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ABSTRACT

In view of increasing financial pressures, this paper argues that a new approach to fiscal policy and to the structure of the financial relationship between state government and institutions of higher education is needed. A proposed three-part budget would include the following: (1) a base or core lump-sum budget managed by higher education institutions, subject to accountability through regular assessment of progress toward institutional goals; (2) a capital budget to cover new buildings and other major asset acquisition; (3) a special-purpose component of 5 to 10 percent of the base allocated to further the state's higher education agenda. This special-purpose budget would be connected to state objectives, and an assessment of progress toward objectives would be built into the process. Such a special-purpose component could take the form of block grants with guidelines; of initiative funding in a competitive peer-reviewed process; of incentive funding as a grant awarded based on demonstrated progress toward a state goal; or of student funding through scholarship and work-study grants. The report reviews strengths and weaknesses of each funding mechanism in relation to the kinds of activities the state seeks in colleges and universities. The paper also describes typical institutional and state-level responses and argues that these are often deleterious to state priorities for higher education. It proposes an alternative approach which would ensure that the state's interests and educational priorities are reflected in the resource allocation process. Appendixes describe programs in New Jersey, Ohio, and Tennessee. (JB)

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USING FISCAL POLICY to ACHIEVE STATE EDUCATION GOALS

State Policy and College Learning

EDUCATION COMMISSION OF THE STATES

USING FISCAL POLICY TO ACHIEVE STATE EDUCATION GOALS

STATE POLICY AND COLLEGE LEARNING

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The **State Policy and College Learning** (SPCL) project was initiated by the Education Commission of the States, with primary funding provided by a grant from The Pew Charitable Trusts. The project was undertaken because of a strong concern that there are serious disincentives in higher education which diminish faculty commitment to teaching, particularly with regard to the impact of state policy on institutions. Countering these trends, will require nothing short of a fundamental transformation of institutional, system and state policies regarding finance, governance and management. To that end, the project seeks to foster a new vision of the kinds of state policies that will support a resurgence of attention to creativity and innovation in college teaching.

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The Education Commission of the States is a nonprofit, nationwide interstate compact formed in 1965. The primary purpose of the commission is to help governors, state legislators, state education officials and others develop policies to improve the quality of education at all levels. Forty-nine states, the District of Columbia, American Samoa, Puerto Rico and the Virgin Islands are members. The ECS offices are at 707 17th Street, Suite 2700, Denver, Colorado 80202-3427.

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FOREWORD

The next decade will be financially difficult for higher education. In most states, competing claims for resources will be so great that appropriations increases will be unlikely to keep up with inflation and enrollment growth. College administrators and government leaders alike seem to believe that decreased funding is a temporary condition. This paper argues that a fresh approach to fiscal policy and to the structure of the financial relationship between state government and colleges and universities is needed.

It proposes a three-part budget that would include the following:

1. A base or core lump-sum budget, with higher education institutions authorized to manage this budget, subject to accountability, through regular assessment of whether institutional goals are being achieved.

2. A capital budget to cover new buildings and other major asset acquisition.

3. A special-purpose component of 5% to 10% of the base allocated to further states' higher education agendas. This special-purpose budget would be connected to state objectives, and an assessment of progress toward the objectives would be built into the process.

The special-purpose component of the budget could take various forms:

1. Block grants with guidelines

2. Initiative, or prospective funding, usually in a competitive, peer-reviewed process

3. Incentive funding, a grant awarded on the basis of demonstrated progress toward a state goal

4. Student funding, e.g., scholarship and work-study grants

This report reviews strengths and weaknesses of each funding mechanism in relation to the kinds of activities the state seeks of colleges and universities. It also cites examples of special-purpose grants used by states and analyzes a component of such funding that the state could use to help improve undergraduate education.

Few areas are more dissimilar than the fiscal and regulatory relationships between public institutions of higher education and state government entities. Almost every conceivable form of resource allocation, governance and accountability mechanism is used. Surrounding all this variation is an increasingly homogeneous set of problems, the biggest of which is increasing demand for higher education services in combination with economic circumstances that limit (and even reduce) states' capacities to provide the financial support institutions need to respond to these demands.

This paper describes typical institutional and state-level responses and argues that these responses often are deleterious to states' priorities for higher education. In addition to diagnosing the problems, the paper suggests an alternative approach to state fiscal policy as it is applied to institutions of higher education. These policies won't channel more money to higher education than alternative fiscal policies would. However, they will help ensure that the state's interests and educational priorities are reflected in the resource allocation process.

POLITICAL AND ECONOMIC CONTEXT

American education is surviving in a world full of paradox. While higher education is increasingly recognized as being key to individual and societal well-being, the public seems unable or unwilling to provide accustomed levels of support. The conflicts are not easily resolved, but the underlying phenomena are readily understandable.

Students and other "clients" of higher education are demanding more from, and becoming more dependent, on the nation's colleges and universities. Enrollment continues to increase as individuals become aware that their personal, economic well-being is heavily influenced by the learning — and perhaps equally by the certification — that comes from a college education. Changes in the nation's manufacturing sector have resulted in the loss of many of the highly paid unskilled or semi-skilled jobs that, during the 20th Century, provided access to middle-class status for individuals without postsecondary education. There is now a much closer correlation between education and economic success than historically has been the case.

While this situation does not mean that a college degree ensures economic security, it is increasingly true that only individuals having education beyond high school get a chance to compete for the best jobs. This reality prompts many young adults to enter college as nontraditional students after having tried — and failed — to succeed without the advantages of a college education.

While students represent the most obvious manifestation of increased demands being placed on colleges and universities, they are by no means the only "client" asking more from institutions of higher education. Employers also have raised their expectations, largely in response to their need to match, if not surpass, global competitors. Employers are demanding that students have a higher-quality preparation, particularly in such areas as critical thinking, problem solving and communications.

The communities in which most colleges and universities are located hold higher expectations of yet another kind. Because colleges

and universities often have a major influence on local economies, surrounding communities want them to grow and to achieve a status that will make them attractive to out-of-state students and research funders. The result is that community pressures are leading to homogeneous institutions in the mold of research universities. While these expectations can be realized only to a limited extent, they illustrate the kind of pressure faced by many institutions.

State Government

The changing expectations of state government are perhaps the most significant of all of higher education's clients. For many years, state government has viewed higher education much as it would a public utility, emphasizing the creation of institutional capacity that could be tapped readily by citizens who were so inclined. This view led to an almost singular emphasis on access, on funding tied to enrollments and on forms of accountability that incorporated enrollment audits and attention to the efficient use of resources. While this particular orientation has not disappeared, higher education is increasingly viewed as a strategic investment and a means to achieving the ends that society deems important. Society seems to have concluded that collective needs are not necessarily served by individuals acting in their own self-interest. Society has its own needs and, through state government, is making those needs known.

Priorities that state government frequently advance on behalf of the broader society include:

- Improved quality of undergraduate education, particularly the general education component, and greater involvement of senior faculty in the instructional (as opposed to the research) functions of the universities
- Preparation of teachers and other contributions to the improvement of K-12 education
- Application of research findings to specific problems, such as environmental quality and economic diversity
- Provision of health-care services to rural areas and inner-city neighborhoods
- Enhancement of economic development

Not all of these priorities are likely to emerge in a single state, but each is a societal issue in need of attention, and these issues are assuming a greater urgency in most states.

