SUMMARY

As California begins to reinvest in public higher education after several years of budget cuts, it could opt to tie funding more closely with outcomes—for example, the number of students educated or degrees awarded. This approach, known as performance-based funding, has the potential to incentivize investment by the state’s higher education systems in areas that further state priorities. Drawing on California’s minimal experience with performance-based funding and the approaches other states have pursued, this report raises four important questions for the state to consider if it wants to link funding for higher education with outcomes without compromising on either quality or equity.

LINKING FUNDING TO OUTCOMES

The prospect of increased funding for California’s higher education systems presents a unique opportunity for policymakers to encourage these institutions to improve their outcomes—to ask the state’s colleges and universities to do more with more. One way to both expand access and improve student progress toward completion is through performance-based funding.

Performance-based funding seeks to tie an organization’s resources to measurable goals and progress toward those goals (e.g., the number of students who complete degrees, the length of time to degree, etc.). This approach is still unproven, and California has not yet embraced it. But there are good reasons to explore the idea of performance-based funding. First, a basic tenet of good government is that public organizations should be able to demonstrate the impact of resources on the achievement of desirable goals. Second, concerns about the increased burden that recent tuition increases placed on students have led to greater scrutiny of spending on public higher education. These concerns are the focus of two companion reports in PPIC’s Higher Education in California series: Student Costs and Institutional Costs. Third, the economic recovery offers an opportunity to think strategically about how schools could use increased state funding to boost student outcomes.

This piece aims to continue the performance-based funding conversation. It provides an overview of California’s limited experience with performance-based funding programs as well as the experience of other states, drawing useful lessons for policymakers who want to leverage the prospect of increased resources. It concludes by outlining the questions that should be considered in designing a performance-based funding program and offering recommendations as to how best to build a system that would maintain quality and equity.

FOCUSING ON RESULTS

California’s public colleges and universities are currently accountable for student outcomes in certain ways. For example, in order to receive accreditation, a school must be able to track student achievement and demonstrate that students are making “timely progress” toward degree completion. The federal government has developed the College Scorecard, which reports graduation rates, loan default rates, costs of attendance, and how much students borrow in an attempt to use transparency to influence behavior.
government has also proposed using student aid as an accountability tool by cutting off access to federal student assistance for schools whose graduates default on their student loans at high rates. California instituted similar requirements in 2012, declaring schools with high default and/or low graduation rates ineligible for Cal Grant funds.

Like the federal and state measures that determine which schools can participate in student aid programs, performance-based funding seeks to tie resources to student outcomes. But performance-based funding involves the money that the state gives directly to the schools and asks them to demonstrate progress relative to a group of outcome measures.

Historically, enrollment targets have been the primary criteria for the distribution of public higher education funding in California. But California’s colleges and universities have faced few direct fiscal incentives to focus on outcomes such as graduation rates, the length of time it takes a student to complete a program, and other goals. The 2013–14 budget eliminated enrollment targets for both the UC and CSU systems. In both 2013–14 and 2014–15, the only condition placed on funding was that the UCs and CSUs not raise tuition.

California’s only experiment with tying resources to the achievement of specified outcomes in higher education began in 1998, when the legislature established the Partnership for Excellence (PFE) for California Community Colleges. Phased in over several years, the PFE was supposed to establish performance goals (e.g., course completion, degree and certificate completion, transfers to four-year programs, etc.), develop measures, and determine baseline performance levels. The idea was for colleges that met performance goals to be rewarded with additional resources.

In practice, community college finance officers reported that, with encouragement from the chancellor’s office, they treated the program as a supplement to their base budgets. A 2002 LAO review of the program found that the accountability dimension was “elusive” because virtually all funding was allocated on a per-student basis, regardless of performance. The dollars involved were substantial: the PFE had $100 million in its first year, and by 2002–03 program funds had grown to $300 million, or 6 percent of the community colleges’ total revenue. The 2003–04 state budget cut the PFE program by 25 percent, and by 2007 it was simply being rolled into base funding for the colleges.

