INCENTIVE FUNDING FOR STATE PRIORITIES

DESCRIPTION

The state would provide financial incentives for higher education institutions to pursue state goals by providing a small amount of funding (2-5% of total funding) if the institutions reach certain outcome indicators, such as graduation rates or exam scores.

CURRENT EXAMPLES

Many states, including Colorado, Connecticut, Florida, Idaho, Kansas, Louisiana, New York, Ohio, Oklahoma, Oregon, Pennsylvania, South Carolina, South Dakota, Tennessee, and Texas, use incentive or performance funding for their higher education institutions. The details of each system differ, but experts identify South Dakota's system as one of the best.

- In 1997-98, South Dakota redirected resources equivalent to 5% of the universities' tuition and General Funds to five incentive funds. If a university achieves its target in a particular incentive area, it receives resources from that incentive fund. The five goals are:

    - Increase the number of South Dakota resident students at higher education institutions.

    - Increase enrollments in academic programs important to economic growth, including information technology, computer science, and biotechnology.

    - Improve academic quality, as measured by improved scores on proficiency and certification exams.

    - Foster inter-institutional collaboration in program delivery.

    - Increase non-public support, such as grants and private gifts, to higher education institutions.

- California's Community College (CCC) Partnership for Excellence (PFE) is structured as an incentive fund. The PFE was established by statute in 1998 and requires the community colleges to improve outcomes in five areas: (1) student transfers, (2) degrees and certificates, (3) successful course completion, (4) workforce development, and (5) basic skills. In return, the state would provide additional discretionary funding ($225 million in 2003-04). The Partnership is scheduled to sunset in January 2005.

Analysts at the Rockefeller Institute and the Legislative Analyst agree that the PFE is not a true "pay-for-performance" scheme because annual funding is provided at whatever level the Governor and Legislature decide, and the CCC reports back on its progress in achieving the specified goals. There is no mechanism connecting performance to funding. For example, the PFE does not reduce funding for individual districts not performing well on PFE measures.

STATE POLICY PRIORITIES TRADE-OFF

- Incentive funding motivates institutions to reach certain goals identified by state leaders as high priorities.

- Institutions will face greater unpredictability in year-to-year funding, and the more flexible the criteria for deciding whether to award incentive funds, the more uncertain future funding will be. To the extent that institutions cannot incorporate incentive funds into their planning, institutional quality may suffer. For example, institutions cannot use incentive funds to pay for outstanding tenure-track faculty because the funding may not be there from year-to-year.

- Incentive funds reduce state budget flexibility and discretion, particularly in difficult budget times. For example, in the last two budgets, the Governor and Legislature have used PFE funds to supplant other funds or have transferred PFE funds for other priorities.

GENERAL FUND IMPACT

Incentive funds can be fiscally neutral, as in South Dakota, if they are created by redirecting existing funds. They may also be quite costly. The PFE was created as an additional incentive funding source, resulting in General Fund costs ranging from $100 million to $300 million a year.

TECHNICAL FEASIBILITY

- Many existing incentive funding systems have created controversy by locking in a numerical target or formula, which some groups or institutions see as unfair or too inflexible. Can we create a set of goals, indicators, and measures that all the stakeholders agree is fair? The more flexible the criteria are, the greater the uncertainty institutions face, as noted above.

- If they are not properly designed, there is a danger that incentive funds will create perverse incentives. For example, if the state declares that more students should complete their degrees and creates an incentive fund for improving six-year graduation rates, institutions may reasonably respond by excluding students who take longer to graduate or by lowering graduation standards.

- Depending on the goals and indicators chosen, incentive funds may also create conflicting incentives. For example, if the state wants to encourage non-state funding, as well as improve student learning, then how should professors use their time—by writing grants or tutoring students?

- Can the Legislature and Governor resist raiding incentive funds to pay for other, higher priority programs in bad budgetary times?