Such societal priorities have at least one thing in common — they are seldom the priorities of academe, especially the four-year sector. Higher education's priorities, as

revealed in the reward (tenure and promotion, merit pay, etc.) systems of most universities, are graduate teaching and research, the activities most likely to be conducted within the confines of a single discipline and within the structure of a single academic department. This narrow, disciplinary focus contradicts the broad, interdisciplinary problem-oriented approaches required to address the kinds of societal needs listed above.

The gap between client expectations and institutional priorities is large and growing; the public is seeking something other than what higher education wants to provide. This conflict is exacerbated by the economic conditions faced by both clients and institutions of higher education. The long-running recession in the United States, and the realization that unemployment remains high even as the country seems to be rebounding, has severely affected all parties. White-collar workers have been confronted with the reality that the economy is undergoing a major restructuring and that they are vulnerable to layoffs and financial uncertainty in ways never before experienced. Their confidence is shaken and their willingness and ability to pay for their children's education is being diminished. While blind faith in the benefits of higher education has been eroded, these workers continue to believe more than ever in the value of a college education.

State governments face economic problems that are similarly daunting. In many states, revenues have been depressed for an unusually long period. Legislators are reluctant to remedy this problem by levying higher taxes on citizens already burdened with their own financial problems. To complicate matters, claims on scarce state resources are escalating, with the major claimant being significantly larger Medicaid bills. In addition, needs associated with corrections, social services, K-12 education and repairs to infrastructure also are exerting enormous pressures on most state treasuries.

The net effect of these economic cross-currents is that higher education is receiving fewer state resources than in previous years. Fiscal Year 1992 marked the first year in a long time in which total state appropriations to higher education were smaller, in absolute terms, than those of the preceding year. The same was true in Fiscal Year 1993 when appropriations to higher education failed to keep pace with inflation in three-fourths of the states. This condition prevails, not because government leaders consider higher education to be unimportant, but because higher education makes up the largest discretionary portion of most state budgets. State legislators focus their budget-balancing actions on higher education simply because that's where the money is.

Hope for the Future

Faculty and administrators believe the financial pressures under which colleges and universities are operating will lessen in the near future and that funding will increase when the economy turns around. Many state government officials, eager to assuage the pain associated with cutting budgets and rescinding appropriations, talk about restoring the cuts "as soon as state revenues rebound." There are many state and education leaders, however, who are much less sanguine about the economic prospects for higher education during the '90s. These individuals believe that even if, or when, national and state economies regain their strength, competing claims for resources in most states will prevent all but the most modest appropriation increases to higher education. Because the authors of this paper agree with this latter point of view, the paper argues for rethinking the policies governing the processes by which state governments support higher education.

RESPONSES TO FISCAL CONDITIONS

Institutional administrators and government officials alike seem to believe that decreased funding for higher education is a temporary condition. Both state and institutional strategies for dealing with the issue have been decidedly short-run in nature. There is little evidence of the kinds of changes in fiscal policy that would reflect a belief that higher education is facing a decade or more of limited financial support from state government. The state approach has been to appropriate fewer dollars within the framework of an existing static policy structure. The institutional response typically has been to cut budgets "across the board" rather than selectively. Neither party has responded to changed conditions; both have focused on the financial aspects of current conditions and largely ignored questions of educational needs and priorities.

State actions have addressed all dimensions of the financial equation — curbing expenditures, allowing and/or encouraging colleges and universities to increase revenues from other sources and increasing academic productivity. In most cases, expenditures have been reduced through the simple expedient of reducing appropriations, usually without direction as to how institutions should accommodate these reductions. In some cases, state government has sought to limit expenditures by banning out-of-state travel, imposing hiring freezes, prohibiting expenditures for capital items and otherwise dictating how institutions of higher education should respond to conditions of financial stringency.

In almost all instances, the latter approach has proved to be ill-advised. It yields less predictable results than an explicit reduction in funding. More important, it eliminates the possibility of making reductions in a planned and prioritized way, almost ensuring that needed expenditures will be foregone and less important ones continued. From the perspective of effective management, such actions fly in the face of the lessons learned and now espoused by industry — that strategic policy decisions should be made centrally, but

operational decisions on how to carry out those directives must be decentralized if the policy decisions are to be implemented effectively. In a few cases, state expenditure limitations have been accomplished through indirect means, for example, by changing the variables in a funding formula so that calculated institutional financial "need" is less than otherwise would have been the case.

For most public colleges and universities, significant funding increases can come from only two sources — state appropriations and student tuition and fees. Many states have actively encouraged or at least allowed public colleges and universities to increase student charges much more rapidly than normal. This action has allowed institutions to stabilize their revenues and states to diminish their financial commitment to higher education. In some states, this short-term solution has changed the relationships among students, institutions and the state, meaning responses to a fiscal problem are affecting education, access and governance. Such state priorities as "access" and "choice" are easily sacrificed in the rush to balance a budget through increased student charges. Impact on access can be particularly acute when funding for student financial aid does not keep pace with increases in tuition and fees.

Given the inability, or unwillingness, of states to provide additional funds to colleges and universities in light of increasing demands, it is no surprise that many states are being called upon to make higher education more productive. It is much less difficult to issue mandates to "do more with less" than to make, or live with the consequences of, decisions to "do less with less." The tendency of states to cut appropriations and let institutions figure out how to meet their obligations with fewer resources works as long as institutions follow their historic inclinations to respond to whatever demands confront them. When colleges and universities conclude that they have been pushed as far as they can be pushed by such actions and respond by reducing services, a different dynamic emerges. State governments tend to exhibit increased interest in directly addressing the productivity issue by legislating faculty workloads. While appealing on the surface, this approach has proved ineffective. College administrators tend to devote their energies to "proving" that institutions are complying with the letter of the law rather than to making the fundamental changes intended. As a consequence, administrative costs and reporting burdens increase, but productivity does not.

Faced with fewer resources and increasing demands, institutional leaders argue for fewer, rather than more, constraints. They argue that the base must be "fully funded" before activities of particular interest to the state receive an appropriation. In times of retrenchment, college and university leaders call for "special funds" to be eliminated before

base funds are touched. Interestingly, most appropriating bodies have bought this argument. Major funding initiatives such as New Jersey's Challenge Grant program and Ohio's Selective Excellence program were the first casualties of reduced state funding. In other areas, college and university administrators contend that, especially in tough times, they need more flexibility and less detailed regulation and oversight if they are to squeeze the last ounce of productivity out of the scarce resources available.

In many ways, institutional administrators are correct — they could manage their institutions more effectively if they were less entangled in regulatory red tape. Granting more managerial discretion, however, is in the state's best interest only if higher education officials guarantee that institutions will pursue an agenda consistent with state priorities. Such assurances are hard to come by. Experience indicates that the priorities of academe often are quite different from those of legislatures and of the general public. Attempts to bring these priorities into line through accountability requirements seldom have been successful, largely because state governments have failed to clearly and concretely specify expectations. Most states lack established forums in which education and political leaders can reach consensus on objectives to be pursued and initiatives to be undertaken. They also don't have effective policy mechanisms for ensuring that state and societal priorities receive appropriate attention and, in fact, are pursued and achieved.

