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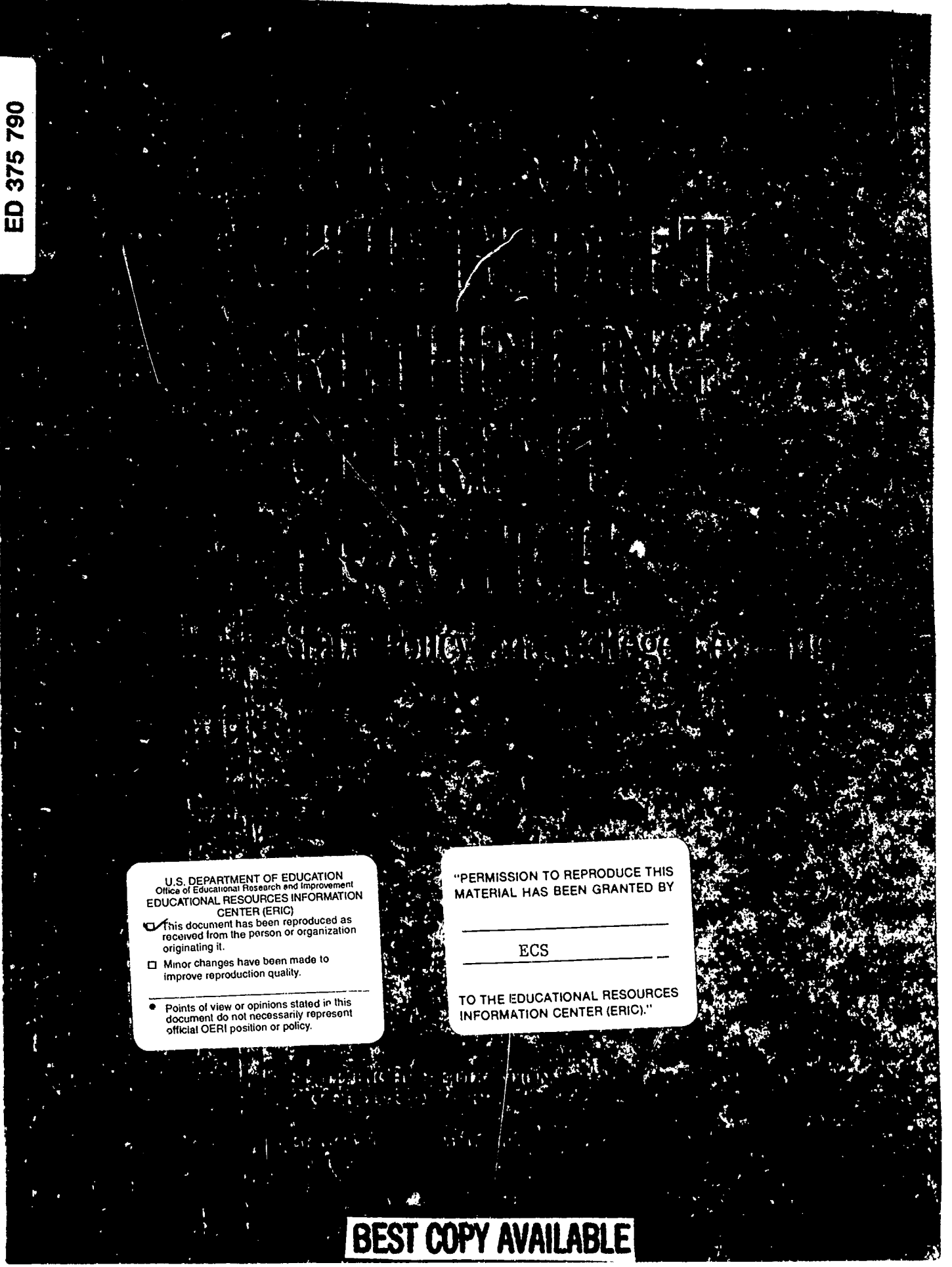
ABSTRACT

The four papers presented here were chosen for presentation at the 1993 annual meeting of the State Higher Education Finance Officers. "A Clean Slate: Principles for Moving To a Value-Driven Higher Education Funding Model," by Brenda Norman Albright and Diane Suitt Gilleland, outlines principles for moving from an accounting-driven funding model, emphasizing input factors, to a value-driven funding model, emphasizing state higher education needs and financial incentives that will meet needs more effectively. It suggests shifting to a new funding philosophy and offers a customized campus sketch of clean-slate funding. "Linking Budgeting to Academic Planning: The Wisconsin Case" (Kathleen R. Sell) presents five policy tools used by the University of Wisconsin System to combine budget and academic planning to improve instructional quality. "An Attempt To Implement Performance-Based Funding in Texas Higher Education: A Case Study" (Mark Bateman and Roger W. Elliott) chronicles a failed attempt to establish performance-based funding in Texas and suggests lessons learned. "Important Safeguards in Funding Processes for Public Higher Education" (J. Kent Caruthers and others) notes that objectives of funding processes have changed focus over time and warns of potential pitfalls in adapting funding processes to meet changing policy objectives in the 1990s. (Some papers contain references.) (JDD)



FOCUS ON THE BUDGET: RETHINKING CURRENT PRACTICE

STATE POLICY AND COLLEGE LEARNING

RHONDA MARTIN EPPER, editor

May 1994

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STATE HIGHER EDUCATION EXECUTIVE OFFICERS

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 reflects a strong concern that serious disincentives in higher education diminish faculty commitment to teaching, and that the impacts of state, federal and institutional policies on the quality of undergraduate education need serious reexamination. The project seeks to foster a new vision of the kinds of state policies that 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 State Higher Education Executive Officers is a nonprofit, nationwide association of the chief executive officers serving statewide coordinating and governing boards of postsecondary education. Forty-nine states, the District of Columbia, and Puerto Rico are members.

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INTRODUCTION

Rhonda Martin Epper
State Higher Education Executive Officers

Using state budgets to achieve policy goals for higher education has sparked heated debate in recent years. For the most part, the principles under debate are not new. Higher-education budgetary decisions always have resulted from an attempt to answer a state's most important needs and policy questions. What is new is that these needs and issues have changed, and that the debate over appropriate budgetary methods has become broader.

In the last several decades, convincing arguments have been made that budgets and policy are inextricably linked. Budget scholar Aaron Wildavsky (1964) suggests that the budget is the primary link between financial resources and human behavior when it comes to accomplishing policy objectives.

Similarly, Ted Hollander (1986), former chancellor of the New Jersey Department of Higher Education, describes budgets as the most powerful tools influencing educational outcomes: "The allocation of public funds or an institution's internal allocation of funds determines those fundamental issues of higher education policy such as who goes to college, which college students attend, what they learn and the standards governing the award of degrees."

In common practice, the direct connection between budgeting and policy outcomes is not so obvious. Institutions of higher learning enjoy considerable flexibility and autonomy in allocating resources. State government officials traditionally have believed campus leaders to be better equipped

Current debate now centers on the degree to which state governments should use their budgetary power to establish policy goals for higher education . . .

than legislators to decide how resources should be spent within an institution.

But, in recent years, this confidence in higher education has waned as institutions shifted dollars out of instruction and into other activities. In *Values in Conflict: Funding Priorities for Higher Education* (1986), John Millett noted this trend in public higher education expenditure patterns: an increasing proportion of state support dedicated to purposes other than student instruction. Millett predicted that this trend was not likely to reverse itself in the near future.

Public concern mounted throughout the 1980s and early 1990s, as expressed most recently in a report by the Wingspread Group on Higher Education (1993). The Wingspread report asserts that "while the public is most interested in achievement, costs, and management, it believes that the academy focuses instead on advanced study and research." Furthermore, "the academic culture and rewards system too frequently encourages graduate education and research at the expense of undergraduate education."

The combination of real trends and perceived institutional tendencies to direct funds away from instructional purposes have damaged higher education's public image, with the result that states are becoming more interested in how public dollars are being spent in public institutions of higher learning.

Current debate now centers on the degree to which state governments should use their budgetary power to establish policy goals for higher education, including how best to use budgets as a tool of policy and which techniques are most successful in achieving desired outcomes.

The State Higher Education Finance Officers (SHEFO) 1993 annual meeting provided a forum to debate the use of base budgets in increasing institutional commitment to teaching and learning. This topic was selected because of a general presumption that base budgets are protected from use as a policy tool. Many states, in fact, have chosen special-purpose or incentive funding approaches to help higher education meet state priorities while protecting institutional base budgets.

Incentive and categorical approaches to funding have received much attention in recent years. For example, a report in the Education Commission of the States (ECS) series on State

Policy and College Learning (Folger and Jones, 1993) argues that special-purpose funding should be used as the primary policy tool to advance a state's higher education agenda, with base budgets allocated in lump sum with few constraints.

Incentive funding efforts to date have affected only a small percentage of the total funds allocated to higher education institutions. In the past, concern for funding stability and institutional autonomy deterred states from fundamentally rethinking institutional base budgets. But, given declining resources and continuing concern about productivity, state coordinating and multi-campus system boards may be forced to go beyond marginal approaches to more systemic changes in their financing policies if they are to align institutional activities better with public priorities.

The 1993 SHEFO planning committee provided finance officers with an opportunity to join the debate. The annual meeting in Denver, chaired by Steve Jordan of the Arizona Board of Regents (now executive director of the Kansas Board of Regents) gave members the chance to share their individual state experiences in using financing policies, particularly within base budgets, to improve institutional commitment to teaching and learning. With support from the ECS project on State Policy and College Learning, SHEFO solicited proposals for papers on this topic to be presented at the meeting. Four papers were chosen for presentation and publication.

Given declining resources and continuing concern about productivity . . . state coordinating and multi-campus system boards may be forced to go beyond marginal approaches to more systemic changes in their financing policies if they are to align institutional activities better with public priorities.

The first paper, by Brenda Albright and Diane Gilleland, outlines principles for moving from an accounting-driven to a value-driven higher education funding model. The underlying premise is that higher education's basic purpose—student learning—has little relationship to a state's approach to allocating resources.

The authors call for a shift from input factors (number of students enrolled, average salaries and costs) that contribute to institutional squabbling over potential net gains and losses in "sharing the pie," to a greater emphasis on state higher-education needs and the financial incentives that will support meeting them more effectively. Albright and Gilleland envision new players at the budget development table, including faculty, lay board members and political leaders.

Starting with a clean slate, they propose a new funding model based on the following five principles:

- Thinking and funding for the future by connecting funding to state and national goals, rewarding improvement, adding stability to the funding process and protecting capital investments.

- Creating new funding parameters that create a budgetary culture of interdependence rather than competition through the creation of performance partnerships.

- Promoting campus choice by ensuring campus autonomy in choosing individual focus and reward centers.

- Planning investments carefully by funding planned growth, promoting mission integrity and rewarding campus responsiveness to workforce, state and student needs.

- Building higher education's credibility through open communication about shifting protocols from institutional needs to state needs, informing the public of campus selectivity and program focus, and directly communicating with stakeholders.

A final suggestion is for states to "humanize" their funding policies by reporting with accuracy and integrity how funds are used to help students succeed in learning and faculty in teaching. The authors provide suggestions for shifting to a new funding philosophy as well as offer a customized campus sketch of clean-slate funding.

Countering the claim that institutions of higher learning seldom reexamine their base funds, the second paper, by Kathleen Sell, presents five policy tools used by the University of Wisconsin System to combine budget and academic planning in an effort to improve instructional quality.

Beginning in 1987, the UW System implemented a series of enrollment management strategies aimed at increasing quality through lower student-to-faculty ratios, higher admission standards and incentives for institutions to limit enrollments. To minimize the impact on student access, the plan took advantage of declines in high school graduating classes and shifted enrollments to lower-cost two-year institutions and a few under-capacity four-year institutions with a primary emphasis on excellent undergraduate education.

UW System officials believe that the two phases of enrollment management implemented so far have enabled them to avoid the kinds of drastic ups and downs in enrollments, class sizes and funding that are occurring in other states. Another result has been to raise Wisconsin closer to the national average in per-student funding. The savings realized through enrollment management have been reinvested toward top priorities through the Quality

Reinvestment Program (QRP). In 1991, system officials announced to legislators that they would use reallocated funds to pay for top priorities not funded by the state. Because the final budget was $26 million short of the request, that amount will be reallocated over a three-year period through QRP. The program requires each institution to reallocate from lower-priority areas to meet its top priorities for educational quality.

Other initiatives discussed in the paper include the "Undergraduate Imperative," base funding of all new programs and various productivity and tuition policy changes proposed through a public dialogue. Among the lessons learned: states should expect institutions to engage top priorities with the help of their own base funds rather than through incentive funding; quality-driven enrollment management policies should be implemented, while reserving centrally any excess fee revenues; and institutions should approach the state as a unified system.

In the third paper, Roger Elliott and Mark Bateman recount the experience of attempting to establish performance-based funding in Texas higher education. Institutional reaction to the funding proposal ranged from well organized, sophisticated lobbying to a "wait and see" approach.

Each sector approached the development of a performance-based funding proposal differently, with various levels of external input. All proposals emphasized outcomes rather than process measures. The proposals for universities and community colleges were designed as "add-on" incentive programs (recommended at two to five percent of the base) that would provide funding over and above the base funding provided by the legislature through the formula-funding system.

