on performance may also generate competition between campuses to improve outcomes.<sup>30</sup>
- **Improved delineation of state and institutional priorities.** The relationship between higher education and the state can have greater clarity under a PBF system. PBF allows governors and state legislatures to set priorities for public higher education and attach funding to them. PBF also allows state priorities and strategic plans to permeate the higher education system, shifting the focus from institutional needs to state priorities. This can lead to greater scrutiny of the effectiveness and scope of campus programs and services, and ultimately to a better synergy between campus planning, budgeting and performance.<sup>31</sup> This may lead to important discussions that re-visit and re-define the missions



of some state campuses to reflect new state priorities and economic dynamics.

- **Enhanced transparency and accountability.**

This approach clearly delineates key state and institutional priorities while allowing stakeholders to evaluate institutional performance. Institutional accountability is an inherent system feature. This can dispel traditional assertions that higher

education is opaque, unaccountable for state dollars or unresponsive to state needs. It may also allow higher education to better compete as a state funding priority.

- **Increased productivity.** PBF policy refinements could result in key productivity gains for campuses, leading to better a value for students, parents and state residents.

**Figure 2. Pennsylvania State System of Higher Education (PASSHE) Performance Funding System, 2011–2017**

**PASSHE Performance Funding System, 2011–2017 (10 total indicators—5 mandatory, 5 optional)**

| Groups                   | Student Success                                     | Access         | Stewardship |
|--------------------------|---|----------------|-------------|
| I. Mandatory             | 2 indicators  | 2 indicators   | 1 indicator |
| II. Optional             | 0–4 indicators                                      | 0–4 indicators | at least 1  |
| III. University Specific | _____ universities may develop 0–2 indicators _____ |                |             |

- Recommended to be equal to 2.4 percent of PASSHE's total educational and general appropriation.
- Each university will have the ability to meet performance on each measure for a maximum of ten points.
- The university will get points for meeting sub-measures.
- All points are tallied for each university, then weighted by the university's base appropriation funding determined by the allocation formula.
- Weighted points are divided into the total performance funding pool to create a dollar-per-point value that is multiplied by the number of points the university earned to establish the allocation.

#### **Student Success**

##### **Mandatory:**

1. Degrees Conferred (two sub-measures)
2. Closing the Achievement Gap (two sub-measures)

##### **Optional:**

1. Deep Learning Scale Results
2. Senior Survey–National Survey of Student Engagement (five sub-measures)
3. Student Persistence (two sub-measures)
4. Value-Added
5. STEM Degree Recipients

#### **Access**

##### **Mandatory:**

1. Closing the Access Gaps (two sub-measures)
2. Faculty Diversity (two sub-measures)

##### **Optional:**

1. Faculty Career Advancement (four sub-measures)
2. Employment (nonfaculty) Diversity (four sub-measures)
3. Student Experience with Diversity and Inclusion
4. Student Diversity

#### **Stewardship**

##### **Mandatory:**

1. Private Support—three-year average of total dollars raised

##### **Optional:**

1. Facilities Investment
2. Administrative Expenditures as Percent of Cost of Education
3. Faculty Productivity
4. Employee Productivity

#### **University-Specific**

Universities may create no more than two of these indicators, which must be approved by the chancellor.

Source: Pennsylvania State System of Higher Education, 2011.

While PBF provides an incentive for meeting certain metrics, it may also lead to a number of unintended, potentially detrimental consequences for colleges and universities.

Key *disadvantages* may include:

- **A limited portrait of university performance.** PBF systems hold universities accountable for a series of measurements of student and institutional success. It offers few “shades of gray” in a multifaceted, complex environment. Rewarding a few campus outcomes is a difficult exercise that can lead to contentious discussions both within and among state universities.
- **Mission distortion/student access.** PBF may lead some institutional leaders to abandon, distort or manipulate the university’s core mission and responsibilities in order to inflate performance metrics. Some systems encourage administrators to change inputs instead of outcomes. This could include limiting access to students from disadvantaged backgrounds. Some changes may even go unnoticed, such as reducing outreach efforts to low-income students.
- **Quality reduction.** The PBF approach may not capture gains in student learning or skills acquired.<sup>32</sup> And because it may stress efficiency over quality, some believe academic quality might suffer.<sup>33</sup> If the incentives are substantial, it is possible that some may act to reduce program rigor to achieve better outcomes. Institutions could also attempt to alter academic programs to improve performance scores (such as completion rates), while ultimately diluting the value of the student’s degree.
- **Lack of program support.** PBF may not be popular among some groups in academia, including faculty members. Some may object to market principles being integrated into academic operations, believing that evaluating performance based on a few metrics is antithetical to academic freedom and campus autonomy.