In times of economic stress, the clash over values is exacerbated. Institutions desire to lessen their attention to state priorities — and to protect their own. At the same time, policy makers give their own priorities more attention, a situation that inevitably results in increased frustration for policy makers. Without mechanisms through which they can direct higher education institutions through non-invasive means, they often resort to tightened procedural controls to accomplish their aims.

Unfortunately, such regulatory actions seldom work. They all too often lead to increased administrative costs, institutional attention to meeting procedural requirements rather than pursuing the intended end results, and heightened tensions between policy makers and college and university officials who see the state taking over institutional functions. All in all, this is a high price to pay, particularly if the larger agenda is not advanced.

What is the alternative? A fresh approach to fiscal policy and to the structure of the financial relationship between state governments and colleges and universities is a significant part of the answer to that question. Fiscal policy remains the single most potent tool available to state policy makers. The resource-allocation process focuses attention like no

other: the use of money is the one way state government can provide incentives for behavior rather than regulate behavior. Resource allocation can point the direction without dictating specific actions. The following chapters describe ways to use fiscal policy as a tool for reconstituting a working relationship between higher education and state government. Such approaches are most important in times of fiscal austerity.

A FRAMEWORK FOR FISCAL POLICY

How might such a fiscal relationship be structured? What guidelines could be followed in devising a new pattern of state government fiscal policy for higher education?

The approach suggested in this paper is conceptually simple and straightforward and could significantly benefit both state government and public institutions of higher education. It could result in clearer expectations and intentions, more clearly established forms of accountability, more control by colleges and universities over how they carry out their obligations.

To begin, *funds allocated to higher education institutions should be organized into three distinct components*: base or core budget, capital budget, and special-purpose budget — that component designed to encourage institutions to focus their energies on the state's priority concerns.

While this overall approach is not new, there are some differences.

Budget Components

The base component is that part of the budget that provides the continuing core funding that allows the college or university to pursue its mission, however that mission is be defined. In almost all cases, this will be, by far, the largest component of the state's allocation. The size of the core allocation can be determined in many ways — typically either by formula or by incremental adjustment to the previous year's base with needed fiscal restraints applied to whatever approach is chosen.

This base funding should (1) be given to the institution as a lump-sum appropriation designed to support the full range of activities required by the institution's mission, and (2) be tendered with few constraints. Institutions should have substantial autonomy over the use of such funds. Most state-imposed controls are purely procedural

and have been shown to have no demonstrable relationship to the quality of instruction or to institutional reputation.

Further, any efficiencies achieved by enforcement of bureaucratic procedures are almost always more than offset by the added costs of monitoring adherence to them. Perhaps most important, these procedural controls contradict what American industry has learned about delegating decision making and control as close to the point of implementation as possible. This means that state governments should establish a working relationship with colleges and universities that accepts state institutions as independent entities rather than state agencies.

Base funding also should (3) be conditional on the existence of an accountability mechanism devised by the institution but mutually agreed upon. This mechanism should be designed to demonstrate the extent to which the institution is achieving its mission and performing appropriately.

Departure from Practice

Within this basic approach, two steps represent a clear departure from common practice. First, this base funding should be adjusted routinely for cost-of-living changes, but not automatically and routinely adjusted for increased enrollments. Most formulas, and even incremental approaches to adjusting the size of the pool of base funding, carry incentives for rapid institutional growth, specifically growth that is higher than that of other institutions competing for resources. This incentive easily can get out of control. Instead, allocation of 'growth funds' should be a state policy decision, rather than a reaction to institutional entrepreneurship, and should be distributed to institutions in such a way that they fund or reward desired increases in services rendered.

Second, these base funds should cover not only institutional operations but also the maintenance of institutional assets such as plant renewal, equipment replacement, some level of acquisition of library resources, program/curriculum review and improvement, and personnel development. In short, institutions should "expense" asset depreciation and interpret the concept of assets broadly. Further, the extent to which this is accomplished should be an explicit part of the accountability mechanism described above. This asset maintenance recommendation is a major departure from current practice, but is both necessary and appropriate. Institutional administrators, not legislators, should be responsible for maintaining assets critical to their operations. These administrators should not be placed

in a position where they can balance their operating budgets by drawing down or depreciating the institution's asset base.

The capital component of the budget would be limited to supporting creation of new "increments" of physical assets — buildings, equipment and information resources such as library books. Common practice requires the renewal and replacement of these assets to be funded out of the capital component of the budget.

There are additional reasons for limiting the capital component of the budget to acquisition of new assets and relegating upkeep to the base component. Such a strategy:

- Dampens the "boom-and-bust" cycles of replacement where capital budgets increase only when states receive windfall revenues — an increasingly rare condition.

- Creates disincentives to the unnecessary acquisition of assets. Institutional leaders are less likely to seek unneeded new plants and equipment if they know the continued upkeep of those assets will be their responsibility.

- Focuses policy attention on new assets, the most appropriate use of scarce policy-making attention. It is better that legislators engage in informed discussion about institutional change and enhancement than about the need to replace a roof.

- Protects administrators from internal pressures to put all operating funds into salaries, to the detriment of other institutional requirements. Administrators want to do the right thing in this regard but are helped immeasurably by outside forces that require them to do what they already know is necessary.

Finally, the special-purpose component of the budget is specifically intended to further the state's higher education agenda. This component should succeed because carrots work better than sticks in changing individual, or institutional, behaviors. Moreover, it is necessary to create a focal point for development of a political consensus around the contributions that higher education should be making to the resolution of important state problems. But it is difficult to accomplish this end within the context of the base component of the budget. To attempt to do so compromises both the pursuit of institution's broader mission and the latitude college and university presidents need to run their institutions as local conditions dictate.

The special-purpose component provides a mechanism whereby state policy makers can exercise their legitimate responsibility to bend institutional attention to matters of central importance to the state without inappropriately involving themselves in institutions' internal operations. Further, development of the special-purpose component virtually requires state government to make its priorities clear in ways that can significantly reduce ambiguities in the conversation between the state and institutions, ambiguities that often help to "get the

deal done" in the first place but almost inevitably result in misunderstanding and deterioration of trust in the relationship.

Guidelines for the special-purpose component of the budget include:

- This component should be the primary device for applying fiscal policy to higher education budgeting.
- The proportion of the budget devoted to this component should be large enough so that it cannot easily be ignored and so that institutions have reason to want it to be continued. The component has to be large enough so that it is in nobody's best interest to see it jettisoned as the first response to fiscal crisis. An amount in the range of 8-10% of core funding might be a reasonable goal.
- This proportion should be maintained consistently in times of fiscal austerity as well as fiscal abundance. State needs increase, not decrease, in times of economic stress. While it may be asking too much to leave the special-purpose component alone when budgets are being cut, it is likewise inappropriate to cut this segment disproportionately.
- This component also should be conditioned on an agreed-upon accountability mechanism that will demonstrate the extent to which the states' policy priorities are being achieved.