Performance-based funding was never adopted by the legislature for a number of reasons, both political and logical. One of the principal reasons was that the fragile agreement by which institutions were willing to support the idea was broken when the House of Representatives adopted the "add-on" incentive at 10 percent of the base instead of the higher-education board's recommended five percent. Combined with institutions' fear that whatever the percentage was would be deducted from the base regardless of its intent, the measure lost substantial institutional support. The authors suggest lessons learned from which other states considering performance-based funding may benefit.

The final paper by Kenneth Walker, Kent Caruthers, and Joseph Marks cautions would-be reformers to bear in mind some important safeguards and desirable features of existing funding processes. Objectives of funding processes have evolved and changed focus over time—from adequacy of base support in the 1950s, growth in the 1960s, equity concerns in the 1970s, stability and quality in the 1980s, to accountability and reform in the 1990s. Achievements in the evolution of funding processes, such as funding based on known ele-

The essays may not resolve long-standing questions about state versus institutional roles . . . but they will expand the dialogue and stimulate new thinking . . .

ments of cost and distributing funds based on known differences in program structure provide desirable stability and equity in funding. These achievements are safeguards, according to the authors, and they should be carefully considered in the current efforts to realign public higher education funding with emerging policy priorities.

In light of state revenue shortfalls, pressure is mounting for funding processes to provide additional stability and accountability. This paper analyzes several options but warns of the potential pitfalls in adapting funding processes to meet changing policy objectives in the 1990s, based on a profile of the major characteristics of current funding processes in the Southern Regional Education Board (SREB) states.

Together these essays present a variety of perspectives on the use of state budgets as a policy tool for higher education. The essays may not resolve long-standing questions about state versus institutional roles in determining resource expenditures, but they will expand the dialogue and stimulate new thinking about the impact of state budgetary policy on college learning.

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A CLEAN SLATE: PRINCIPLES FOR MOVING TO A VALUE-DRIVEN HIGHER EDUCATION FUNDING MODEL

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College and university funding frequently is described as incremental, meaning that it changes only very little from year to year. The same can be said for state funding policies—they too change only incrementally, and many are similar to those in place 20 years ago. This lack of apparent change over time has led people outside higher education to question not only today's overall funding level for public systems but also the policies that drive it.

Legislators and state leaders are among those asking what messages state policies are intended to convey to the campuses. They are also among those raising questions about how responsive these campuses traditionally have been. Put another way, they wonder what state policy has been intended to accomplish and whether the campuses have been listening.

Higher education needs to be forthright in answering these serious questions if institutions are to maintain their credibility and, with it, their ability to influence the priority of resource appropriations. As part of their response, institutions need to assess their funding systems in terms of what has been accomplished thus far, what truths must be faced and what decisions need to made to improve teaching and learning.

This call for productivity and accountability, often under the rubric of efficiency measures, *is the issue of the nineties.*

But what do current funding models look like—what are their strengths and weaknesses? Developed in a highly political environment, most funding mechanisms have a common denominator—equity in funding, meaning similar funding for a like numbers of students.

This equity-model has been very successful to the extent that increasing numbers of students have been accommodated within the system. Previous financial incentives embedded in enrollment-driven formula models, as well as other techniques that recognize and reward growth, have produced results. Today, however, the emphasis is shifting from access to quality, and higher education is under fire for not addressing the qualitative aspects of productivity, cost and accountability.

This call for productivity and accountability, often under the rubric of *efficiency measures*, is the issue of the nineties. Up to this point, most state formula models have been based on financial accounting categories for expenditures—instruction, research, student services, maintenance and operation of physical plant or administration. Campuses usually have not been required to expend funds as they are allocated, and the resemblance of expenditure to funding allocations is often coincidental. Accountability has been slight or non-existent, in part because states have not usually reviewed expenditure patterns except globally or to deal with issues of special interest.

No consistent effort to tie funding to state priorities has taken place either. In the past, most state allocations usually have had little relationship to state goals, although this has been changing in the last decade with some states using funding approaches to address state needs. In those states that do use funding in this way, approaches such as targeting resources to specific program activities or purposes have frequently been blended with formula, incremental or across-the-board funding methods.

Given legislative interest in reexamining funding policies, the key question is where the authority will rest in coordination and governance decisions affecting higher education. Will it rest with the campuses themselves or will the states determine how resources are spent?

On the surface, state formulas may appear to be powerful tools in shaping a particular discussion. But state funding allocations usually have little relationship to institutional expenditure patterns. Because states treat all campuses

similarly, funding policies create a highly competitive environment in which change becomes difficult. Once a pattern is set, change upsets the status quo and thus is perceived as creating winners and losers. Since winning or losing is relative and everyone cannot win the goal becomes consensus. At that point, the debate shifts from education policy and the financial incentives that support it, to facing financial reality with its potential net gains or losses in "sharing the pie." In this context, funding mechanisms more often provide a convenient excuse for avoiding issues rather than an avenue for addressing them. Funding approaches are also not well understood by the public or even by most people in higher education, from either a technical or policy perspective. State officials who use and develop them have not, or only lately have, attempted to connect these policies to higher education's basic purpose—student learning and mastery.

Because higher education has moved slowly in changing its policies, the widespread perception is that current policies are obsolete and non-responsive to productivity, state and national fiscal realities and education goals. Higher education is, in fact, sometimes compared with the health care industry as the next crisis in public finance. It remains to be seen who will take primary responsibility for averting this situation. Will Washington be the source of resolution? Will it be the governors? Will it be the state legislatures? Or—preferably–will it be higher education itself?

If higher education is to take the lead, institutions must work with their states to rethink

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funding systems—to redesign them from being accounting-driven to value-driven. In this way states can better align values and rewards through linking funding to success, and institutions can manage their resources more effectively. By taking cues from what is already known, higher education leaders can retool policies to add substance, promote learning and open up and demystify the funding process. Rather than nibbling at the edges, if a state begins with a clean funding slate, exploring the basic philosophy, principles and vision behind higher education, funding can be an exciting challenge.

VALUE-DRIVEN PHILOSOPHY AND PRINCIPLES

As this work begins, it is important to keep in mind the six basic principles that underlie the process for rethinking the higher education funding process.

Thinking and funding for the future means looking forward and being farsighted. It first requires institutions and states to ***connect all funding policies to state and national needs.***

Principle #1: Think and Fund for the Future

Thinking and funding for the future means looking forward and being farsighted. It first requires institutions and states to **connect all funding policies to state and national needs.** Within the current national climate, higher education officials can improve the likelihood of successful funding if they focus on the long-term needs of the state and the institution and if they tie funding to these goals.

Each state's higher education master plan, with its educational missions, goals and objectives, can serve as the vehicle and essential foundation for a new funding system. Usually developed in concert with lay board members, campus officials, business and industry and other citizens with interest in higher education, master plans can propel higher education to higher levels of achievement and public trust.

In the past, plans and goals have been at best peripheral, rather than integral, to funding. Powerful goal directions that align campus goals with the public agenda can be a solid foundation for financial allocations—with each funding component tied to a realistic, measurable objective.

The second step in redesigning the funding process is to **focus on rewarding improvement.** Each state wants an improved education system for the future and cannot afford poor quality education on any campus. Why not change the current system to recognize educational improvements?

Current funding policies have created interinstitutional competition for more students, more programs and more and bigger physical plants. These policies, by consequence, have done little to focus on improvement. Since it is in the state's interest for each institution to progress, why not encourage educational improvement to be continuous and institution-specific? A single institution can be encouraged to better its performance by competing with itself to meet state needs within its own unique area of expertise. This approach promotes fairness and equity within the funding framework by introducing a level playing field upon which all institutions can compete and succeed. By focusing on improvements for all campuses, states encourage all to improve. What is needed, then, is a sustained commitment to improvement.

The third step is to **add stability to the funding process by extending funding**

beyond one year. If a state's intent is to invest in the future by changing instruction and learning, it makes sense to measure and fund campuses over a longer time frame.

Few real changes in teaching can be realized in a single year. Multi-year "contracts" between states and campuses, on the other hand, may encourage higher education institutions to innovate and concentrate more on the teaching mission. Stability in funding might also encourage faculty and institutions to try innovative new teaching or delivery approaches that use technology, more interactive learning processes and outcome-based education programs. States should treat these experiments as basic research, that is, expect, allow for and learn from mistakes, as well as successes.

The fourth step is to **protect capital investments.** Most states and campuses do not treat their capital asset portfolio or equipment and technology resources with the same seriousness as they do equity and bond investments. While financial accounting standards require private institutions to depreciate facilities and establish capital reserve accounts, these practices are not in place in the public sector, and many states, in consequence, face significant requirements to sustain facilities. To protect higher education's largest fiscal asset, "funded-depreciation" reserve accounts should be built into the operating fund system. A major accomplishment would be a percentage factor combined with bonded or other support, with funds dedicated exclusively to this purpose.

[K-12 and higher education] appear to be in separate vehicles that pass one another or occasionally collide.

Principle #2: Create New, More Cooperative Funding Partnerships

The artificial lines used in budgeting are like state boundaries: they frequently interfere with the good of the community. Higher education needs to erase existing funding boundaries and instead create performance partnerships between higher education and K-12; between higher education and other public services, business and industry; among higher education institutions; within the campuses themselves; and between the capital and operating budgets.

Fund "K through life"

In most states, higher education and K-12 schools do not have a constructive relationship built upon meaningful shared policies and goals. John Bragg, chairman of the Tennessee House Finance, Ways, and Means Committee once described this separateness by asking the

Through performance partnerships, states can substitute "competition for student learning success" for "competition for limited resources."

following questions: "Are K-12 and Higher Education in the same car going down the same road? Why do we talk about K-12 and Higher Education rather than K through Life?"

The objectives for schools, campuses, other public services and businesses are the same—a high quality, competitive education and economy—yet we frequently appear to be in separate vehicles that pass one another or occasionally collide. It is possible that by creating new funding perimeters, shared destinations can be reached sooner, at a higher quality level and with less cost.

In most states, the current funding system has high school principals working hard to graduate students—with no consequences, rewards or sanctions based on how well their students do in college or in the work force. At the college level, funding methods encourage college presidents to work hard to enroll students—also with no consequences, sanctions or rewards based on how well students are prepared, or even whether they complete their education. Modifying funding policies so that a portion of the funding of each school system and of each college and university is based on performance improvements in joint efforts could result in real learning gains.

Higher education has the capacity to work effectively with school systems through teacher education programs that include internships with neighboring school systems or through teaching schools modeled after teaching hospitals. Common ground exists in curriculum content, teaching strategies, learning styles and student mastery. If students are to succeed, a better job must be done, preferably in high school or earlier, to help them understand their intellectual capacity and interests.

With few exceptions, funding for higher education and K-12 is separate; both sectors must, therefore, compete for the same limited state dollars. With few incentives for the two to work together, issues such as remedial and developmental education or teacher training and retraining in areas such as mathematics, science and reading education are seldom addressed collaboratively. The competitive funding environment also inhibits cooperation in other matters of substantial state interest. By basing a portion of the higher education and K-12 budgets on their mutual success in achieving certain common, agreed-upon goals, states could establish a refined framework for success. Funding policies that reward both colleges and schools for improvements—such as the college

participation rate of students from certain underserved areas, or reducing the percentage of students entering college who require remedial education—would create a budgetary culture of interdependency.

Decrease competition within higher education

Competition for funds is as fierce among higher education institutions as it is between higher education and K-12. Through performance partnerships, states can substitute "competition for student learning success" for "competition for limited resources." For example, most states have established articulation goals from two- to four-year institutions, yet few funding strategies recognize these goals. A better alignment of values and rewards can occur if a portion of each four-year and two-year campus state funding is contingent on success in accomplishing improvements or reaching certain common, agreed-upon goals, such as improved transfer rates.

Competition and separateness also exist between the public and independent higher-education sectors. Many states support the independent sector through grants to students or direct grants to institutions. A financing model with performance partnerships between the public and independent sectors might result in more effective instruction.

Align campus departments

By substituting broader goals for allocations that emphasize narrow accounting expenditure, activity-centered or departmental categories, campuses can focus more on educational matters. Campus leaders are best qualified to decide the purpose for which funds should be spent. But to assure the most effective use of resources, they need the flexibility to roll over resources from year to year.

Funding policies that reward both colleges and schools for improvements—such as the college participation rate of students from certain underserved areas, or reducing the percentage of students entering college who require remedial education—would create a budgetary culture of interdependency.

Even more important, campuses need autonomy to manage their affairs. States should avoid intervening in academic and fiscal management and should move away from using such cost measures as student-faculty ratios to calculate or determine instructional spending. If student learning or service-orientation is the highest goal, then rewards need to be tailored toward success in these areas.

If strengthening management is the goal, categories such as *administration* should move from explicit funding categories into ones with incentives provided for demonstrated manage-

If student learning or service-orientation is the highest goal, then rewards need to be tailored toward success in these areas.

ment success. If state funding models provide incentives for team-building across departmental lines, grouping faculty by output or on a customer basis, campus organization may become more fluid and adaptable to external environmental changes.

Cooperate to minimize capital outlays

The two costliest components of higher education are instruction and facilities. Frequently, the two are neither related nor cost-effective. For example, the more spacious the campus, the more the liability it incurs. Space requires cleaning, heating, cooling and repair, meaning fewer resources available to support teaching.