- **Increased inequality and instability.** Some believe PBF hurts institutions that need the most help, especially those serving disadvantaged populations. In some cases, the lack of resources, not university efforts, may be the driver behind poor performance.<sup>34</sup> Some PBF approaches could also lead to large swings in funding and institutional instability.

**The successes and failures of past systems have yielded a number of best practices now being utilized in new program design and implementation.** Effective practices to consider when developing a PBF system include:

- **Establishing state postsecondary education goals.** PBF should be integrated in a state plan for higher education.<sup>35</sup> This provides meaning and direction for the campus and clarity for state higher education. The institution should know its role and goals in this plan, with performance measurements tied to these goals.
- **Bipartisan political commitment.** To be successful, PBF requires bipartisan legislative champions. Ideally, a broad coalition of program supporters should be garnered to ensure its success during changes in political administrations.
- **Support from institutions.** Multi-state research of PBF programs at the community college level has demonstrated that a lack of institutional support or indifference from campus officials led to program failure or prevented its spread to other campuses. PBF advocates need to address common program concerns, including undercutting autonomy and failure to account for institutional differences.
- **Stakeholder collaboration throughout the program design process.** PBF needs “buy-in” and involvement from a number of different stakeholders during all parts of the policymaking process in order to be most effective and sustainable. This includes college presidents, political leaders, faculty members, student groups,

K-12 and business groups. Advocates should also reach out to groups committed to educational equality for underserved students. These groups may be drawn to PBF systems that reward enrolling, educating and graduating students from disadvantaged backgrounds.<sup>36</sup>

- **Stable program funding.** For the program to function properly, incentives must remain in place and remain predictable. State and campus leaders must protect the program from budget cuts for PBF to be successful and sustainable in the long-term.<sup>37</sup> If this is not possible, PBF advocates may want to consider embedding state funding into the performance formula, such as the systems in Tennessee and Ohio. This ensures that changes in appropriations do not interfere with performance goals.

Program design remains the most critical component to PBF success. Funding system architecture should consider the following best practices:

- **Allow institutional autonomy.** Campus and political leaders should revisit state regulations that could hinder an institution's ability to meet performance benchmarks.
- **Keep it simple.** PBF should only emphasize a handful of measurements in order to be most effective, balancing institutional complexity and state goals.<sup>38</sup> Too many goals can lead to confusion and conflict; too few goals can provide an inaccurate picture of institutional performance. PBF should also consider intermediate goals (such as credit milestones) in order to focus on improving all segments of the postsecondary education pipeline.
- **Account for institutional differences.** PBF architects must ensure that programs do not discriminate against institutions that serve the needs of poor or at-risk students. Mission creep should not be encouraged. They must account for the institutional missions, roles and outcomes.

- **Allow time for implementation.** PBF requires that campuses have time to change to achieve better outcomes, as it will take time to understand the measurements and make changes to campus programs, systems and processes. One way to achieve this is to have a “learning year” when performance is tracked but no performance funds are exchanged.<sup>39</sup>
- **Anticipate challenges.** There are concerns that PBF systems will be manipulated by grade inflation, institutions changing their student makeup or reducing program rigor. PBF formulas should anticipate and address attempts to manipulate the systems.
- **Evaluate outcomes, ensure recognition.** PBF systems require extensive and ongoing evaluation. State and campus leaders should recognize excellent performance and share both best practices and pitfalls to avoid.