The following sections are devoted to a more detailed discussion of the special-purpose component of the budget.

THE POTENTIAL AND PITFALLS OF SPECIAL-PURPOSE FUNDING

All states have some special-purpose funds in their budgets to support particular activities and objectives. In most states, these funds are not connected systematically to state objectives and therefore have not had much effect in changing institutional behavior. In planning the use of special-purpose funds to advance state objectives, it should be recognized that different kinds of special-purpose funds have different incentive effects. There are four major types:

1. **Block grants with guidelines**, like all special budgetary allocations, are incentives for institutions to carry out the activities for which the funds are granted. However, they are not awarded for achieving particular outcomes, a factor that distinguishes them from incentive grants. Nor are they competitively awarded, which distinguishes them from initiative awards. Block-grant guidelines specify purposes for which they can be used, eligibility criteria for their receipt and any rules for expenditure, such as funds must be spent in the year they are received, or fund expenditures must be separately accounted and reported. The guidelines may or may not require institutions to apply for a grant, although they often do require the institutions to establish and forward a plan for use of funds in order to receive them.

   Ohio's Academic Challenge Grants are an example of block grants. Ohio provided each university and community college with 1% of its state appropriation to enhance and strengthen programs selected by campus leaders. The guidelines required the programs selected to have their budgets enhanced at least 10%. Ohio distributed about $66 million in this program between 1985 and 1991. It was one of five programs in the state's Selective Excellence initiative in Ohio (see description of Ohio's Selective Excellence).

2. **Initiative funding** requires institutions, or groups within institutions such as faculty or departments, to develop a request for funding according to guidelines. These guidelines specify the objective desired (e.g., improved instruction in science and math), but leave specifics to each eligible applicant. These programs are competitive, but sometimes everyone who submits an acceptable proposal is a winner. A majority of federal research funding is distributed on this competitive model.

Initiative funding is useful when it is hard to specify detailed outcomes or assure that a given practice will produce results. (A particular research project, for example, may not progress toward a cure for cancer, but is funded on the basis of its promise of yielding useful results.) Initiative funds are prospective awards, provided to carry out activities (research, program operation) expected to advance the funder's objectives. Funding comes prior to results.

3. **Incentive funding** is a reward given for achieving a desired end or outcome. It is intended to motivate eligible participants (institutions, units within institutions or faculty) to improve performance or to focus on a high-priority goal. For example, to encourage the private sector to increase its funding of higher education, Florida (and some other states) matched increased private giving with state funds, if (and when) the private giving reached the desired level. Another example, Tennessee's Performance Funding program, allocates funds based on improved or above-average scores on a test of general education or in a major field test such as economics or chemistry. Other incentive-funding programs have rewarded institutions for graduating students having certain characteristics — capitation grants for graduation of minorities or health-care professionals, for example. Amount of the award is based on the amount of improvement or the level of the average score. These are rewards given for demonstrated performance, not expected performance, and in Tennessee, awards earned in one year are included in the next year's budget and are spent the second year after they are earned.

4. **Grants to students**. This type of grant increases attention to attracting and serving students and increases the importance of market forces and the incentives they bring to the academic enterprise. Such funds include need-based awards that can be used at any accredited institution (such as federal Pell Grants), awards that are only valid for a subset of institutions (e.g., scholarships for attending in-state, nonprofit institutions) or awards for study in selected fields (e.g., chemistry, public administration). Institutions also use these grants to attract more and/or better students.

All states have used grants to students or other beneficiaries. Most states also have used one or more of the other types of special-purpose funding mechanisms. Each has its strengths and weaknesses and works better for some state objectives than others. These strengths and weaknesses are reviewed below.

Block Grants

The good news about block grants is that they are very acceptable to institutions. Colleges and universities prefer money with no strings, but block grants are a good second-best alternative, especially when they provide funds for activities or programs that are institutional priorities. Block grants usually don't make major shifts in the distribution of funds between institutions because no eligible institutions are left out. This aspect gives block grants greater political acceptance with institutions than initiative or incentive funding programs, both of which are more uncertain and can have a greater redistributive effect on funding.

The bad news about block grants is that their incentive effects can be problematic and variable. If there is a major difference between state and institutional priorities, the outcome may be institutional compliance (and use of the money) without achieving any lasting effects. Block grants fund activities. The connection between the activities and the state objectives may vary in different types of institutions.

If the state develops detailed guidelines to assure the money is being spent "properly," it can become involved in ineffective micro-management. An alternative approach is to require institutions to establish goals to be achieved through use of the funds, to assess effects of the grants and report them to the state. While an evaluation process can have substantial costs, it has the potential of saving much more by modifying programs to make them more effective and by eliminating ineffective programs.

If possible, the state should determine in advance the extent to which the objectives of the block grant are congruent with institutional goals. They may correspond to the goals of some institutions but not fit well with goals of other institutions. Ohio's Academic Challenge grants illustrate this point. One state objective was to get institutions to identify and strengthen their strong programs and sharpen their missions. Most university leaders believed that this was important. Because there wasn't enough money to make every program top quality, difficult choices were needed, and Academic Challenge empowered campus administrators to begin the process of sharpening their institution's mission.

In most community colleges, the egalitarian ethic is strong. The primary criteria for program development, continuation or termination are community need and student demand. University ideals of academic quality that are built on research and graduate reputations don't fit community colleges, and many of them are wary of programs, such as Academic Challenge, that smack of academic elitism. In some of Ohio's two-year institutions, Academic Challenge didn't fit the goals and norms of the campus. Community colleges could participate and use the money, but they also could blunt its effects by using other flexible funding to support programs not selected for Academic Challenge.

Block grants have other advantages. They can be quite flexible in terms of duration, and program size can be adjusted to provide enough resources to achieve desired effects. Block grants are most appropriate when:

- There is a clear and well-understood connection between activity funded by the block grant and the outcome the state is seeking to encourage.
- The state purpose applies in a similar way to all eligible institutions.

- The institutional action needed is straightforward and easy to monitor or evaluate. For example, block grants are very suitable for providing special equipment or dealing with library deficiencies. (Although, as indicated earlier, library deficiencies should be remedied by allocations in the base budget under most circumstances.)

Block grants are least appropriate when:

- The state is supporting a goal or program that is low among institutional or faculty priorities.

- The state objective is complex and the actions to be supported by the grant would have different effects in different institutions.

- There is a possibility that the institution will take the money but use it to advance a different objective. Block grants do not have any built-in accountability, so unless there is an evaluation or monitoring program, achievement of the grant's purposes can't be determined.

Competitive or Initiative Funding

A number of states have used competitive initiatives to encourage institutions, or programs within institutions, to engage in entrepreneurial activity designed to achieve state goals. Initiative funding is particularly useful when a general state objective, such as increasing the retention and graduation rates of undergraduates can be identified and when the objectives can be achieved in a number of ways. There may not be one best way to increase the graduation rate that fits all institutions, and institutional creativity can be fostered by competition. Often the process of developing a proposal will focus campus attention on an issue, and even if funding is not received, the college or university may act to improve the situation.