Campuses could improve their quality and efficiency and cut costs at the same time by either reducing space or providing classes in underused K-12 facilities or public-library space in the evening. By relating operating and capital activities and providing incentives for efficiencies in areas such as utilization of space, therefore, states can create new funding models that promote productivity.

Principle #3: Promote Campus Choice

True learning improvements will occur only if embraced by people on the front line—students, faculty and administrators. Yet current funding systems and mechanisms are external in both adoption and application. If change is to be real and positive, therefore, external forces, including states, cannot force campuses to improve teaching and learning. Instead, they can effect change on campus through other means.

Encourage campuses to focus and become centers of excellence

Standardization is a common theme in current funding policies. However, a "thermostat," or direction-setting approach, can be far more effective in achieving state and institutional goals. If measures can be designed to reflect the diversity, cultures and desired distinctiveness of mission among campuses, funding then can be customized to match where campus strengths meet with state needs and goals—a win/win situation.

When faculty and other campus officials select and buy into education goals, teaching is more likely to improve. From the state's perspective, the most important criterion for

focused centers of excellence would be their relationship to student learning needs. By giving campuses choice regarding the goals and objectives by which they are funded, and as long as they are consistent with institutional mission and state needs, state and campus goals can merge and become congruent. This process establishes a dependable method for measuring qualitative achievements.

Campus choice also may result in greater commitment. By publicly indicating desire to achieve improved student learning in certain areas, campuses underscore their pledge to instructional improvement and assure that commitments are communicated to all parties in the learning process.

Encourage campuses to establish tuition within a given range

States that share tuition-setting with campuses should give campuses the choice of setting tuition levels within an index or range, such as 30 to 40 percent of costs. This step toward market-driven pricing could spur innovation as it gives the campuses both flexibility and motivation to experiment with new programs and services.

Principle #4: Make Planned Investments

It is important that funding policies be set in the context of outcomes and future needs. This can be promoted through actions designed to encourage and then recognize institutions for their responsiveness.

If measures can be designed to reflect the diversity, cultures and desired distinctiveness of mission among campuses, funding then can be customized to match where campus strengths meet with state needs and goals—a win/win situation.

Fund planned growth and strengthen equity by adding quality

Central to all education funding systems is the need to support enrollment growth in an equitable manner. States can address comprehensive needs by identifying high-priority geographic, work-force, racial, gender and other issues and then target resources for planned growth in these areas. Funding before-the-fact, rather than after-the-fact represents planned investment. Upfront accountability is essential, with continued support based on both quantitative and qualitative measures.

By adding qualitative factors such as value-added student testing or improvement in freshman retention, states can augment their support of growth through a focus on teaching and improvement.

Promote mission integrity

Spreading resources across-the-board tends to blemish the integrity of institutional mission

If states direct modest incentives to encourage students to become more responsible for their own learning, productivity and mastery may improve.

by diluting resources. States can target resources and encourage institutions to declare program priorities by developing multi-year contracts and focusing resources on a limited number of high priority programs.

Reward responsiveness

By encouraging institutions to respond to work force and educational needs in underserved areas, states can improve the delivery of desperately needed services. Improved educational programs for the underserved, unemployed and underemployed should be a component of each state's funding mechanism.

Principle #5: Encourage Students to Become More Responsible Partners

Most state funding programs are directed toward institutions or programs, yet the most critical factor in learning is individual commitment on the student's part. If states direct modest incentives to encourage students to become more responsible for their own learning, productivity and mastery may improve. Incentives may help a student become a willing learning partner and, in the process, change both individual and institutional behaviors.

One example is the Arkansas Academic Challenge Program. Created in 1991, the program targets Arkansas high school seniors who come from families with incomes of $40,000 or lower (with an additional $5,000 for each child in the family) and have completed the precollegiate core curriculum, achieved a certain grade-point average and ACT score, pledged to remain drug-free, and maintained a B average in school. In recognition of meeting these requirements, students are granted scholarships. This incentive has increased the number of students who take the precollegiate core curriculum by 20 percent in two years. As a result, Arkansas students entering college are better prepared for higher education.

If students who either successfully pass or test-out of college credit courses in high school were to receive either a modest rebate or a pro rata waiver on college tuition, more students would probably take such courses and thus reduce remedial class sections at the collegiate level. Giving students pro rata waivers for taking courses at 7 a.m. or on Saturdays, could also reduce a university's need for capital expansion and capital equipment, again freeing up resources for instruction.

Many other options are also available. If a waiver were to be granted for students receiving video instruction, costs might go down while an institution's ability to meet increasing demands could expand. Fee waivers for summer and spring terms might also result in facilities being used more equitably. Likewise, if universities contracted remedial and developmental education to community colleges, both consumer and state could save. If higher education were to give students a choice regarding how they receive freshman English, this too would result in savings. Perhaps the time is ripe for pricing courses based on cost and value-added measures.

Principle #6: Open Communications

If funding processes are to change, communication must flow between funding agencies, the institutions themselves and the public that supports them. A number of actions can be taken to promote this needed exchange:

Shift the protocol from the state meeting the institution's needs to the college or university meeting the state's needs, and change the budget language from "numbers" to "learning" and "educational achievement"

Rather than centering budget discussions on the number of students enrolled, number of dollars provided and average salary and costs, states should focus on what students have learned and what priority changes are needed. Goal-based funding can change budget discussions from reviewing institutional expenditures

Shift the protocol from the state meeting the institution's needs to the college or university meeting the state's needs, and change the budget language from "numbers" to "learning" and "educational achievement"

to reviewing teaching and learning, evaluating success in meeting state and student needs and attaining educational achievement. Publicizing assessment, accountability and effectiveness builds credibility and support. This makes it an effective way to stress the significance of what higher education does.

Reveal campus selectivity and program focus to the public

States and campuses should inform the consumer of the essence and aspirations of each campus. How selective is the campus in admissions? What are the major program areas? How successful are students in "adding value"? How successful are its graduates?

Publicly stated values and visions build public support and credibility. Ruth Holmberg, chairman of the board of the *Chattanooga Times* and member of the Tennessee Higher Education Commission, spoke directly to un-

By understanding, involving and responding to customers, higher education can improve delivery systems and build new coalitions.

versities when she made the following comment: "If the higher education community does not state its purposes, aims and vision itself, someone else will eventually step in and do it for you . . . it is best done from within . . . you have your dreams and you know your constituencies. Articulate your vision with clarity and imagination and the press is your best ally. We will promote, publicize and editorialize in support of effective higher education. We will endeavor to build both the public support and the financial commitment that such a vision deserves."

Consult customers

Current budgetary design is a top-down solution when students would be better served by a bottom-up or decentralized approach. Why not design funding systems that reward institutions that effectively communicate with students, families, taxpayers, education, business and industry, government, faculty, administrators, board members and political leaders about their needs? By understanding, involving and responding to customers, higher education can improve delivery systems and build new coalitions.

Humanize funding policies

The vision and directions expressed in funding policies are only useful if they inspire students, faculty and other customers. States should personalize funding policies and report with accuracy and integrity how funds are used to help students learn and faculty teach.

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Table 1 shows how these principles might look if applied as clean-slate funding on a campus.

TABLE 1
A Customized Campus Sketch—Clean-Slate Funding

The following outline shows how clean-slate funding might look once it is place within a campus setting.

Funding Linked to Master Plan Goals

Campus discussions and deliberation have taken place and a set of goals established in accordance with state needs and campus mission. Two particular areas have been targeted:

(a) Freshman retention—the state and campus have established a goal of a 15 percent improvement in freshman retention within three years.

(b) General education—the state and campus have established a goal of improving the value added to students in terms of general education to be in the upper 25th percentile.

Planned Improvement Investments–Mission Integrity and Responsiveness

On the basis of multi-year contracts with specific goals, objectives and measurements, the campus and the state have also identified planned investment areas.

The campus has set the goal of enrolling more students from selected counties. Funding is targeted for a certain number of students at a specific funding level. An evaluation component and a qualitative factor are included in the funding.

Performance Partnerships

K-Life Partnerships: The campus has selected a program to improve the mathematics readiness of students in a selected school system by 25 percent within a five-year period. If successful, the school system and higher education institution will receive improvement rewards.

Workforce Training: The campus has selected a program to improve the transfer rate of five feeder two-year colleges by 20 percent within a two-year cycle. The evaluation criteria include a qualitative success factor.

Equipment and Capital Portfolios

Equipment and Capital Portfolios: Based on analysis of long-term requirements, the state has allocated funds to equipment/technology and capital renewal/infrastructure. Although resources must be expended for these purposes, campuses have flexibility within broad guidelines. For example, the campus may allocate an annual amount of 5 percent of the replacement of the physical plant for capital renewal and infrastructure, with the campus itself determining project priority and timing.

Management Competencies

An allocation of funds has been made based on stewardship-goal attainment in such areas as facilities utilization, accounting, and custodial services (where the goal is to provide these services at a rate comparable with the private sector). Those campuses achieving these goals or demonstrating improvement will receive financial reward.

Student Productivity Incentives

The state has selected certain student-productivity incentives designed to give students more choice. There is a new sensitivity to pricing, with lower charges for courses offered at 7:00 a.m., a $100 rebate for students using TV or video instruction and lower fees for the summer term.

REALITY, ROADBLOCKS AND TRANSITION

How these new funding systems are created is vitally important. They may be designed by teams new to higher education. Included may be finance officers, presidents, lay board members, political leaders, chief academic officers, students and faculty—a mix of people who understand both finances and academics. Planning and finance officers, of course, are integral to the process because of their insight into measuring the quality, productivity and cost effectiveness of the institution's performance. Each person on the team will have much to offer.

An overwhelming concern on campus will be the potential effects of the proposed funding-system changes. Since a major premise of the performance-based funding model depends upon taking a long-term view, natural uncertainties concerning future funding must be addressed. This might be done through a combination of new choices:

- creating a funding-base band.
- setting aside a certain percentage of funds for phased-in adjustments to address previously unrecognized inequities.
- setting aside a certain percentage for inflation or salary increases.

All across the nation, policy-makers are sending the same messages to higher education. . . . higher education must produce a better product in real terms with the same amount of money, if not less.

- setting aside a certain percentage for performance measurements to meet priority goals, with some funds earmarked for short-term results and others earmarked for improvements from an institution's baseline.
- establishing multi-year contracts for specific pilot innovations, program reallocations or enhancements.
- granting flexibility for institutions to select agreed-upon priority changes and performance measures; for example, specific programs consistent with institutional mission, collaborative pro grams with K-12 schools and tuition rebates (where state-directed) to achieve measurable objectives.

While it is impossible to find a single state that embraces all these concepts, several states have adopted some. Tennessee, for example,

. . . it is possible to envision higher education funding policies that move away from an accounting-based system with its categories of expenditures toward a value-driven system focusing on student and institutional performance and improvements.

has a multiple-year history of performance funding and centers of excellence. These programs focus on results, incentives, improvements and statewide goals.

Missouri has changed its budgeting system to focus on results, standards and public statements of mission in areas such as admissions. Missouri institutions declare their status as highly competitive, competitive, moderately competitive or open-door.

Arkansas is proposing new guidelines that tie funding to improvements and goals from the statewide master plan, with goal determination based on a consensus-building process involving campus and state leaders.

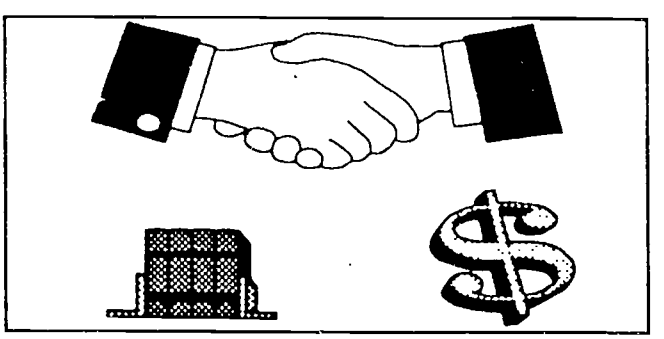
All across the nation, policymakers are sending the same messages to higher education. They are saying that while higher education is valued and appreciated, budget realities have all but eliminated opportunity for significant discretionary budget increases. This comes at a time that global economic competition is creating a growing demand for a well-trained work force. In effect, policymakers are saying that higher education must produce a better product in real terms with the same amount of money, if not less.

Within this context, it is possible to envision higher education funding policies that move away from an accounting-based system with its categories of expenditures toward a value-driven system focusing on student and institutional performance and improvements. It is also possible to envision a fundamental shift in the rhetoric, or protocols, of higher education funding and a non-traditional team at the budget development table. A strong consensus among higher education leaders on appropriate goals is needed, as well as a well-planned and agreed-upon transition that will serve students and taxpayers by increasing in quality and productivity.

LINKING BUDGETING TO ACADEMIC PLANNING: THE WISCONSIN CASE

Kathleen R. Sell
University of Wisconsin System

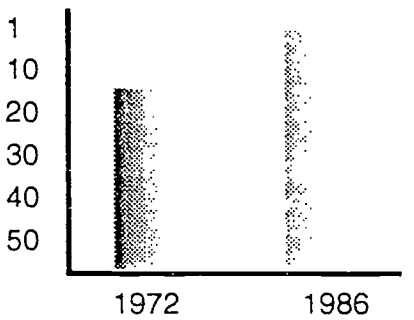
Popular mythology holds that institutions of higher learning seldom examine or reallocate their base funds. The University of Wisconsin System, however, has combined budget and academic planning in efforts to improve instructional quality. While changes within individual institutions are less apparent at the systemwide or state level, annual institutional change in the Wisconsin system has been continuous and increasingly driven by careful institutional strategic plans. What follows is a discussion of Wisconsin's planning structure and the system's programs for linking budget to academic planning.