In recent years, the state has flirted with the idea of performance-based funding, only to back away. In 2010, Senator Carol Liu introduced SB 1143, intended to incentivize course completion in the state’s community colleges. SB 1143 required that a second enrollment count be taken at the end of the term and averaged with the census taken in the third week of the term. The bill did not pass, but it led to the creation of the California Community Colleges Student Success Task Force, which considered including “outcomes based funding” in its recommendations to the legislature. In the end, the task force chose to provide only an overview of the concept in its final report.

Over the past couple of years, the governor has included performance-based funding in his budgets. In his 2013–14 budget, he proposed that the CSU and UC systems be required to provide data about student and institutional performance, which would eventually allow the state to allocate a portion of state funds according to performance. The proposed budget included up to a 20 percent increase in General Fund appropriations to UC and CSU over a four-year period (2013–14 to 2016–17), representing about a 10 percent increase in total operating funds contingent upon progress made by the systems toward 10 percent increases in performance indicators like graduation rate, number of transfer students, and degrees completed. The idea received a cool reception in the legislature and both UC and CSU opposed it. The final budget did require reporting on some metrics but did not link the data to funding.
Some thought the governor might again propose some type of performance-based funding in his 2014–15 budget. But he appeared to go in the opposite direction, proposing increases in higher education funding with only one “string” attached: the requirement that the institutions not raise their fees. Also included in 2014–15 final budget was a $50 million set-aside for Innovation Grants. Some might call this program a “lite” version of performance-based funding. Since funds will be awarded to institutions on the basis of proposed changes, the Innovation Grants will be rewarding the promise of improved performance as opposed to demonstrated progress toward performance goals.

**PERFORMANCE-BASED FUNDING IN OTHER STATES**

Though California’s experience with performance-based funding has been limited, other states have experimented with the concept. Beginning with Tennessee in 1979, the number of states adopting performance-based funding in higher education has grown to 25. The specifics of the early models differed, but all shared the principle of establishing performance measures (e.g., graduation rate, retention rate, job placement, credit thresholds, etc.) and rewarding schools that met particular goals with bonuses from a designated pool of resources.

Research concluded that these early models did not improve student outcomes. Over time, some states gave up on performance-based funding, others altered their approaches, and still others introduced new models. The current iteration of performance-based funding models makes adjustments that address the problems associated with earlier attempts. Table 1 describes how three states have structured their performance-based funding programs.

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It is too soon to tell whether any of the current applications of performance-based funding in other states could be a template for California. But these efforts to link funding to outcomes on a significant scale, combined with the lessons learned from earlier iterations, can help guide California as it considers how best to structure funding for higher education.

**CREATING AN EFFECTIVE SYSTEM**

A discussion of how best to approach performance-based funding should begin by thinking about unintended consequences that could undercut a successful program. The most significant concern is that a performance-based funding system might lead to reduced educational access or quality. For example, a system that simply rewards schools for degree completion could lead to schools accepting fewer low-income or other underrepresented students who have a lower probability of graduating. Conversely, such a system might prompt schools to loosen graduation requirements in an effort to meet performance targets. Concerns about access and quality cut across all dimensions of performance-based funding. Below, we identify the key questions to consider in devising a performance-based funding system, with a particular focus on concerns about access and equity.

**What are the objectives?** California has never substantively updated its Master Plan for Higher Education, which was developed more than 50 years ago. The state still embraces many of the plan’s broad goals, but a performance-based funding system would need to be based on a set of explicitly defined objectives. Starting points could include altering the share of high school graduates eligible for UC and CSU, setting targets for transfer rates from community colleges to four-year colleges, and defining completion and time-to-degree objectives. In addition, explicit consideration should be given to equity in terms of access and outcomes.