When the objective is important, but it isn't clear which actions will be successful, peer review of competitive proposals by impartial experts is one of the best processes for increasing the chance of a favorable outcome.

State and federal research funds usually are awarded in a competitive, peer-reviewed process. Virginia has had a competitive grant program since 1980, with a varying proposal focus in different years. New Jersey made extensive use of peer-reviewed competitive program grants for academic improvement in the 1984-90 period, awarding more than $50 million through a dozen different programs. Most of the programs, such as teaching math and science, humanities or foreign language or international education made awards to faculty groups or departments endorsed by their institutions (see description of New Jersey programs). Awards made directly to faculty put the funds in the hands of the people who must make the

improvement, but awards to individuals are less likely to lead to permanent changes because the institutional administration is not as involved.

An advantage of competitive grant programs is that they can be used for a variety of objectives and are flexible in magnitude of funds, time period for carrying out the grants (although most are short-term — one or two years) and degree of specificity of the outcomes sought. Further, such approaches require the states, as well as institutions, to commit to action. The state commits to multi-year funding and the institution commits to use the funds in a constructive way.

Another important advantage is that competitive grants signal that the objective is important to the state. The competitive process itself builds motivation for success and provides recognition for successful programs, which is also a motivator. Comparison with peers can give institutions a realistic view of the worth of their own proposals.

A potential disadvantage of competitive funding programs is that they have a lower priority with institutions than base funding, so whenever budget requests have to be cut, competitive programs are likely to be the first to go. New Jersey, which made major use of competitive funds, dropped all of its competitive programs in 1990-91. Former Chancellor Edward Hollander commented, "All of the programs were closed, ostensibly casualties of the state's budget crises. The real reason for their elimination lay in the broad opposition to the program by the colleges and universities."

Ohio also eliminated funds for two competitive parts of its Selective Excellence program — Eminent Scholars and Program Excellence — in the 1991-93 biennium. The elimination resulted not only from a big cut in the state budget, but also because several institutions believed the Eminent Scholars program required more matching resources than they could afford to provide for a single "star" faculty member.

A second disadvantage stems from the fact that institutions use competitive grant awards as temporary "add-ons" to the base budget. The major patterns of institutional expenditure are not strongly affected, and this type of award isn't likely to lead to systemic, continuous change in institutional operation. Evaluations of continuing programs such as Virginia's Funds for Excellence show that some grants lead to ongoing activities, but others terminate when the grant funds end. If grant funds are available to fund an institution's priority activity, the chance of an continuing effect is increased. If grant funds are for an activity that is a low institutional priority, the effect usually ends when the money stops.

A third limitation is the short-term nature of most competitive grant programs. Most academic improvements take time to implement, and multi-year efforts are usually needed to

institutionalize academic changes. This can be accomplished by providing multi-year grants or by requiring institutions to submit plans for institutional funding of the program when the grant ends, or both.

New Jersey, in its Challenge Grants program, provided substantial funding ($1.7 million to 6.7 million for each institution) to enable state colleges (and later community colleges and private colleges) to improve undergraduate education. Institutions could expend funds over a several-year period and had to agree to continue changes with their own funds after the Challenge Grants ended. Institutions' proposals were based on their own priorities and, as a consequence, most were implemented.

Another limitation of these grants is the lack of built-in accountability. An evaluation process must be added to determine whether the grant advanced the purposes for which it was awarded. Evaluations are important and should be part of all special-purpose incentive fund programs.

Incentive-Performance Funding

A major advantage of incentive funding is its built-in accountability. In recent years, governors and legislators have been requiring the development of assessment and performance accountability systems in higher education, and incentive funding is a way of implementing this requirement.

The advocacy of performance funding by governors, legislators and business leaders is a two-edged sword for institutional leadership. The political and business leaders want support for their budgets but are afraid incentive funding will be used improperly. Measuring institutional performance is difficult and requires multiple measures, not all of which are appropriate for all institutions. There is danger that the institution will not do well on some measure and get unfavorable publicity, which will hurt the institution's standing among potential students and other constituent groups.

So, while campus leaders of public colleges and universities want the support of their most important funding source — the legislature and governor — they are wary of the possibility of unfavorable outcomes and of being held accountable for outcomes they don't control, such as student motivation and effort. This fear helps explain the limited use of incentive funding. Tennessee (see description) is the only state that has adopted a comprehensive incentive grant program focused on educational outcomes, although several states, including Texas, have or are developing programs in response to legislative mandates.

Another advantage of all special-purpose funding, but especially of incentive funding, is that it requires states to identify goals for their higher education system and to prioritize which goals will get special support. Do policy makers want colleges and/or universities to develop more research directed toward state economic development? Improve undergraduate education? Develop cooperative training programs with business and industry? Sharpen missions and reduce redundant programs? Operate more economically? Incentive grants will be more effective in stimulating goals that institutions have as high priorities. For example, incentive grants almost always have been successful in encouraging institutions to raise more private funding for endowed professorships, centers of excellence, etc. These are programs institutions want, and matching grants are incentives to private givers. Incentive grants have been less successful in dealing with a complex general goal, such as improving undergraduate education, where outcome measures are difficult to develop, and the goal has a lower priority with faculty than graduate education and research.

A third advantage of incentive grants is that a small percentage of the total budget (1-2%) can be motivating. Each year, 85-95% of the budget is committed to the continuation of existing activities (salaries, supplies, plant operation and maintenance, etc.). Therefore, the provision of 2% of incentive money may represent 20% of the funding that can be used to enhance existing programs or start new ones.

Incentive awards can be provided as awards for performance which the institution can use in any way it wishes (the Tennessee model), or the awards may carry some conditions. For example, the state may specify that funds must be used in successful programs or activities. The "no-strings" awards allow top institutional administrators to decide how to use the funding. The program also could turn decisions about spending over to the unit or program that generated the award. Ohio's research challenge used both approaches. Some of the research challenge money was returned to the research unit that had generated the outside funding by its research activity, while the remainder was used to support new research ventures or other enhancements of the institution's research efforts.

Incentive funding has some important limitations, however. It requires clear definition and measurement of effectiveness of the objective to be rewarded. For example, improving undergraduate education is a very broad goal with many facets and is much harder to measure than a goal of rewarding institutions for getting increased external support. If money is to be awarded on the basis of improvement, measurement and the possibility of cheating become major issues.

If multiple measures are used, they may give conflicting results. Tennessee requires a test of general education outcomes, but there has been little or no improvement in average scores over the decade it has been administered. The state also requires alumni surveys which usually turn up high marks for their alumni's educational experiences. Faculty are inclined to accept positive ratings of graduates and reject test-score results as not being good measures of their curriculum. A common faculty attitude is that high marks from graduates are a more important criterion than test scores.

When an objective can be unambiguously assessed, such as improving retention or graduation, it has met one criterion for an incentive award. Even if the goal is easy to measure, a good incentive program has to take into account differences in institutions' ability to achieve the goal. If the goal is a high graduation rate for entering students, institutions that have more able entrants are likely to have higher graduation percentages than institutions that admit almost all applicants. Making the incentive award equally accessible to all institutions requires careful design. In the example cited above, improvement of graduation percentages over time may be a fairer standard than basing awards on graduation rates.