Wisconsin's system budget has not been based on an enrollment funding formula since the early 1980s. The state abandoned the formula when it resulted in unfundably large figures. Instead, the university system submits a program budget just like any other state agency, asking for standard costs-to-continue (utilities, debt service, fringe benefits, but

FIGURE 1

Wisconsin's National Rank by Percent of State Population Enrolled in Public Higher Education



not inflation for supplies). It then justifies other specific needs such as library-acquisitions funding, laboratory-modernization costs and additional faculty. Compensation is linked to the state pay-plan with additional funding to provide competitive salaries that approach the midpoint in similar markets.

Budget planning and academic planning are joined through the process, participants and policies described in the rest of this chapter. Enrollment management is one example, as is the requirement that all new academic programs identify base resources for their funding in order to receive planning approval from the system. The biennial budget request is developed during monthly meetings between representatives from system offices of budget planning and academic affairs and the chief academic officers (vice chancellors/provosts). Each institution must develop and justify a set of systemwide requests to the state. Other individual institutional initiatives typically must be funded from the base budget.

Funding is allocated to the colleges and universities based on a Composite Support Index (weighted student credit hours for program costs and for four levels of instruction), equity check and minority enrollment and program-based needs-assessments, among others.

As state resources have tightened, the Wisconsin system has begun a series of comprehensive planning efforts to match resources with students and missions. These efforts interlock, and their cumulative effect exceeds the sum of their separate goals. All have one common aim: to target budget resources toward improving the quality of undergraduate education.

INCREASING INSTITUTIONAL COMMITMENT TO INSTRUCTION

Since 1987, then, the Wisconsin system has revamped its budget practice to link budget and academic planning. In the process, four key approaches have been identified to increase institutional commitment to the core mission of instruction. These are enrollment management, base reinvestment, a public-planning dialog, and the undergraduate imperative.

1. Enrollment Management

In 1979, the university system undertook a plan called *Preparing for a Decade of Enrollment Decline*, predicting that by 1986, the system would enroll 137,289 students (head count) and would experience reduced budget growth.

The prediction was half true. By 1985, the system was indeed without proportional fiscal support, but it had enrolled 164,546 students, over 27,000 more than expected (figure 1).

In 1986, the Board of Regents called for a comprehensive strategic planning effort to reexamine institutional missions, program array and sufficiency of resources. The plan noted that Wisconsin had risen from twelfth to second in the nation in percentage of total state population enrolled in public colleges and universities. At the same time, its rank in state support per student had dropped from fourth to thirty-first among the 50 states.

It was clear that increased state support could not be expected, nor would tuition be a major solution in a traditionally low-tuition state. Enrollments were the only factor that could be adjusted to increase support per student. The regents knew the system could not maintain both access and excellence, so they chose improvement in quality as the primary goal.

The resulting set of policies, known as *Planning for the Future*, recommended a four-year enrollment-management plan to reduce enrollments by 7,000 full-time equivalent (FTE) students (from 138,710 to 131,710), a 5 percent drop; a return to the pregrowth student-instructor ratio of 17:1 systemwide; and an increase in support per student. At the same time, to achieve the desired student-staff ratio, the university system requested additional FTE staff from the state.

The regents knew the system could not maintain both access and excellence, so they chose improvement in quality as the primary goal.

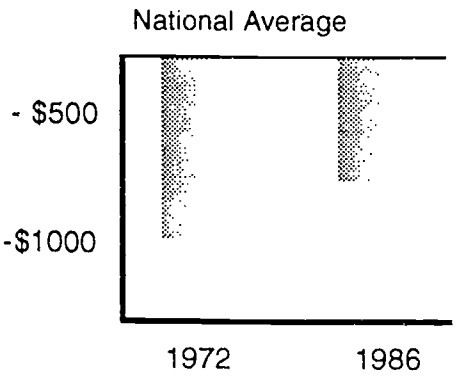
It seemed politically impossible to increase instructional staffing by 400 while the system decreased students by 7,000 FTE. However, regular newspaper photos of students camped in the halls to register and the horror stories of backlogged demand for class sections attracted the sympathy of the Governor and the legislature. The legislature appropriated funding for an additional 321 FTE instructional staff. At the same time, however, the legislature asked for policy improvements to discourage students from dropping out of courses well into the

Recipe for Quality

⇨ Decrease students by 7,000 FTE
⇨ Increase instructional staff by 321 FTE
= 17:1 student to instructional staff ratio

FIGURE 2

Wisconsin's National Rank by State Support per FTE Student



semester, thus denying available slots to others. "Planning for the Future" also called for the university system to begin increasing admissions standards to improve the undergraduate retention rate and protect the state's resulting investment in their education.

Enrollment targets were established by institution, and under Enrollment Management I (1987–91), three four-year institutions and 13 two-year centers were targeted to increase enrollments, chosen for their available fiscal, staffing and space capacity. Increased enrollments in the two-year centers and three comprehensive institutions allowed undergraduates to go where the focus was on excellent undergraduate education (see table 1 for the timeline).

Others that were found to be over-capacity, particularly the doctoral institutions, were able to decline in enrollments, thus assuring that they could better serve their undergraduates.

Was the policy successful? It neared its 17:1 target; state support per FTE student increased from 23 percent below the national average to 14 percent below the national average (figures 2 and 3); and FTE enrollments dropped by 4.1 percent compared to the 5 percent target. Complaints about closed sections and overcrowded classes diminished considerably.

FIGURE 3

Enrollment Management I Scorechart

	Before	After
Student:Instructional Staff Ratio	18:9	17:1
State $ per FTE Student Below National Average	-$1,000	-$758
Percent of State Support Per FTE Student Below National Average	-23%	-14%

In 1991–95, Enrollment Management II was instituted to take advantage of a decline in the high school graduation cohort. Targets were based on that decline, allowing a further increase in support per student without a proportional decrease in access. It was hoped that by the end of Enrollment Management II, the national average in support per student would be reached, in part because of the planned enrollment decline and in part because of declining fiscal support for universities in other states.

Enrollment Management II called for resources to be transferred temporarily from instructional salary bases to underfunded undergraduate instructional support (computers, laboratory modernization, classroom modernization, library acquisitions and automation support, instructional supplies, *etc.*). Institutions were asked to maintain the 17:1 ratio and then apply any unused salary funding to one-time needs. If projected enrollments materialize between 1995–2000, these resources and instructional positions can revert to accommodate additional enrollment demand.

Current assessment of enrollment

Management II suggests that the two phases of enrollment management have enabled the system to avoid the kinds of drastic ups and downs in enrollment, class size and funding occurring in other states (see Edward Hines' *State Higher Education Appropriations 1993–94* and also Elaine El-Khawas' *Campus Trends*). By planning ahead, taking advantage of natural demographic trends and enlisting the state's partnership in increasing the number of instructional staff while decreasing FTE enrollments, Wisconsin has avoided what Hines describes bleakly as "tuition increases, increased class sizes, fewer course sections, hiring freezes and spending reductions on libraries and construction."

2. Quality Reinvestment Program and Other **Base-Reinvestment Strategies**

The University of Wisconsin system uses base funding whenever possible to fund its

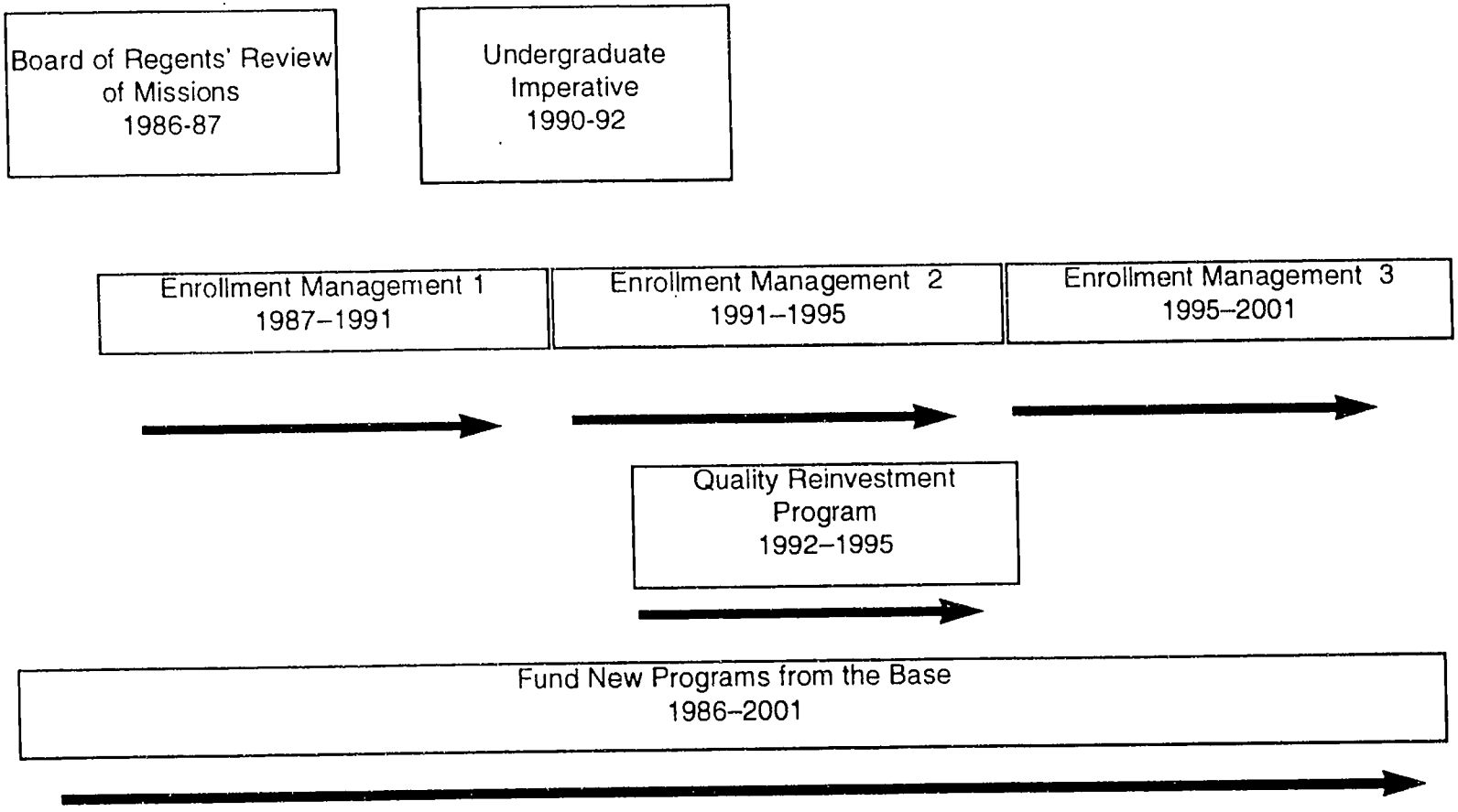
. . . the two phases of enrollment management have enabled the system to avoid the kinds of drastic ups and downs in enrollment, class size and funding occurring in other states. . . .

major priorities. For instance, it has a unique policy for the funding of new academic programs. Institutional base budgets are required to pay for all new degree programs through the elimination of other, lower-enrollment programs or by reallocation from other activities such as administration. Other institution-specific priorities are base-funded.

As enrollment-management planning proceeded, however, Wisconsin's Board of Regents became concerned over a potential credibility gap between the university and the legislature. The concern was that major university budget requests were always labeled "urgent." Yet when full funding was not obtained, the system did not necessarily reallocate from the base for those same priorities. This led the state legislature to become increasingly skeptical about the urgency of those requests.

There was also some question as to whether the university would be able to reallocate internally and be able to retain dollars saved by enrollment management. The possibility existed that these funds would be removed from the

TABLE 1
University of Wisconsin Timeline



base if important existing instructional needs could not be clearly identified.

As a result, the 1991–93 biennial budget request included a commitment on the University's part to use Enrollment Management II savings to finance any unfunded portion of the system's priority budget requests for improved instructional quality, a strategy that proved successful. By the end of the state budget process, the legislature had left $26 million in unfunded priorities for the university system. Thus was born the *Quality Reinvestment Program* or QRP (figure 4).

Many of the original undergraduate instruction-related needs identified in the regents' issues of the '90s matched the unfunded priorities (or QRP). The budget requests, however, were for an increment of the unmet need; the base dollars were to be for a further increment.

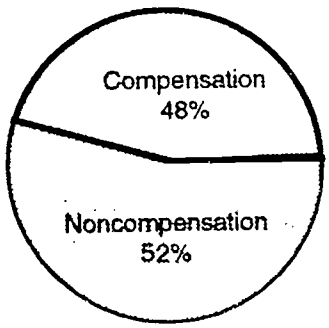
The QRP's initial year involved far more internal consternation than outside question or comment. Faculty and staff were concerned about a "system mandate" to reallocate base funds for "generic purposes."