**What should be measured?** It is tempting to focus on institutional outcomes such as degree completion and retention rates as a way to measure performance. As noted above, however, the focus on institutional outcomes could lead to unintended consequences. For example, a focus could motivate community colleges, whose primary mission is open access, to “counsel away” students who are less likely to complete their courses of study. Instead, performance-based funding in other states generally focuses on individual-level data such as whether students complete their programs of study, how long it takes them to graduate, and their progress relative to important milestones while pursuing their degrees. In addition, performance targets should include both progress toward a goal (a relative measure) and its achievement (an absolute measure). Using both absolute and relative measures offers incentives to low-performing institutions and guards against unfairly rewarding high-performing schools. For example, the University of California, Los Angeles, has a six-year graduation rate of 85 percent. The comparable figure for California State University, Los Angeles, is 37 percent. Because of their different starting points, an absolute performance target of graduating 90 percent of students presents very different challenges to the two schools. A related concern is that the state’s higher education systems attract students with differing levels of college preparation. In addition to acknowledging relative progress, policymakers should focus specifically on outcomes associated with at-risk students: for example, performance measures could give extra weight to successful outcomes realized by low-income or underrepresented students. Measures like these would help foster and maintain an equitable public higher education system. Finally, there is a tendency for performance-based funding formulae to increase in complexity over time as adjustments are made. The greater the number and complexity of the metrics, the more difficult it becomes to hold institutions accountable. Simplicity not only makes it easier to communicate the state’s expectations to the public but should also reduce the potential for controversy about whether these expectations have been met. In sum, a set of performance-based funding measures should be relatively simple, student based, include both absolute and relative measures, and incorporate specific incentives for schools to successfully serve at-risk students.

**How big are the stakes?** As we have seen, the amount of funding at stake in other states ranges from a relatively small bonus (1% to 7% of total resources) to a much larger portion of the pie (Ohio’s model puts
all of the dollars for instruction at stake). Shulock and Moore characterize the incorporation of performance measures into the baseline of funding for colleges and universities as “investing in success.” They note that investing in success involves acknowledging that improving performance is an ongoing and costly undertaking and should be institutionalized to provide a stable and significant funding source. Using a bonus pool would not send the same message and might not provide enough leverage to encourage colleges and universities to make significant changes. For this reason, we would recommend that any California performance-based funding system include a large enough portion of base funding to motivate institutions to pursue change and not simply opt out. At the same time, there should be a provision that establishes a funding “floor” below which a school could not fall. Otherwise, a low-performing school could find itself in a downward spiral from which it cannot recover.

Who decides? If California were to implement a performance-based funding system, it would need to assign responsibility for the development of performance measures and for monitoring institutional progress toward goals. Decisionmaking could be centralized, placed in the hands of the legislature and/or the governor’s office. Having most decisions made in Sacramento offers the promise of consistency but could lead to a “one size fits all” approach that might not work well with California’s diverse higher education systems. At the other end of the spectrum, individual campuses could be responsible for setting their own goals and monitoring their own progress. However, this approach would not provide many incentives for campuses to be tough on themselves. With control over both what they set as performance goals and how to measure progress, they are likely to set a very low bar for themselves. We recommend placing decisionmaking responsibility in the hands of the system administrators—UC Office of the President (UCOP), the CSU Chancellor’s Office, and the California Community College Chancellor’s Office (CCCCO)—and requiring oversight from Sacramento. Within such a framework, each system could work with its campuses and districts to identify measures and goals and report its decisions about funding consequences to the executive and legislature. Such an approach differentiates among the three California systems, consistent with the tenets of the Master plan. Also, because it offers the promise of both flexibility and transparency, it may be more likely to garner support from the schools.

CONCLUSION

After the recession-era cuts, the expansion of resources for higher education is a welcome development. Tying these additional funds to improved student performance presents an opportunity to broaden the impact of the state’s higher education investment and give more students access to those institutions.

The above discussion has drawn several lessons from efforts in California and other states to use funding to improve student outcomes. A successful performance-based funding approach should articulate clear goals and institutionalize the emphasis on performance by building it into a substantial portion of base funding. These goals should be relatively simple and should be based on student-level data; the measures should be both absolute (goals achieved) and relative (progress toward goals), and should provide incentives to successfully serve at-risk students. Finally, the linking of funding to student outcomes should be based in the individual systems—UC, CSU, and the community colleges—with required regular reporting to the governor and legislature.