Unless institutions perceive the incentive process as fair and unbiased, they won't support or be motivated by it. It's often hard to design a "level playing field" given the diversity of institutional resources, students served and program offerings in a state's public institutions.

Finally, incentive awards will have a much greater effect if they are given to the persons or units responsible for progress toward the goal. A research award, for example, should bring benefits not just to the institution, but also to faculty members and others who get research grants and do the research. The president's or dean's priorities for using the money may be different from those of the faculty who do the work.

Funding Beneficiaries

When achievement of a particular goal (such as attracting more and better students) depends on the actions of the beneficiaries, it usually is more efficient to provide funds directly to them. This action is particularly the case when beneficiaries, such as students, have choices and can operate independently of the management and administration of the institution. In the case of students, awards also can make the institution more responsive to their needs.

State funding for non-student clients of public service programs is less common than student aid, for example, non-credit, inservice training for teachers or farmers. Nevertheless, it, too, can cause institutions to be responsive to external clients who can be helped by the university. One disadvantage of this funding is that institutions can be drawn to serve groups not central to their mission, just because funds are available.

As more states limit state appropriations, and institutions raise tuition and fees to close the gap, the importance of student aid will increase. The so-called high-tuition/high-aid strategy will require big increases in aid to enable low-income students to attend college and to have some choice among programs. Special-purpose funding for clients is the largest type of special- purpose funding in terms of number of dollars, number of institutions and number of recipients, and is likely to grow even more in the next decade.

Principles for Successful Special-Purpose Funding

States considering establishing or modifying their special-purpose funding so the budget will support state policies more effectively should consider the following principles and cautions.

It is necessary to fit funding to the complexity of the goals being sought. If the effort is to meet a complex goal such as improving undergraduate education, block grants, competitive grants and incentive awards may all be needed.

A comprehensive effort of the sort initiated by New Jersey, Ohio or Tennessee uses more than one type of special-purpose funding. This fact has important consequences both for the likelihood of effective outcomes as well as the acceptability of special-purpose funding with various constituents. A state's success in sustaining special-purpose funding long enough to make a difference will depend on how politically acceptable the package is. It will depend even more on an effective combination of funds that can empower administrators and stimulate faculty and students.

Tennessee built its special-purpose incentive funding into the formula budgeting process, which has helped to assure its continuity. States contemplating new funding initiatives should consider how they can make them a continuous part of the regular budget process. Can it be an ongoing part of the budget and still be flexible enough to allow special funding to be shifted from one policy objective to a higher priority objective? Tennessee has dealt with this problem by revising its criteria and objectives every five years. The most recent revision (the third) added several new objectives and changed the relative weight of others.

Institutions will give a higher priority to their base budget allocation than to any special-purpose funding unless the special-purpose money supports a high institutional priority that can't be funded as effectively from the base budget. Special-purpose funding that empowers institutional leadership to accomplish important objectives will get strong campus support.

Ohio was creative in designing its Selective Excellence program so that it combined competitive grants (Eminent Scholars, Program Excellence), block grants (Academic Challenge and Productivity Improvement) and an incentive grant (Research Challenge). A program with multiple components is more likely to engender action from a wider segment of the institutional constituency.

Political acceptability of a program also is enhanced if it is primarily a "distributive," rather than a "redistributive," program. Block grants are distributive in their institutional effects, although within an institution they can have the opposite effect. Competitive grants have varying redistributive effects, depending on the criteria for award and the differences among competitors. Incentive grants also can have variable redistributive effects, depending on the award criteria. Tennessee's program of incentive grants led to very modest redistribution of funds. One part of the program, "corrective actions," functioned as a block grant since almost all the institutions got the maximum award for that portion every year. Redistributive effects in the Tennessee program are reduced somewhat because the institutions compete more against their past record than with other institutions. One institution's gain is not another institution's loss.

Awards also are more politically acceptable to institutions if they are made to the institutions, rather than to constituents, such as students, or to units or individuals within institutions. Part of the political vulnerability of New Jersey's competitive grant program came about because some of the programs made awards to faculty within institutions, rather than to institutions themselves.

Political acceptability must be balanced with impact and effectiveness. It doesn't advance state policies if the program is designed to be politically acceptable to the institutions, but doesn't meet objectives of the special-purpose funding. If the state objective is to improve teaching and learning, the program must involve faculty and students. Awards to institutions must lead to rewards to the people who must make the difference if the grants are to have an effect. New Jersey ensured that faculty would be involved by making awards directly to them, and Ohio's Program Excellence awards also were made to the faculty. Tennessee's funds went

to the institution and became a part of the institution's budget. As a result, faculty weren't rewarded directly and were less involved.

The challenge to a state is to design special-purpose funding that not only is acceptable enough to continue long enough to make a difference, but also to assure that the funds will have an impact. Continuing impact depends on the funds stimulating changes in the way teaching and learning occur or in the way the institution is organized and managed.

This is a daunting challenge because universities and colleges are complex institutions, staffed with highly specialized professionals who have substantial autonomy and control over the key functions of teaching, research and service. A state can improve its chances of having an impact by using the following principles in its special-purpose funding design:

- Select a limited number of goals and objectives for special funding. Don't try to reform the whole system through fiscal policy alone. Special-purpose funding is marginal funding that can induce incremental change. Since colleges and universities usually change incrementally, if at all, special-purpose funding is a main state lever for inducing incremental change. If more comprehensive "restructuring" of institutions is sought, changes in governance and other policies usually will be necessary.

- Outcomes that can be measured at reasonable cost are essential for block grants and incentive programs to succeed. Competitive grants don't require as much outcome specificity, but the activity being funded and the goal being sought should be clearly connected. Complex general goals, such as improving undergraduate education, require more complicated special-purpose funding strategies, using several types of funding and involving multiple measures. It is hard to prevent substituting the institution's goals for the state's goals, especially when state priorities are not congruent with institutional priorities. Clear goals and outcomes are important and the best assurance of success.

- Incremental change takes time. Special-purpose funding should operate long enough to give change a reasonable chance of succeeding. Block and incentive grants can operate on a multi-year basis. Competitive grants are often short-term, for one or two years, but they can be set up on a multi-year basis if needed.

- Provide enough funding to be an incentive. The substantial programs in Ohio, New Jersey and Tennessee provided 2-5% of the total appropriation, and each of these programs led to changes in institutional behavior and outcomes. Whether the funding is sufficient depends in part on whether the institution considers the goal a priority and in part on how complex the goal is.

- To achieve an impact, funding must be directed to the persons responsible for achieving the goal. This usually means the faculty, although a few goals can be implemented at the administrative level (raising matching funds, for example). At the same time, if the program is going to continue after special funding ends, the institution must be involved. Any commitment to continue activities or to provide matching money has to be an institutional commitment.

For block grants to work well:

- The program supported by the block grant should work effectively in all eligible institutions.
- State goals should be clear.
- The program should not be so complex that institutions substitute their goals for the state's.
- An evaluation process should be built in with opportunity to modify the program if it is not succeeding.