The QRP's initial year involved far more internal consternation than outside question or comment. Faculty and staff were concerned about a "system mandate" to reallocate base funds for "generic purposes." The size of the reallocation, reaching an annual $26 million by the third and final year (1994–95), also was a concern. The strategy of agreeing to reallocate the base to fund whatever the state did not

FIGURE 4
Original and Unfunded QRP Needs

Original QRP Undergraduate Needs	Unfunded Budget QRP Needs
1. Library needs (acquisitions, *etc.*)	1. Library needs (acquisitions, *etc.*)
2. General computer access	2. General computer access
3. Supplies and expenses	3. Supplies and expenses
4. Instructional laboratory modernization	4. Instructional laboratory modernization
5. Faculty/staff compensation	5. Faculty/staff compensation
6. Assessment	6. Assessment
7. Physical-plant staffing	7. Professional development
8. Program renewal (engineering, teacher education, minority/disadvantaged programs, student services, economic development)	8. Outreach needs

FIGURE 5
Quality Reinvestment
1992–1995



finance was seen as a dangerous budget strategy. It was also pointed out that about half of the reallocation went to salaries and was, therefore, staying right in the institutional base (figure 5).

Legislators were more accepting, and some even went with system and campus administrators to address faculty and staff senates, saying that reallocation was one of the few ways to continue improving faculty salaries compared with national peers (even after QRP, it is projected that the system will be a few percentage points below the mid-point of the respective institutional and cluster peer groups).

So well established was the idea that by the time the state asked for submission of an annual plan showing how the reallocations would occur by institution and by category, along with the number of FTE position vacancies, neither the first nor the second year's plans even drew a legislative hearing in response.

But not all went smoothly. After de facto acceptance of the second-year plan, the legislature's Joint Finance Committee suddenly passed a motion to use half of the QRP base funds (the non-compensation share) as part of a biennial-budget strategy during its review of the 1993–95 biennial budget. By the spring of 1993, it seemed that all commitments might be overturned.

Why did this occur? Interestingly, this turnabout was linked to the university system's effort to include the legislature in its public planning dialogue for Enrollment Management III.

3. The Public Planning Dialogue

Phases I and II had been planned internally by the system and campus administrations and then presented to the Board of Regents for approval as a coherent policy. In fall 1992, however, the system began a *public planning dialogue* slated to take place at the monthly Board of Regents' meetings through February 1994.

Public dialogue well in advance of a new plan entails risks as well as benefits. Public discussion regarding whether to increase the number of entering students in the 1995–97 biennium, for example, had affected the legislature's 1993–95 deliberations.

During the budget session, the legislative Joint Finance Committee concluded that a good

solution for 1995–97 enrollment increases would be to earmark some of the QRP dollars toward increasing access. These were the funds already committed for unfunded needs from the prior biennial budget. If they were substituted for new funds for "upsizing," the planning commitment not to remove QRP base funds would have been broken and larger budget requests for QRP needs would have materialized in future biennia. Strategic planning that identifies resources in the base for other priorities would also have been strongly discouraged.

Fortunately, the system was able to get the full legislature to eliminate the take-back of QRP funds when the final budget was passed. Many of the same legislators had, in fact, helped to sell QRP to campuses with system officers two years earlier. They were able to explain that the QRP strategy assured institutions they could keep their base savings from Enrollment Management II if they used them to fund QRP priorities. They also explained that setting aside QRP funds for enrollment increases would result in higher future requests for libraries, computers, laboratories and other QRP categories, including specific compensation commitments in this budget, which faculty and staff expected over the next two years.

In the end, Enrollment Management II discussion was able to return to its assumption that vacant positions from QRP would be available for upsizing, but that dollars must be found other than in the QRP funds themselves, which were to be dedicated to crucial ongoing needs.

. . . the process has continued to be public, thorough and inclusive, inviting testimony from interested internal and external constituents.

Despite this complication, the process has continued to be public, thorough and inclusive, inviting testimony from interested internal and external constituents. Some planning sessions still occur jointly with interested legislators at the state capitol.

At the same time that the 1993–95 budget was being discussed, a Legislative Audit Bureau report criticizing trends in faculty workload was released. While newspaper editorial pages supported university rebuttals of the analysis as selective use of data, faculty productivity was clearly an issue in Wisconsin, as in the rest of the nation. The issue, therefore, has been discussed throughout the planning process for Enrollment Management III.

In this light, some accommodation to increased demand for access seems likely. This may well include increased faculty productivity and other base reallocation expectations or increases in efficiency. Among this year's plan-

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ning papers is one that looks at a partnership between the board/system and institutions in reviewing future program planning, including considerations of program array, cooperative and/or regionalized programs and a look at future workforce demand compared to specialties of graduating students.

A number of major policy questions raised in the public dialogue have raised significant debate. Should, for example, the university system continue to draw the same percentage of high school graduates, or should it—in its partnership with the state's postsecondary vocational school system or technical preparation programs in the high schools—encourage a greater percentage of students to go into vocational programs directed at future jobs (health care, computer repair and maintenance, etc.)? Those believing the latter point out that the U.S. stands at or near the top in the proportion of young adults enrolled in higher education (Clotfelter et al., 1991).

Another policy question concerns whether state funds should be concentrated on students most likely to complete their education. Continuing to raise admission standards would accomplish this, but legislators objected that such action would risk creating what one described as a system "headed toward educational Darwinism."

Increasing class sizes is another topic of discussion. But enlarging average class enrollment would reverse the deliberate reductions in overcrowding accomplished by Enrollment Management I & II.

Consolidating programs regionally has also been proposed, that is, moving students to institutions with available space. (It has even been suggested that three approximately adjacent institutions in western Wisconsin consolidate their administrations.) For medium and larger comprehensive institutions located within an hour or two of one another, an alternative solution may be to regionalize certain programs, especially at the master's level.

Some have suggested that tuition be increased for out-of-state, professional-program and graduate students in order to maximize access at an affordable cost for lower-income students. As it has turned out, this option may be part of the final equation.

The program array at smaller institutions has also come under scrutiny. Some have asked whether broad offerings can be continued and

justified in terms of graduates per faculty member. Decreasing offerings must be approached with caution, however, for if the Wisconsin system is to recruit additional students, reducing the current program array may make the institution less attractive.

Obviously, these policy questions have created lively debate. Student groups have expressed concern that the first two phases of enrollment management essentially reduced enrollment and limited access, particularly for place-bound minority students from poor school districts. But regents and system officers have raised the counter-concern that access to an overburdened system is no bargain and is, in fact, "bogus access."

Preparation for significant policy changes requires considerable dialog between system and institutional officers, and the papers subsequently presented to the regents result from this joint planning. As the multiple budget and academic policy proposals move somewhat simultaneously forward, integration of budget and academic planning must function effectively.

For instance, what are the consequences if graduate tuition is increased for professional programs? For one thing, the professions might become less attractive to qualified minority and lower-income students. And the university might fall short of meeting the need for ongoing training for professional certification if tuition is higher than they can afford or beyond what employers are willing to reimburse. Overpricing might also create a market for proprietary continuing-education programs.

Student groups have expressed concern that the first two phases of enrollment management essentially reduced enrollment and limited access. . . . But regents and system officers have raised the counter-concern that access to an overburdened system is no bargain and is, in fact, "bogus access."

4. Undergraduate Imperative

The real goal of enrollment management is improving the quality of undergraduate education. Specific goals for undergraduate educational improvement were developed through a comprehensive board initiative known as the *Undergraduate Imperative*. In a year-long study of undergraduate education in 1991, the regents held hearings at institutions across the system, asking students, staff, faculty and community members to identify deficiencies and redundancies in current undergraduate education. The Board immersed itself in the national literature on undergraduate education reform. It also reviewed each institution's mission in tandem with a similar campus review and made some modifications.

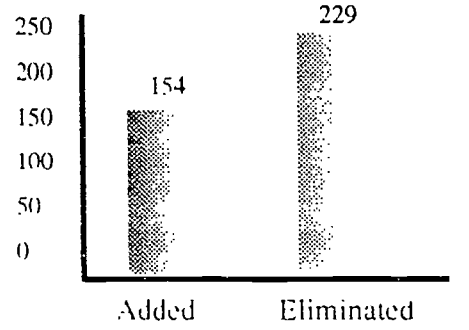
The board report called for action on nearly two dozen major initiatives and mandated ongoing progress reports for each of the goals.

TABLE 2

Undergraduate Imperative	
Initiative	Funding Source: New Dollars or Base
1. Teaching assistant training and English language proficiency	New dollars requested but denied. Initiatives under way from base
2. General education	New dollars requested and denied. Using base funding
3. Requirements in major	Using base funding
4. Systemwide and institutional program array	To be determined after self-study
5. Joint national/state review of teacher education (at participating institutions)	Using base funding
6. Integrated course work in Math, Science and Social Studies	Using base funding
7. Addressing shortages of minority faculty members and students	No new funding received, except for targeted minority/disadvantaged financial aid inflationary increases. Continued base funding and Board mandate to maintain existing M/D program funds
8. Bill of student rights and responsibilities	Drafted using base resources
9. Academic advising	Requested and received new funds; also using base resources
10. Orientation, out-of-class activities, and career advising and counseling	Chancellors considered but rejected making a request for new funds; activities are being base-funded
11. Tailoring student services to suit student constituencies	Using base funding
12. Evaluating teaching and using results	Using base funding
13. Improving opportunities for faculty and staff development	Requested, but did not receive new funding; continuing to use base
14. Post-tenure review	Part of request not funded in #13 above. Implementation through base resources is now proceeding
15. Payment to cooperating teachers	Not applicable
16. School physical therapists	None at this time
17. Articulation/communication	Using base resources
18. Academic calendar	Using base resources
19. Admissions standards	Using base resources
20. Internationalizing curriculum and improving international study	Using base funding

Major policy goals included revising general education programs more frequently and comprehensively in order to build a coherent curriculum requiring more stringent review of specialized undergraduate programs and their length of time to degree (see table 2 and figure 6).

FIGURE 6
Academic Programs Added and Eliminated 1974–1992



SUMMARY

Wisconsin's university system does not generate its state funding through an enrollment funding formula. Instead, Wisconsin prefers to stress quality, refocus the base budget toward effective undergraduate education and incorporate continuous quality improvement practices or strategic planning principles into higher education. In this way, the university seeks to demonstrate system responsibility.

The Wisconsin system proposes that its effectiveness be measured by outcomes. It is in the process of working with a gubernatorial commission on accountability to design measures that would result in an annual or biennial report card. In return, the system is asking for increased management flexibility to allow it to plan for balanced quality and access wherever possible, but with primary emphasis on undergraduate education when funding is tight.

The Wisconsin system thus accepts responsibility with its partner, the state government, to target base budget resources toward undergraduate educational quality through a number of carefully calibrated policy tools:

- Use of enrollment management policies.
- Integration of those policies with those designed to pool tuition revenue to minimize enrollment-reduction effects on remaining students' tuition.
- Reinvestment of the base budget through the systemwide Quality Reinvestment Program.
- Focusing of institutional funds through the requirement to fund all new academic programs through the base.
- Examination of faculty productivity, program array and re-tooling of tuition policy to consider increasing graduate, professional, non-resident and other fees. These fees would represent a larger percentage of program cost, thereby releasing more state funds to subsidize improved undergraduate educational quality and, possibly, increased undergraduate access.

This budget and academic-planning approach focuses resources most effectively by

This planning approach fits well with recent literature in higher-education budgeting. In fact, it anticipates some of the most common recent criticisms of higher education budgeting, including the lack of base reallocation for top priorities.

comprehensive reviews such as the Undergraduate Imperative; ongoing updates on progress in meeting specific goals of that plan; and systemwide, comprehensive lateral reviews of specific degree programs. Resources are allocated to institutions based on multiple factors, including a per-student funding equity check known as the Composite Support Index (CSI), which weights student credit-hour production by level of instruction (freshmen-sophomore through doctoral) and by cost of discipline groups (from humanities through clinical health sciences). Qualitative and quantitative measures are correspondingly assessed.

This planning approach fits well with recent literature in higher-education budgeting. In fact, it anticipates some of the most common recent criticisms of higher education budgeting, including the lack of base reallocation for top priorities.

In his review of higher education finance and management literature, John Waggaman concludes that a number of "common themes in the reports" provide the principles for an appropriate strategy:

> First is to clarify the mission of the institution, then set priorities among the programs. . . . Strategic planning with a clear focus on both the external environment and internal operations is necessary. . . . These strategies should be in place before the next fiscal emergency.

In a recent study of state budgeting for higher education, Daniel Layzell and Jan Lyddon also emphasize the importance of planning:

> These concepts [costs, productivity and quality] are seen as inextricably linked. Costs of higher education are increasing rapidly as a result of a number of factors, including the lack of internal constraints on resources and the propensity of colleges and universities to grow rather than reallocate to meet needs. At the same time, little agreement on measures of outcomes leaves state policy makers concerned about productivity, or the lack of it, in higher education. Even more troublesome has been the goal of maintaining quality in higher education. In an effort to enhance quality, several states have devised incentive funding programs in areas such as undergraduate education and research. It remains clear, however, that the key to keeping costs down and productivity up, while maintaining quality in higher education, lies in the ability to formulate specific goals, exercise constraints on resources and encourage innovation.

The combined budget and academic planning policies of the Wisconsin system since the mid-1980s take that approach to enhancing

undergraduate educational quality and will continue to do so in the comprehensive plan for Enrollment Management III—with its productivity, tuition and academic program review policies—through the year 2000.