**State leaders throughout the country are exploring PBF.** Budget cuts, turnover in political leadership, continued low completion rates and calls to increase educational attainment have led many states to explore or re-examine PBF (*see Figure 3*). Policy proposals by political and higher education leaders include the following:

**Arkansas:** In his 2011 State of the State address, Gov. Mike Beebe (D) called for state funding to be tied to coursework completion and graduation rates.<sup>40</sup>

**Colorado:** Legislation has been sent to Gov. John Hickenlooper (D) that would eventually build up

**Figure 3. Performance-based Funding (PBF) Legislation in the States**

| State        | Bill Number | Status              |
|--------------|-------------|---------------------|
| Colorado     | SB 11-52    | Sent to Governor    |
| Illinois     | HB 1503     | Passed House/Senate |
| North Dakota | SB 2300     | Failed to Pass      |
| Oregon       | SB 242      | In Committee        |
| Texas        | HB 9        | Passed House/Senate |
| Virginia     | HB 2510     | Signed by Governor  |
| Washington   | SB 5915     | In Committee        |

*Source: State websites, National Conference of State Legislatures.*

to 25 percent PBF over the next five years. This would replace the existing performance contract approach.<sup>41</sup> The governor is supportive of the PBF plan.

**Connecticut:** A bipartisan group of lawmakers has recommended linking institutional performance to state appropriations. This has been considered in the context of overhauling the state's higher education governance system.<sup>42</sup>

**Illinois:** In December 2010, the state's Higher Education Finance Commission released a report highlighting performance-based funding as an option for state higher education finance reform.<sup>43</sup> The Illinois House and Senate passed PBF legislation in April 2011.<sup>44</sup>

**Massachusetts:** Gov. Deval Patrick (D) has included a \$7.5 million performance set-aside competitive grant program for campuses in his FY 2012 state budget proposal.<sup>45</sup>

**North Dakota:** Gov. Jack Dalrymple (R) called for performance-based funding during his 2011 State of the State address.<sup>46</sup> However, an effort to create a higher education finance commission was defeated by the state legislature in April 2011.<sup>47</sup>

**Oregon:** State lawmakers are weighing a series of policy and governance changes for the state's education system, including a performance compact proposal for higher education.<sup>48</sup>

**South Carolina:** Gov. Nikki Haley (R) is developing a plan with state college leaders that would link state funding to factors such as graduation rates, job placement, institutional outcomes in economic development and service to disadvantaged students.<sup>49</sup>

**Texas:** In his 2011 State of the State address, Gov. Rick Perry (R) called for an "outcomes-based funding" model for the state's public universities and community colleges.<sup>50</sup> A PBF bill has passed the

state's House of Representatives and Senate.<sup>51</sup> The Texas Higher Education Coordinating Board has also developed a plan that would set aside 10 percent of based funding according to outcomes.<sup>52</sup>

**Virginia:** Gov. Bob McDonnell (R) signed legislation in April 2011 overhauling the state's higher education financing system. This change includes some performance funding measurements.<sup>53</sup>

**Washington:** Legislation was introduced in April 2011 to allow institutions greater autonomy while holding them accountable for performance.<sup>54</sup>

**West Virginia:** The West Virginia Higher Education Policy Commission released a report in January 2011 calling for the adoption of a performance approach that includes incentives for increased degree production, enrollment of nontraditional students and course completion.<sup>55</sup>

## Conclusion

Performance-based funding for higher education has reemerged as a state policy solution aimed at generating greater institutional productivity, accountability and educational attainment. Through funding incentives, PBF is designed to encourage efficient resource allocation, greater awareness and attention to state priorities, and a results-oriented campus culture. Past PBF approaches have shown that program development, implementation and evaluation must be thoughtful and comprehensive so that college access, affordability, quality and institutional stability are maintained, if not enhanced. New incentive-based and outcomes-oriented approaches hold promise for improving productivity and must be evaluated to provide the clearest picture of the effectiveness of PBF as a state higher education finance approach. Refined PBF approaches will be evaluated in the coming years and may provide new perspective on this approach to higher education finance and institutional productivity.

## Resources

- Illinois Higher Education Finance Study Commission, 2010. *Final Report*.
- Louisiana Board of Regents, 2010. *GRAD Act Agreements*.
- Lumina Foundation for Education, 2009. *Performance Funding 2.0 Tip Sheet*.
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**Contact:**

**Thomas L. Harnisch, Policy Analyst • [harnischt@aascu.org](mailto:harnischt@aascu.org)  
ph 202.293.7070 • [aascu.org/policy](http://aascu.org/policy)**