There is no guarantee that the introduction of performance-based funding would improve student outcomes. Linking resources to goals and outcomes, however, would help institutionalize the focus on student performance and enable California’s higher education systems to demonstrate to taxpayers that the state’s investment is producing significant results.
Conversations with numerous individuals with expertise in higher education financing helped to inform this effort. Charles Ng of Mira Costa College and Mary McKeown-Moak of Moak Casey & Associates, were particularly beneficial. Lynette Ubois, Paul Warren, Niu Gao, Paul Golaszewski, and Nancy Shulock reviewed drafts and offered important insights. Mary Severance exercised great patience and editorial skill in shepherding this piece to completion.

1. It is worth noting that the Government Finance Officers Association has embraced the notion of linking funding and outcomes as one of its “best practices” for community colleges.

2. See the Western Association of Schools and Colleges (WASC) Senior College and University Commission’s 2013 “Standards at a Glance.” California’s junior college standards are similar. WASC is the accrediting body for most of California’s schools.

3. See the College Scorecard on the White House website.


5. See “2012 Eligibility Changes as a Result of the 2012 Budget Act” on the California Student Aid Commission website. In 2012–13, 154 institutions were ineligible—and all but one were private.


7. Patrick Murphy, Financing California’s Community Colleges (PPIC, 2004).


9. The community college system was also going to receive a similar performance-based funding plan, but the performance measures were to be developed at the end of 2014. The governor’s performance-based funding plan was abandoned, so the performance measures were never negotiated.

10. The statute did stipulate that these measures should be part of future budget discussions, and they were indeed discussed during the 2014–15 deliberations.


13. After looking at states with and without performance-based funding systems, Tandberg and Hillman conclude that “states using performance funding yielded no systematically different outcomes than other states.” Sanford and Hunter focus on Tennessee before and after it implemented performance-based funding. They conclude that “tying retention and graduation rates to performance funding was unrelated to changes in the performance measures.” See David Tandberg and Nicholas Hillman, “State Performance Funding for Higher Education: Silver Bullet or Red Herring?” (policy brief, Wisconsin Center for the Advancement of Postsecondary Education, 2013); Thomas Sanford and James Hunter, “Impact of Performance-Funding on Retention and Graduation Rates,” Education Policy Analysis Archives 19 (33), note 33.

14. There were several reasons why states gave up on performance-based funding. They included a lack of buy-in because state policymakers neglected to consult higher education administrators, faculty, and/or students during the development of these funding policies; low stakes that put too few resources “at risk” and so failed to motivate real organizational change; the economic downturn, which intensified pressure on policymakers to jettison performance-based funding programs in order to preserve base funding for all institutions; and the timing of bonuses at the end of the academic year often created uncertainty regarding school budgets that was difficult to manage.

15. Chapter 367, Statutes of 2013 (SB 195, Liu) established three broad goals for higher education in California. A follow-up bill (SB 1196) was introduced in the legislature in 2014 to create a working group to develop metrics to measure progress toward these goals. The bill was held in the Assembly Appropriations Committee.

16. The performance-based funding model recently introduced in Washington state awards points to colleges when students reach one or more educational “milestones” on a continuum from remedial programs (including adult basic education and pre-college, developmental education) through the completion of specific credentials and targeted training programs.

17. Tennessee and Ohio include weights for progress and/or completion by at-risk students in order to motivate colleges to improve these students’ outcomes.


19. The floor could be calculated as a percentage (e.g., 75%) of total funding in the year before the implementation of a performance-based funding system. To make the stakes high enough, there would need to be a possibility that an institution’s funding could decline in real terms.

20. It should be noted that Cal Grants requirements treat all of the systems—including private ones—essentially the same. Also worth noting: Ohio has largely excluded community colleges from its performance-based funding system because their mission is different from that of the universities.
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