IMPLICATIONS

In approaching the topic of funding for higher education, this paper has addressed the question of how state financing and enrollment management policies can be modified to effect the distribution of resources across institutions and sectors toward the objective of improved effectiveness of teaching and learning. A key focus has been the suggestion of techniques that encourage targeting of base funds toward undergraduate educational improvement.

Dennis Jones, president of the National Center for Higher Education Management Systems, has identified two common approaches to accomplish this: the use of incentive funding and the use of state regulation. But both rely on the state as the catalyst, when the responsibility should rest with the universities themselves.

Statewide higher education systems are in a better position, perhaps, than single institutions to initiate proactive planning efforts without state incentives (which will be increasingly unavailable in the fiscal environment of the '90s) or disincentives (which inhibit the kind of creative base-budgeting flexibility required to accomplish these ends). Multi-institutional systems with multiple missions can target enrollment growth of undergraduates to appropriate institutions. They also can shape their own budget request and budget allocation approaches to emphasize priorities and ensure equitable support per student.

Wisconsin prefers to stress quality, refocus the base budget toward effective undergraduate education and incorporate continuous quality improvement practices on strategic planning principles . . .

The University of Wisconsin System's experience suggests that the following principles provide an effective approach:

- Link academic planning with budget planning. Work early and often with institutional academic leadership throughout all budget and academic policy development.

- Approach the state as a unified system, not as a set of individual and competitive entrepreneurs. To ensure continued unity, internal budget allocations must be equitable with institutions given maximum flexibility to manage their own base funds.

[incentive funding and the use of state regulation are] two common approaches . . . but both rely on the state as the catalyst, when the responsibility should rest with the universities themselves.

• Expect that institutions will carry out priorities with their own base funds, rather than rewarding this action as exceptional behavior through the use of incentive funding.

• Encourage efficiency and responsiveness to "customers" by requiring that all new academic programs be funded from the institutional base through modification or elimination of existing lower-demand programs.

• Put in place comprehensive, quality-driven enrollment management policies and centrally reserve any excess fee revenue. This will discourage exceeding targets and will pay for the tuition effect of declining enrollments on the fee base for remaining students.

• Review undergraduate education comprehensively and publicly. Institute concrete improvement goals and require each institution to provide an annual accountability report to the governing board.

• Avoid basing state-funding results on enrollment formulas. States never can fully fund rapid growth. The approach encourages overcrowding and diminished quality as institutions admit too many students in pursuit of marginal funding increases.

• Request new state funds for systemwide priorities and fund institutional priorities from the base.

• Establish tuition policies that maximize the use of state funds to subsidize undergraduate education and pass a larger share of costs to professional and graduate students.

• Plan publicly and be concrete about objectives and commitments. Begin by ensuring the state's commitment in the partnership and remind state officials of their part of the bargain throughout policy implementation.

• Employ such tools for state partnership as gubernatorial/legislative task forces, inclusion of policies along with budget submissions and joint public hearings during policy development with the board and key legislators

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AN ATTEMPT TO IMPLEMENT PERFORMANCE-BASED FUNDING IN TEXAS HIGHER EDUCATION: A CASE STUDY

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Texas Senate

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In 1991, the Texas Legislature began a reform movement designed to modify the process by which state funds were allocated, streamline the appropriations review process and provide greater accountability. This reform process was supported by efforts from the Governor's Office, Lieutenant Governor's Office, individual legislators, and Legislative Budget Board (LBB). Institutions of higher education were affected by these proposed reforms because performance-based funding was to be used to allocate future state dollars to them in 1993.

REFORM INITIATIVES

The development of performance-based funding involved a series of statewide legislative initiatives. House Bill 2009, passed by the Legislature, required state agencies to submit six-year strategic plans to the Governor's Office and the LBB. Agency strategic plans included mission statements, goals and objective statements; measures of out-

Some legislators were skeptical of performance funding. [One senator] stated upfront, "Performance funding is dead."

put and outcome; identification of service populations and analysis of agency resources in meeting needs; and plans and strategies for meeting the needs of service populations. These plans were to be used to establish performance measures and to identify the outcomes that institutions of higher education should pursue.

Reform was also present in the General Appropriations Act of 1991. For the first time, the Texas Higher Education Coordinating Board (THECB) was charged with developing a proposal for performance-based funding (PBF) for Texas' health-related higher-education institutions. The specific charge was worded as follows:

> The Legislature finds it in the best interest of the State to adopt a funding policy for health-related institutions which reflects an interest in outcomes and incentives. Accordingly, the Legislature instructs the Texas Higher Education Coordinating Board to develop and implement a distribution of state aid in fiscal year 1993 called performance State Aid (General Appropriations Act of 1991).

In addition, performance categories were identified for four-year institutions. Institutions could access state aid upon certification by the THECB that performance levels had been met in these categories. The performance levels were not established by the Legislature, however, but were to be developed during the interim before the next legislative session. Over the next two years, performance-based funding plans were developed for all types of institutions of higher education, including health-related institutions, universities and community colleges.

Following the 1991 legislative session, the Lieutenant Governor and Speaker of the House of Representatives appointed agency directors, members of the legislature and staff members to the Inter-Agency Performance Budgeting Panel. This panel reviewed and streamlined legislative appropriations and reviewed the process by which state dollars were distributed. Additionally, the committee reviewed performance-funding proposals, some of which focused on higher education. These three initiatives provided the groundwork for the development of the performance-based funding plans that were to be developed during the interim.

THE ROLE AND RESPONSE OF LEGISLATORS, AGENCIES, AND INSTITUTIONS

Legislators and state agencies played important roles in the implementation of PBF. One such legislator was a member of the House of Representatives, the House Appropriations Committee and the Legislative Budget Board (LBB). The LBB, composed of ten members of the House and Senate in addition to the Lieutenant Governor and the Speaker of the House of Representatives, is the budget authority for the state and develops funding policy for all state agencies. As a result of this member's influence, the Legislative Budget Office (LBO), which provides staff support to the LBB, became an active member in the development of PBF proposals and the determination of performance indices.

Some legislators, however, were skeptical of performance funding. In May 1992, Senator Parker, chair of the Senate Education Committee and the Joint Select Committee on Higher Education, who also served on the Senate Finance Committee and the LBB, stated upfront, "Performance funding is dead" (*Comments before the Joint Select Committee on Higher Education*). Although this senator chose to voice his concern over PBF, most members of both houses remained silent on the issue.

As a result of the diversity and size of the Texas system, institutions responded to to PBF

Institutions with sophisticated lobbying forces began to collect information in an attempt to shape the PBF proposals, while others adopted a wait and see approach.

in various ways. The Texas system of higher education includes a large number of disparate institutions: 35 universities, 49 community college districts with 67 campuses, seven medical-or-health related institutions and the Texas State Technical College System, which has four components. According to the THECB, these institutions served 811,000 students in 1991 (*Fiscal Year 1992 Statistical Report: Texas Higher Education Coordinating Board*). Institutions with sophisticated lobbying forces began to collect information in an attempt to shape the PBF proposals, while others adopted a wait and see approach. The most common response, however, was one of concern, with an accompanying sense of inevitability.

THE DEVELOPMENT PROCESS

Although not by design, different approaches were used to develop performance-based funding schemes for health-related institutions,

All of the plans placed a relatively high level of emphasis on success in enrolling and graduating additional minority students—a high priority among all sectors of Texas higher education

universities and community colleges. In response to the charge to the THECB to develop a performance- funding proposal for health-related institutions, the Commissioner of Higher Edu-cation appointed a committee, chaired by the president of one of the state's health-science centers and consisting of high level administrators from each of the health-related institutions.

Meeting at each health-science center, the committee provided opportunities for input from interested parties. This committee developed its proposal through a methodical, almost scientific examination of the issues related to performance funding while seeking regular feedback from institutions. Committee meetings totalled well over 80 hours in length. Consequently, the plan developed by this committee was the most comprehensive and detailed. The committee's recommendation was endorsed by the chief executive officers of all the health science centers and adopted without change by the THECB.

An important factor in this committee's approach was the leadership provided by the chair. This individual provided much of the vision for the proposal. As a result, the performance-funding proposal for health-related institutions was closely tied to an individual proponent. Neither of the other two proposals was so closely associated with a single individual's leadership.

The staff of the THECB, with significant amount of input from external sources, developed the performance-based funding proposal for universities. However, before the staff began their work, the Commis-sioner of Higher Education appointed a small committee to recommend possible approaches. This committee forwarded its work to the THEBC staff, which solicited additional information from interested parties. Chancellors, faculty associations and private citizens were among those responding. Two public workshops helped gather additional comments on proposed plans.

Numerous approaches, as well as a variety of different performance measures, were proposed. Approaches that represented the most radical change from the current cost-based approach were submitted by an LBB staff member and by a legislator. Both proposals included a strong tie between funding and the production of graduates. Although neither was finally adopted, both played important roles in defining the discussion. Prior to final adoption of a proposal by the THECB, a statewide teleconference was held that included over 100 rep-

resentatives of higher education. The plan was accepted by the chancellors of the two largest university systems and received an endorsement from most others participating in the teleconference. The plan was adopted without change by the THECB.

The Texas Community/Junior College Association developed a performance-based funding program as well, although there was no legislative mandate to do so. The association, made up of community college presidents, appointed a committee of ten presidents to design a performance-funding plan, which was developed with relatively little external input, compared to the activities of the health science centers and universities. The plan was accepted by the Higher Education Coordinating Board and forwarded to the Legislative Budget Board for action.

PROPOSALS FOR PERFORMANCE-BASED FUNDING

All of the Texas proposals involved three steps:

• Legislative appropriation of sums of money to accomplish certain objectives or goals. Associated with each of these objectives was a quantitative performance measure.

• Determination that total performance for all institutions toward each goal would be measured.

Prior to final adoption of a proposal . . . a statewide teleconference was held that included over 100 representatives of higher education.

• Appropriation of funds to each institution in direct proportion to its contribution to the state's total performance. For example, one goal was to increase the number of degrees awarded to minority students. The associated performance measure was simply a count of the number of degrees awarded to minority students. Each institution would receive a share in the funds appropriated for that goal in direct proportion to the total degrees awarded to minority students.

In addition, all of the plans placed an emphasis on outcomes rather than process or efficiency measures. For example, rather than developing efficiency measures such as classroom utilization, it was found preferable to develop measures for desired outcomes and give institutions maximum flexibility in determining how to best obtain those outcomes. All of the plans placed a relatively high level of emphasis on success in enrolling and graduat-

. . . all of the plans placed an emphasis on outcomes rather than process or efficiency measures.

ing additional minority students—a high priority among all sectors of Texas higher education.

There were also unique features to each proposal. The proposal for the health science centers was intended as a mechanism for allocating all funds appropriated to those institutions, although it was suggested that the scheme be phased in over a period of years. The proposals for universities and community/junior colleges were designed as add-on incentive programs that would provide funding over and above the base funding provided by the Legislature through Texas' formula funding system.

There was, however, widespread belief that the Legislature would decide on a funding level for higher education and then allocate a portion of those funds for performance-based funding, leaving the remainder to be allocated through the formulas. The result of such legislative action would be a deduction from the base rather than an add-on as proposed.

Each plan also varied in the complexity and number of measures involved. The performance-based funding plan for health-science centers was the most complex, involving more than 100 different performance measures. The plans for universities and community colleges each initially included 10 measures. (Tables 1 and 2 contain some representative performance measures proposed for universities and community colleges respectively).

One of the more controversial issues associated with performance funding was the percentage of the base to be allocated for this purpose. There was no specific recommendation associated with the health-science center recommendation. For universities and community/junior colleges, recommendations called for allocating two percent of the base the first year of the biennium and five percent in the second. These recommendations were highly influenced by Tennessee's experience, where after ten years, performance funding accounts for slightly less than six percent of total funding.

Because there was a strong desire to avoid creating a large data collection effort with an associated bureaucracy, goals and measures were selected so that performance could be measured from data currently available at the

TABLE 1

Some Representative University Goals and Performance Measures

Degrees

Goal: Increase the education level of citizens of the state

Measure: The number of degrees awarded at the baccalaureate level or higher

Minority Graduates

Goal: Increase the successful participation rates of minority students

Measure: The number of Hispanic, African-American and native-American U.S. citizen graduates

Tenure Track Teaching

Goal: Improve the quality of undergraduate teaching

Measure: The number of lower-division class sections taught by tenured and tenure-track faculty

Externally-Funded Research

Goal: Increase the external support of research in Texas universities

Measure: Funds expended for the conduct of research and development from sources other than state and local funds

Intellectual Property Income

Goal: Increase the commercialization of research conducted in Texas universities

Measure: Income from research-related intellectual property

TABLE 2
Some Representative Community College Goals and Performance Measures

Course Completers

Goal: Increase the efficiency of the teaching function

Measure: The number of contact hours of courses for which students are registered on the final day of the semester

Degrees

Goal: Increase the education level of citizens of Texas

Measure: Number of associate degrees awarded

Transfer Students

Goal: Improve articulation between community colleges and Texas public universities

Measure: The number of undergraduate students enrolled in Texas public universities who completed 15 hours at the two-year institution within the past three years

Remediation

Goal: Increase the success rate of poorly-prepared students

Measure: The number of sections of the TASP test passed by students who had formerly been in remediation because of having failed corresponding sections of the test

Minority Transfers

Goal: Increase articulation of minority students between community colleges and universities

Measure: Similar to TRANSFER STUDENTS except applied to Hispanic, African-American, and native-American students

institutions. Although the data necessary for the health-science-center plan was currently available, it would have involved a significant increase in the amount of data reported each year.