For competitive grants to work well:

- The grant criteria should assure a fair competition among eligible institutions or individuals.
- Awards should be sufficient to allow institutions to make progress or succeed in their efforts.
- Awards should reach and reward the persons who must implement the activity or program.
- Institutions should be required, or at least encouraged, to continue successful programs within their base funding.
- An evaluation process should be built in.

For incentive grants to work well:

- The goal to be rewarded must be clear and an effective, not too costly, way of assessing progress must be available.
- The rewards must motivate the people who must implement the program. This means they have to be large enough and continue long enough to induce action and improvement.
- The institution must have the capability, organization and knowledge necessary to make progress on the goal.
- If change and improvement are going to last, incentive funds must be available long enough for improvements to be institutionalized.
- An evaluation of program effectiveness should be built in.
- If state priority goals are different from institutional priorities, incentives have to be larger and may have to be in effect longer to lead to success. If state and institutional priorities are the same, smaller incentives may do the job.

For grants to constituents to work:

- The target group of constituents has to be clearly identified.
- Funds have to be sufficient to induce the desired participation.
- If funding is designed to achieve institutional purposes as well as fulfill individual objectives (for example, achieving a more diverse student body), those purposes should be clearly defined, and an evaluation will be needed to see if those goals are being attained.

USING SPECIAL-PURPOSE FUNDING TO IMPROVE UNDERGRADUATE EDUCATION

An increasing number of states are identifying the improvement of undergraduate education as a priority. The preceding discussion of special-purpose funding noted that broad, complex goals such as improving undergraduate education are particularly challenging areas for state policy to influence. Changing the way teachers teach and students learn, which is what improving undergraduate education implies, is a difficult task.

- The responsibility for teaching and curriculum development is decentralized to many departments and to individual faculty who operate independently.

- Faculty and departments respond principally to rewards for research, scholarship, publication and specialized graduate teaching. Undergraduate teaching is a lower priority in the faculty reward system of most universities and requires special attention if it is going to be a higher priority. (Teaching is a high priority in most colleges and community colleges.)

- It is difficult to assess the outcomes of undergraduate education. There are few standards to tell institutions how well they are doing or to identify weaknesses that need improvement.

- Because almost all colleges and universities are organized into specialized departments, general education — where communication, critical-thinking and problem-solving skills are emphasized — is no department's priority. No faculty owns general education in most institutions.

On the other side of the equation, efforts to improve undergraduate education are assisted by the fact that university faculty and administrators believe that undergraduate education is important, and they want to do a good job. The majority of the budget in most institutions is generated by, and spent on, undergraduate education. General education is not unimportant, but other activities, such as research, are more rewarding.

Despite these formidable barriers to change, state special-purpose funding can help make undergraduate education better. This section suggests how special-purpose funding might be used to improve undergraduate education. Examples are drawn largely from efforts

that have already been tried in one or more states, although no state has put together a comprehensive special-purpose funding program containing all of the suggestions presented.

Setting the Goal

The first step is to establish the improvement of undergraduate education as an important goal which the state is willing to make a priority. This process often has been initiated by a "blue-ribbon" commission composed of state political, business, civic and education leaders, which sets goals and priorities. Virginia's Commission on the University of the Twenty-First Century and Ohio's Managing for the Future Task Force are recent examples. Unless the goal is large enough to sustain substantial special-purpose funding for several years and gain the commitment of state officials, it is unlikely to make a difference.

At this point, the state has to decide whether or not to leave the money in each institution's base budget and require institutions to make identified improvements? This would be a simple action not involving any state costs in providing for the operation of a special-purpose fund. However, funds in the base budget will be used to support the priorities of the college or university and its faculty. Because undergraduate education is rewarded less than graduate education and research, it will be hard to initiate and sustain a change process, even if institutional administrators favor it, without the leverage that special funds bring.

Special funding for undergraduate education indicates the high priority the state has for improving undergraduate education. Campus administrators can be given the opportunity to provide rewards for undergraduate improvement that can offset some of the profession's rewards for research, scholarship and publication.

A multi-faceted approach to improvement, using more than just one type of special funding and extending over several years, will be most likely to have an impact in improving undergraduate education. Undergraduates make up 85-95% of the enrollment in most public universities, and a large part of the budget is for undergraduate activities. To support improvement in such a large part of the university's activities, special funds probably should represent at least 2-5% of the budget. For a decade, Tennessee has allocated 5% of total state appropriations for performance funding, so this is not an unrealistic target.

Assessment for Improvement

If the state has not already developed an assessment program to provide indicators of undergraduate effectiveness, block grants to institutions to develop assessments would be a

good starting point. Some of the assessment can be based on readily available indicators, such as the proportion of entrants who graduate in five or six years, the proportion of graduates who are accepted for graduate and professional study, pass rates on licensure exams, etc.

But the key to an assessment process that can guide instructional improvement is how well students meet the college or university's own educational objectives. Such measures must be credible with the faculty and provide information useful for improving curriculum and teaching. Many commercially available measures are weak on these criteria, so institutions need the resources to develop a "self-regarding" assessment process. Block grants can provide the resources to enable institutions to develop the "guidance system" for their improvement process.

Emphasizing Good Practices

Considerable agreement exists about instructional practices that can lead to greater student learning.[1] These include:

- High expectations
- Coherent curriculum focused on key outcomes the institution is seeking
- Use of active-learning principles that enable students to practice and apply what they have learned and to incorporate theory into their own repertoire
- Combining classroom learning with field experiences and internships
- Collaborative and teamwork learning opportunities
- Frequent assessment and feedback
- Frequent student-faculty contact
- Exposure to diverse ideas, ways of learning and value systems

Institutions could be challenged by a competitive or block-grant program that would fund institutional initiatives to improve undergraduate teaching practices. Guidelines for either competitive or block grants should give priority to proposals that have the largest potential for impact on student learning, have a reasonable chance of becoming

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[1] A.W. Chickering and Zelda Gamson (1991) Applying the Seven Principles for Good Practice in Undergraduate Education. New Directions for Teaching and Learning, No. 47. San Francisco, Jossey-Bass.

institutionalized, and reinforce state funds with institutional support for these improvement activities. Institutions should evaluate the effectiveness of each program's activity in achieving specific improvement goals. Proposals also should identify how the institution proposes to continue the program after special-purpose funding ends.

Incentive Funding

States can develop indicators of undergraduate quality and effectiveness, some of which can be the basis for allocating incentive funds for improvement. Incentives can be provided for achieving or exceeding some standard (program accreditation, for example) or for improving over past performance (increasing the percentage of minorities in attendance and retaining them to graduation, for example).

State awards for improving the proportion of entering freshmen who graduate will focus institutional attention on why students drop out and what can be done to retain more of them to graduation. This effort can lead institutions to take a variety of actions. For example, some colleges or universities may focus on admissions standards, others on remediation and still others on improving the institutional culture and climate for groups with a high dropout rate. Incentive money can be awarded to institutions with no strings on its use, but it may have more impact if it is tied to the goal for which the campus received the money.