A recognized deficiency of the plans was the relatively small emphasis on quality measures, primarily because widely accepted and quantifiable quality measures such as teaching effectiveness and the success of graduates are difficult to establish. Often data to support quality measures is unavailable.

Although they shared many ideas, there was no direct link between the performance funding plans developed for institutions of higher education and the strategic plans developed as a result of House Bill 2009.

ACTIONS BY THE LEGISLATURE

Changes in the composition and leadership of the 73rd Legislature, which convened in January 1993, affected the implementation of performance-based funding. A new Speaker of the House was elected, and the primary advocate for PBF lost his seat on the House Appropriations Committee and the Legislative Budget Board. This meant that the sense of inevitability over the implementation of performance-based funding evaporated. Also, the LBO prepared a draft appropriations bill that

A recognized deficiency of the plans was the relatively small emphasis on quality measures, primarily because widely accepted and quantifiable quality measures such as teaching effectiveness and the success of graduates are difficult to establish.

included performance-based funding as part of the base funding to institutions. This proposal included performance-funding at a level of 10 percent of total funding, instead of five percent proposed by the THECB. As a result, the fragile agreement by which institutions would support PBF was broken.

With these changes as a backdrop, the Senate Finance Committee and House Appropriations Committee began deliberations on the biennial budget. Each committee adopted dramatically different schemes for PBF. The Senate proposed setting aside a $20 million pool of funds for access by institutions as add-on funding if they met state goals.

The House, after a dynamic debate, adopted the LBB's 10 percent performance-based funding recommendation over the objection of the chair of the House Appropriations Committee. However, during conference committee debates, PBF received relatively little attention and was eliminated from the budget for higher education.

The proposals would have re-allocated a significant amount of funding. The university proposal, especially, tended to shift funds from politically powerful institutions to those less powerful . . .

REASONS FOR THE PROPOSALS' FAILURE

In discussing the reasons for the proposals' failure to be adopted, arguments tend to fall into two categories:

• No champion strongly supported the concept of performance-based funding. None of the legislators involved in the debate had a firm commitment to the concept, so there was no broad support for it.

• The proposals would have re-allocated a significant amount of funding. The university proposal, especially, tended to shift funds from politically powerful institutions to those less powerful a factor that worked against adoption. Although the proposals would have allowed legislators to emphasize one factor or another to favor a program or programs at virtually any state institution, the Higher Education Coordinating Board proposals tended to be supportive of institutions with heavy concentrations of minority students.

• The legislature did not believe the proposals offered significant advantages. Accord-ing to researchers Meisinger and Dubeck, legislators believe that rational orientation of performance-budgeting reduces the amount of influence they can bring to bear on institutions. Also, legislators dislike the complexity and volume of budgeting documentation necessary for performance budgeting.

• The original agreement by the institutions to support the proposals was fragile. The institutions agreed to support proposals calling for incentive (add-on) funding limited to two percent the first year of the biennium and five percent the second. When the LBB proposed a bill that included second year performance-funding of ten percent to be subtracted from base funding, institutions felt free to oppose the concept.

But more than politics was involved. The proposals also had fundamental logical shortcomings:

• The appropriateness of performance-based funding for public higher education has not been established. Although private sector models are often cited, it is not clear whether that experience is transferable. In theory, poorly performing institutions will either improve or go out of business when faced with the prospect of fewer resources as a result of poor performance. But political reality suggests that this is not going to happen. It is not at all clear that reducing funding for poorly performing institutions will cause them to improve; in fact, this runs

contrary to the conventional wisdom of legislative bodies. Nor is it clear that additional funding is the most effective motivator for high-performing institutions.

• In an effort to make the proposals simple and easy to administer, a number of compromises were made that affected their logical integrity. The proposals rewarded performance, but not necessarily changes in performance. Although institutions could choose to emphasize different performance measures, the same set of performance measures was available to every institution regardless of institutional mission. At the beginning of the effort, individual performance goals for each institution appeared to be a major impediment to consensus; in the end, it was lack of this individuality that proved to be the impediment.

• The proposals were perceived by many as "anti-quality." Degree production, transfer between community colleges and universities and minority enrollment are all recognized problems in Texas higher education. Yet, at the same time, it was believed by many—especially faculty members—that providing financial incentives for institutions to address these problems would compromise the quality of these institutions. In the minds of many, the quality of the institution was separate from the institution's effectiveness in dealing with these issues.

• The lack of successful models in other states was also an important impediment to the adoption of these proposals. Performance-based funding is not a new idea, having been been tried and discarded in several states. But in states that do have incentive programs, they constitute relatively small parts of the total funding. While institutions of higher education are often considered to be bastions of liberal thought, in financial affairs they are very conservative, and a significantly different funding program is not readily embraced.

It is not at all clear that reducing funding for poorly performing institutions will cause them to improve; in fact, this runs contrary to the conventional wisdom of legislative bodies.

LESSONS LEARNED

Lessons learned from this experience lead to four conclusions:

• Higher education must promulgate a new, broader definition of *quality*. The dominant faculty definition is centered around distinguished professors, small classes and research. But different factors make institutions successful from

Higher education must promulgate a new, broader definition of quality. *The dominant faculty definition is centered around distinguished professors, small classes and research.*

the perspective of students and the general public. These factors include matriculation in four years, successful transfer from community colleges and success of students from all racial and ethnic backgrounds. A larger vision of quality needs to be embraced by all those in higher education.

• A champion for the concept of performance-based funding is necessary. Performance-based funding is a significant departure from current practice. It is impossible to overstate the importance of leadership from someone with significant political influence who is committed to making it happen.

• Logical consistency is as important as administrative simplicity. Administrative simplicity is critical for both the operation and acceptance of performance-based funding plans. Because performance-based funding represents a significant change for most institutions, it will be subjected to a great deal of scrutiny. It must make sense from everyone's point of view.

• Successful efforts in other states are needed in linking performance to funding. Because any proposed change is greeted by predictions of dire consequences, the most successful counter-arguments are examples of successful implementation of the proposed change. In the case of performance-based funding, there is a paucity of successful examples. Obviously, more templates of success would greatly increase the likelihood of further successful implementation of performance-based funding.

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IMPORTANT SAFEGUARDS IN FUNDING PROCESSES FOR PUBLIC HIGHER EDUCATION

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The convergence of state economic woes, growing public investment in health care and criminal justice and concerns about higher education accountability over the past five years are causing state leaders to reconsider funding processes for public higher education.

In many states, this reconsideration has been triggered by revenue shortfalls and competing state priorities that have made it impossible to continue to fund colleges and universities at the levels defined by existing funding processes. While supporters of public higher education express serious concerns about lack of adequate funding, some elected and policy leaders have responded to tight budgetary times by questioning the realism of the traditional funding processes themselves.

Policymakers raise this question within the context of a public higher-education system that has been criticized for being oversized, overspecialized and underfocused on undergraduate education. In particular, they ask whether the funding process can or should be used to improve the focus of colleges and universities on undergraduate teaching and learning.

. . . while the need to increase public higher education's focus on undergraduate teaching and learning is real and compelling, important safeguards embedded in current funding processes must be considered when evaluating proposed changes.

This paper discusses some major issues and options, as well as their implications, for changing public higher-education funding processes. To place these issues into context, we compare briefly public higher-education funding processes nationwide and review the evolution of funding process objectives over time. Then we present a profile of the major characteristics of funding processes today. Our thesis is that while the need to increase public higher education's focus on undergraduate teaching and learning is real and compelling, important safeguards embedded in current funding processes must be considered when evaluating proposed changes.

COMPARISONS OF FUNDING PROCESSES

Funding processes for public higher education are complex in any given state or system. Each has its own history, traditions and terminology. Some states, for example, distinguish between the base budget and supplemental funding. Some states distinguish formula from non-formula (incremental, program justification or categorical) components in their funding process. Some states distinguish the base or continuation budget from incentive funding. This paper uses the term *funding process* to encompass both budget-building methods and the rules governing their uses or results.

The most widely used budget-building methods are *formulas*—quantitative statements that prescribe how to build a request for funding or for allocating funds among institutions. Incremental, programmatic justification and categorical funding are additional common methods. Several non-mathematical but routinized decisions are part of the funding process, but they are not considered part of the formula. These decisions include such issues as whether to fund next year's utilities at the level of prior-year actual expenditures, as well as various "rules" concerning how to apply the formula (e.g., which credit hours are counted, whether formula-generated funding can be less than prior-year actual, or how to handle situations where the appropriation is inadequate to fund the request).

Over time, funding processes (formula and non-formula) have evolved to serve different objectives. Formulas, for example, play one or more of the following roles: providing adequate funding, distributing funds equitably, or provid-

ing stability from year to year. Table 1 depicts the evolution of the objectives of the funding process over the past four decades.

It should be noted that for the most part, each decade added new and additional objectives to the funding process, without setting aside the previous purposes being served.

During these years, funding processes came to rely on comparative data such as salary averages of peer institutions and quantitative elements such as student/faculty ratios to meet the objectives of adequacy, growth and objectivity (basing requests on known elements of cost). In response to concerns that formulas had a leveling effect, equity among institutions and sectors was pursued by basing funding on known differences in program structure and activity (e.g., by adding mission, level and program differentiations), which complicated funding processes. When periods of rapid enrollment growth passed, stability was pursued through "formula- use" policies, "rolling-average" rules and "hold-harmless" provisions. Later, quality concerns were addressed by implementing non-formula, special initiatives such as endowed chairs, centers of excellence and incentive funding.

. . . for the most part, each decade added new and additional objectives to the funding process, without setting aside the previous purposes being served.

TABLE 1

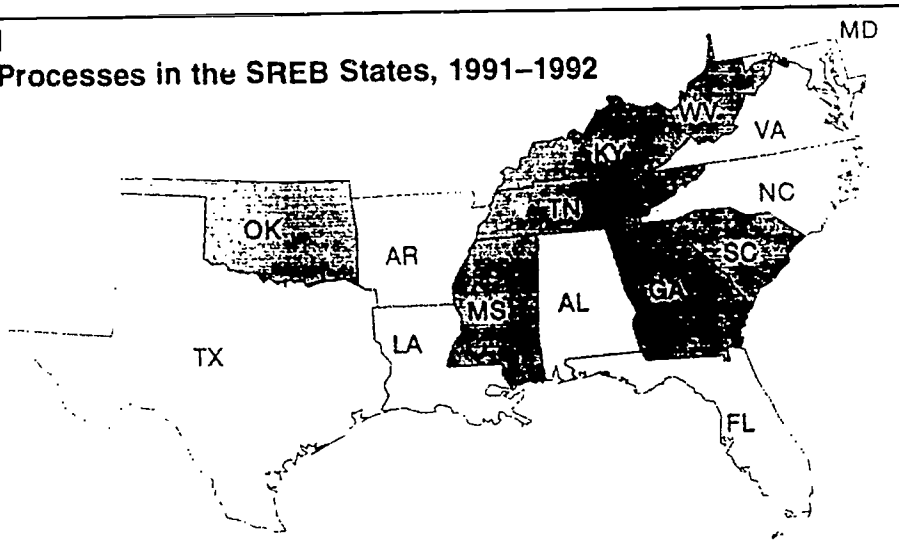
Funding Processes for Higher Education 1950s–1990s

1950s	1960s	1970s	1980s	1990s
Adequacy⇨	Growth⇨	Equity⇨	Stability/Quality⇨	Stability/Accountability/Reform

FUNDING PROCESSES TODAY

In 1991 and 1993, the Southern Regional Education Board (SREB) surveyed the funding processes for public higher education in 15 states (Alabama, Arkansas, Florida, Georgia, Kentucky, Louisiana, Maryland, Mississippi, North Carolina, Oklahoma, South Carolina, Tennessee, Texas, Virginia and West Virginia). Because of the historic leadership of the SREB states in developing new funding processes and the diversity within the SREB region, these states indicate likely directions for future higher-education funding policy and practice across the nation (see Caruthers and Marks, *Funding Methods for Public Higher Education in the SREB States).*

FIGURE 1
Funding Processes in the SREB States, 1991–1992



Use Formula Exclusively
Use Formula Plus Incremental, Program Justification, or Categorical Funding

Twenty statewide higher education agencies are responsible for public higher-education funding in the SREB states. In all 15 states, some party (state higher education agency, governor or legislature) used a formula method at some phase of the budget cycle (request/review/recommend, appropriate, allocate to institutions) for either public two-year or four-year colleges and universities. Of the 20 agencies, eight used a formula method exclusively, 11 used a formula in conjunction with incremental/program justification or categorical funding methods and one used no formula. (see figure 1).

Formulas and other budget-building methods are used to request and appropriate funds at the system or institutional level and allocate funds among institutions. Characteristics of funding processes vary greatly, in part because of the different uses states make of them and in part because of the scope (systemwide versus institution shares) of the method.

Building budget requests is the most common use for formula funding methods. Nineteen agencies used a formula method, at least in part, for requesting funds, reviewing funding

TABLE 2
Formula Usage in the SREB States, 1991–1992

	State Agency	Governor	Legislature
Review/Request/Recommend	19	14	14
Appropriate			14*
Allocate Institutional Shares	7		

** Four of these legislatures appropriate at the system level, ten at the institutional level*

requests or recommending funding levels. Four state legislatures used a formula method, at least in part, for appropriating funds at the system level; 10 for appropriating at the institutional level. Seven agencies used a formula method, at least in part, for allocating institutional shares in cases of system-level appropriations (see table 2).