Student Funds

Another way to enrich undergraduate education is to improve the students who are admitted and retained. Scholarships are used widely for this purpose, and they are an important component of a comprehensive undergraduate improvement strategy. Financial aid can reduce the loss of students who drop out because of the cost of education. Scholarships to high-achieving students enriches the student "mix," which can have positive effects on overall achievement levels. Unless awards to students are combined with changes in teaching and expectations for achievement, the full potential of awards to students will not be realized.

Combining Special-Purpose Funds

A higher priority for undergraduate education involves a number of actions that change campus rewards and organizational culture. Special-purpose funds are used to provide

rewards and support for changes in goals, assessment, teaching, the student mix and redirection of institutional resources and efforts. Institutions should be challenged to make a comprehensive attempt to raise the priority and the rewards for attention to undergraduate teaching and learning.

To improve the outcomes of undergraduate education, states need several reinforcing special-purpose fund programs, including block grants where appropriate, competitive grants, incentive grants and grants to students. They also need to sustain support for their objective for several years because changing the rewards and behaviors of faculty and students is difficult, and sustained improvement won't come easily or quickly.

APPENDIX

New Jersey's Challenge and Competitive Grants

New Jersey made its budget a primary instrument for promoting state quality-improvement objectives. In the early 1980s, the Board of Higher Education (the statewide coordinating board) shifted from an enrollment-driven formula funding budget process to a negotiated base budget for each institution, plus several special-purpose grant programs designed to encourage state priorities.

In 1984, the state initiated a competitive grant program for which faculty and departments within institutions could compete. The Federal National Science Foundation, National Humanities Endowment and Fund for the Improvement of Postsecondary Education were used as the models, and between 1984 and 1991, the state granted about $53 million to more than 1,400 successful proposals in 12 different programs. Those programs included computers in the curriculum ($15 million), technical and engineering education ($12 million), humanities ($8 million) and Fund for Improving College Education ($5.7 million). The Board of Higher Education issued a funding prospectus for each program, and out-of-state review panels rated all proposals.

The Board of Higher Education initiated the program with strong support from then-Governor Thomas Kean and the legislature. Colleges and universities participated extensively in the program design. Total state appropriations grew at an above-average rate during the 1984-90 period, so this program was an addition to adequately funded base budgets.

The challenge grants were the second major budget initiative designed to get institutions to sharpen their missions and focus on improving their high-priority programs. The challenge initially was for the nine state colleges, and in three annual rounds of competition, eight received major developmental grants ($1.7-$6.6 million per institution). Subsequently, another competition was held for

community colleges (15 awards made), and a third set of grants for independent colleges (nine awards). Altogether, more than $60 million were awarded between 1986 and 1991. Evaluations of the program impact were very positive.

About 2% of total appropriations in the 1984-91 period were for the challenge and competitive grants. These programs were terminated during budget reductions in 1991; institutional leaders put a higher priority on their base budget than on the competitive grant programs.

Ohio's Selective Excellence Program

In 1983, Ohio began a program to recognize and encourage excellence in research, undergraduate education and technical training for new jobs. When fully developed between 1985 and 1991, the program had six different parts, plus money for a supercomputer center. Selective Excellence combined block grants, competitive grants and incentive grants in a program which had substantial support from colleges and universities.

The first part was **Program Excellence**, a statewide competition open to all public two- and four-year institutions. Institutions identified their best undergraduate programs which could receive up to $200,000 in an enrichment grant. Institutional proposals described why each program submitted was outstanding and what outcomes were being achieved. All proposals were peer-reviewed. Between 1983 and 1991, this program awarded $12 million.

The second part was **Eminent Scholars**, a competitive initiative in which the state matched up to $500,000 from institutional funds to provide an endowment to attract a nationally or internationally distinguished faculty member. Institutions had to compete based on the soundness of their proposals in addition to being able to raise necessary matching money. The institutions raised about $1 million on the average, because the costs of attracting scholars included research labs. This competitive program was open only to four-year universities, and about two-thirds of the 36 awards went to the two major research universities.

The third part was **Academic Challenge**, a block grant of 1% of state appropriations to be used by institutions to strengthen their strong programs and additional "centers of excellence." The institutions chose the programs to be enhanced (at least 10%) with grants providing up to six years of support. This program awarded $66 million between 1985-91.

The fourth part was **Research Challenge**, an incentive program with awards consisting of a percentage of external research funds received by the institution. Private universities were also eligible. Institutions could use the funds for starting new research

efforts, for competitions among faculty for small research grants and for rewards to the faculty who had brought in the research funds. More than $100 million has been awarded through this part of the program.

The fifth part, **Productivity Improvement**, helped community colleges and technical institutions develop new ways to improve job training and retraining and develop more qualified persons to contribute to Ohio's economy. This program distributed more than $20 million in awards.

The sixth part was a one-year competitive grant program open to private colleges with outstanding liberal arts education programs.

Research Challenge and Productivity Improvement were reduced in the 1991-93 biennium, and the other programs were unfunded because of the downturn in Ohio's economy. An 1992 evaluation by the National Center for Higher Education Management Systems provides a comprehensive assessment of the program's strengths and weaknesses for persons interested in more details.

Tennessee Performance Funding (Also Called Instructional Improvement)

In 1975, Tennessee began to develop an additional budget formula component designed to measure outcomes and quality. At that time, the state had a budget-formula process based on enrollment and cost. The concept was backed strongly by key legislators and by some college presidents who were looking for ways to justify budget increases in a period of stable enrollment. With foundation support, the Tennessee Higher Education Commission involved about half of the two- and four-year institutions in pilot studies of ways to assess quality. In FY 1979, this effort led to a performance funding component budget component through which each institution could earn up to 2% of its state appropriation.

Initially, five different measures of quality were adopted: (1) outcomes in general education, measured by a test, (2) outcomes in the major field, measured by various tests, (3) specialized accreditation, (4) survey of alumni satisfaction and (5) corrective measures. During the 1979-82 pilot phase, points were awarded to institutions that implemented the assessment process. Institutions competed against their own past record, and funds earned at one institution had no effect on any other institution's chances.

In 1983, the performance-funding component was increased to 5%, and the first cycle (1982-83 to 1986-87) began. By the end of the period, most institutions were earning between 90% and 100% of the maximum award of 5%.

Revised scoring criteria were developed for the 1988-92 cycle that put more emphasis on improvement or high scores. Institutions were evaluated against both their past performance and their relative standing among out-of-state peer institutions. Universities earned an average of 77% of the maximum award possible, and community colleges about 81% during this second cycle. A sixth bonus criterion was added to allow institutions to earn up to 10% additional for developing and testing new pilot instruments.

A third cycle, which began in 1993, was more extensively modified. Additional criteria dealt with retention and graduation rates and minority achievement and graduation and put more emphasis on peer review and process criteria such as strategic planning and improvement activities.

The performance funding program has been supported consistently by the governor and legislature, the higher education system and state higher education leaders and by most of the college and university leadership. Because it is a part of the budget formula process, it is not viewed as an add-on that is subject to elimination during budget downturns.

More than $180 million was awarded from 1982-92. During the 1984-89 part of this period, total budget funding was above average. The proportion of programs with specialized accreditation increased, and major field scores improved in some areas. Scores on the general education test remained quite stable in almost all institutions.

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