Two basic formats are used in funding formulas: a dollar rate times a student credit hour (SCH) or full-time-equivalent (FTE) student measure; and student/faculty ratios times a salary rate or set of salary rates. Among the 20 cases in the SREB states, 10 use the first method (either for the entire formula amount or for the growth portion), five employ the second method and five a mixed method.

Mission differences are recognized in 13 cases. The number of missions ranges from only two up to recognizing a unique mission for each institution in the state. The typical number of missions recognized is three to four. Levels of instruction are recognized in 14 cases, with four to five the typical number recognized. Program or discipline differences are recognized in 18 cases. As few as two program categories and as many as 46 are recognized. The typical number recognized is 14.

Nineteen cases have formula provisions for at least part of the instruction, student services and institutional support functions;18 cases have formula provisions for operation and maintenance of plant; 13 use formula provisions for departmental research; 12 for general public service; and nine have formula provisions for continuing/community education activities.

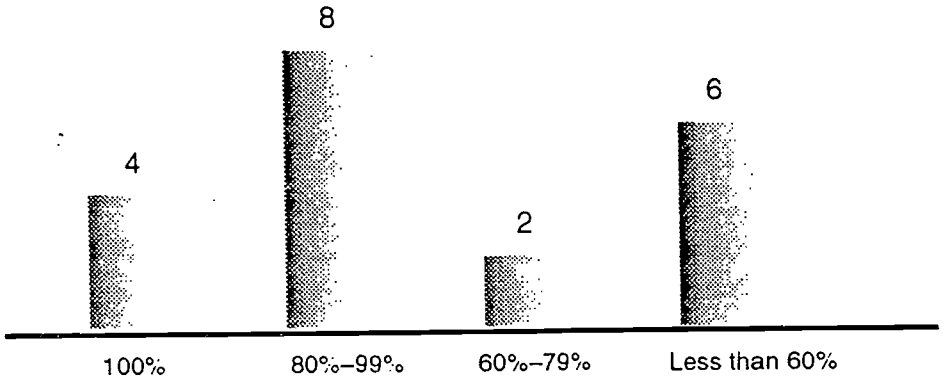
Characteristics of funding processes vary greatly, in part because of the different uses states make of them and in part of the scope (systemwide versus institution shares) of the method.

Formula methods accounted for 100 percent of the general operations request for state funds in only four of the 20 cases. In eight cases, the formula covered from 80 to 99 percent; in two cases from 60 to 79 percent; and, in six cases, less than 60 percent of the request for state funds. (In the remaining three cases, the percentage could not be determined.) The balance of the budget request is on the basis of incremental program justifications, categorical funding or incentive funding (table 3).

Budget requests by higher education to states have not fared well in recent years. In 1991–92, only two of the 20 requests were funded at the requested level and, in one case, available funding was only 58 percent of the request. The median was a 75 percent funding level; the average was 79 percent (table 4).

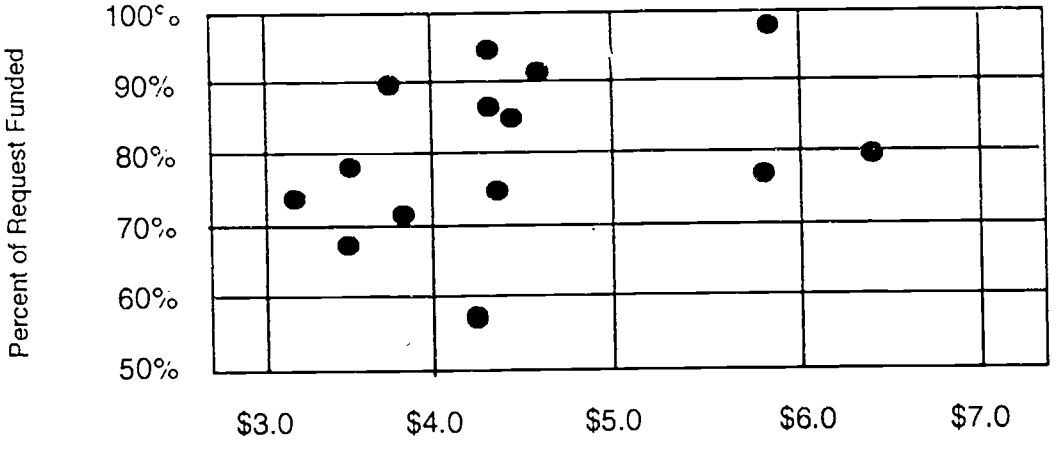
Observers of comparative data will notice that one formula may yield very different funding levels than another. In the SREB region, 58

TABLE 3
Percent of General Operating Budget Request Covered by Formulas in SREB States, 1991–92



percent of one formula may yield the same per student funding of $4,000 as 94 percent of another; $3,800 can be 71 percent of one, 90 percent of another; or 78 percent of one can be $5,800, or 99 percent, of another. This point is of particular interest and deserves further study because of its bearing on the question of funding process adequacy.

TABLE 4
Funding Levels Related to Percent of Request Funded Public Four-Year Institutions in SREB States, 1991–1992



ISSUES, OPTIONS AND THREATENED SAFEGUARDS

Pressures are building to serve new objectives, such as stability in light of revenue shortfalls, accountability and improving teaching and learning. How might funding processes be adapted? What will be the consequences on previously pursued objectives such as adequacy of funding from year to year and equity of funding between institutions or sectors?

. . . frequent and severe budget cuts . . . establish and environment in which decision makers at all levels . . . become more open to new funding approaches.

State Revenue Shortfalls

Lack of funds is one of the primary issues facing higher education today. (Most institutional representatives indicate this is the primary issue.) Kentucky institutions of higher education, for example, have absorbed four budget cuts (sometimes more than one per fiscal year) since October 1991. These cuts amount to 14 percent of the original 1991-92 state appropriation base.

Only four SREB states (Arkansas, Louisiana, Oklahoma and West Virginia) have had increased funding each of the past three years; six states (Alabama, Georgia, Kentucky, North Carolina, South Carolina and Tennessee) have had reduced funding at least once; three (Maryland, Mississippi and Texas) have had reduced funding twice; and two states (Florida and Virginia) have suffered reduced funding for three years running (Hines, 1994).

Budget cuts resulting from revenue shortfalls are difficult to absorb and manage in any given year. However, frequent and severe budget cuts as experienced in the 1990s establish an environment in which decision makers at all levels (institutions, statewide coordinating or governing boards, executive offices and legislatures) become more open to new funding approaches. Arkansas, Kentucky, Tennessee and Texas for example, have proposed just such major revisions of their funding processes. Optimally, these new funding approaches will be based on mutually developed or agreed-upon statewide goals and objectives, such as improved teaching and learning, and will not conflict with desirable achievements in the old funding approaches such as adequacy, stability and equity. In reality, however, such an optimal combination of circumstances will be difficult to achieve.

Maintaining quality is a major challenge in a time of prolonged revenue shortfalls. Institutions and governing boards are reconsidering whether they can be all things to all people. States and institutions have several major options to address this issue (table 5).

TABLE 5
Evaluation of Options for Dealing with State Revenue Shortfalls

Options	Potential Problems
Reduce enrollment/service levels (enrollment management)	Works against previous access/growth priorities Hold-harmless provisions could limit available funds for reallocation
Freeze "base budgets"	Leads to inequities if campuses experience differences in marginal demand Emphasizes status quo
Recalibrate formula(s)	Threatens adequacy of funding
Increase non-state revenue (student fees, private giving, sponsored research)	Leads to inequities if institutions vary in ability to generate revenue Tuition increases threaten access May lead to change in institutional missions

Perhaps the most direct is to reduce service levels, particularly in instruction and public service programs. Implementation of this option, however, may require a retreat from such previous high-priority objectives as improving the access and education attainment levels of states' residents and supporting institutions' desires to continue to grow in size and influence.

Enrollment- and service-level management also could allow institutions to relieve pressure on programs by committing limited resources to priority programs and activities. However, given the enrollment-based nature of many funding systems, "hold-harmless" provisions might be required which could in turn reduce the amount of statewide resources available for redirection.

Another alternative is to freeze base budgets at each institution and to use only increases in state appropriations to effect new priorities. Although such an approach would be more attractive to institutional supporters, it assumes that current program commitments and funding levels are higher priorities than new demands or initiatives. Perhaps more important, this approach may preclude states' efforts to change priorities when no additional funds are likely.

Another option, one recently implemented in Texas and being seriously considered in at least one other SREB state (Tennessee) is to adjust elements of the funding formula such as increasing student/faculty ratios or decreasing unit cost factors to match, or more nearly

match, anticipated revenues. This option, however, threatens the adequacy objective.

To counter shortfalls in state appropriations, institutions are aggressively seeking to increase revenues from sources other than state budgets, including student tuition. But continued tuition increases above the inflation level may limit the pool of students who can afford to attend and threaten the increasingly important access goal. To the extent that institutions vary in their ability to generate revenue, inequities may also result. Further, as institutions become more dependent on other revenue sources, institutional missions may unintentionally be changed.

Accountability

Accountability is the second major issue emerging in the 1990s. While there has been long-term interest in financial accountability (adequately accounting for the use of funds provided by the state and federal governments), the new focus is in the area of program accountability represented by performance and outcomes measures. Ten SREB state legislatures (Arkansas, Florida, Kentucky, Louisiana, Maryland, North Carolina, South Carolina, Tennessee, Texas and West Virginia) have passed legislation requiring higher-education accountability reporting (Bogue et al, 1993).

TABLE 6
Evaluation of Options for Dealing with Accountability Concerns

Options	Potential Problems
Control expenditures by function or object	Creates incentive for inefficient operations Invites "gamesmanship" in classification of expenditures
Provide categorical funding for areas of concern such as endowed chairs, special research funds	Invites potentially inappropriate political intrusion Encourages campus entrepreneurs to go outside normal channels
Incentive or performance funding	Encourages potentially unhealthy competition

One option, as yet untried, is to adjust funding formulas to redirect funds from the graduate and upper levels to the lower levels, where teaching and learning theory indicates students need more attention.

Funding processes have rarely affected allocation of resources within institutions. (Academic deans and department heads, in fact, are often unfamiliar with details of the state funding formula.) But this will have to change since some proposed methods for dealing with emerging priorities would require new, more restrictive budget-control devices. Given that funding processes today play the greatest role in building budget requests and allocating the resulting state support across institutions, many unanticipated and potentially damaging implications can be anticipated. For example, adaptations might include recategorization of expenditures to get around certain requirements, rather than using the normal governance and management process (table 6).

One alternative approach might be to maintain established funding models (formula or otherwise) while providing separate funding for selected accountability initiatives through incentive funding. But, for several reasons, this approach may have only limited utility. For one thing, it may compete for funds with the ongoing funding process, and, for another, it may invite inappropriate political intrusion (pork-barrel) into the process.

Teaching and Learning

Though accountability programs, states may be able to encourage institutions to progress in legislative priority areas and to reward institutions for such progress. Performance indicators such as satisfaction surveys of alumni and employers, time to degree, maximum funding credits and faculty workload and distribution of effort measures can be used to put emphasis on teaching and learning. As proposed in Kentucky, input measures (for example, credit hour or FTE enrollment) may yield to more outcome or performance-measures. The advantage of this approach is that higher education systems will be better able to advocate for needed funds by indicating progress, or lack of progress, in priority areas as identified by state-level decision makers. The disadvantage is the possible disruption of established and generally accepted funding models, coupled with the critical need to establish quantifiable performance measures to drive formula calculations. The stability and equity of funding levels could also be upset (table 7).

One option, as yet untried, is to adjust funding formulas to redirect funds from the graduate and upper levels to the lower levels, where teaching and learning theory indicates students need more attention. Given the magnitude of lower-division enrollments, however, such an effort could be costly and could conflict with other efforts aimed at adapting to revenue shortfalls.

TABLE 7
Evaluation of Options for Renewing Focus on Teaching and Learning

Options	Potential Problems
Convert formulas to being outcome rather than input driven	Threatens adequacy of funding Could cause inequity due to outcome measurements
Combine process and outcome variables in a formula	Could create element of instability in funding levels Adds complexity to funding process
Adjust cost factors to redirect funds from upper levels to lower levels	Conflicts with recalibration and other efforts to deal with revenue shortfalls No assurance that internal campus allocation would change

Yet another approach is to exert more control at the state level on expenditures by function or object of expenditure. But if the objective is program performance, institutions should be held accountable for these program-level results. State-mandated expenditure levels do not ensure program performance and instead may encourage inefficient rather than productive operations.

CONCLUSION

State higher-education funding processes have been described as changing only marginally over time, becoming more elaborate yet not redirecting institutional priorities. This assessment, however, does not take into account the multiple objectives and uses for which the funding process has evolved. Creating a funding system based on known elements of cost was no small achievement. It helped assure adequate funding that kept higher education responsive to growing demand. Distributing funds based on known differences in program structure and activity was also no small achievement. It provided a more level playing field for determining equitable funding levels. Current efforts to realign public higher education funding with emerging priorities should proceed with caution lest important safeguards evolved over time be weakened or lost.

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