Chapter 4

Higher-Education Finance and Accountability

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Introduction

The finances of colleges and universities are increasingly under the scrutiny of policymakers, researchers, and families. Much of the attention focused on money has been in reaction to skyrocketing tuition costs. From 1980–81 to 2008–09, the average list price of a public, four-year institution rose twice as fast as inflation.[1] Questions about whether the escalation of college costs has been justified have translated into calls for greater accountability in postsecondary finance. The focus on college prices reached a fever pitch with a 2003 proposal by Rep. Howard P. (Buck) McKeon to penalize colleges that raise their prices too high by denying them eligibility to participate in federal student-aid programs. While the measure was hotly debated, the ensuing debate highlighted the view that colleges are doing little to keep costs in check.[2]

Rising college prices, however, are not the only concerns voiced by proponents of accountability. As more information has become available about the outcomes of college enrollees, there are questions about whether college expenditures are being used effectively to help students. Less than 60 percent of students at four-year colleges graduate within six years, and at some colleges, the graduation rate is less than ten percent.[3] Such high rates of attrition call into question whether colleges are working to maximize students' likelihood of success.[4] Certainly, there are reasons to question whether college expenditures are being devoted to student needs, given that the proportion of institutional spending on educational services has declined over time across higher education while expenditures on noninstructional activities,

such as administrative services, have increased.[5] Perhaps it is not surprising that even college graduates have begun to question the return to higher education.[6]

Many postsecondary institutions have also become concerned about their own finances as additional external forces have made it more difficult for schools to balance their expenditures with their revenues. With increasing competition from other public services, state appropriations to public institutions have steadily declined as a proportion of revenue.[7] As other sources of revenue vary with economic conditions, many colleges and universities have been forced to consider cost models in which they make do with less.

While there is increasing scrutiny and pressure to monitor higher-education finances and ensure that funds are being used efficiently, little is understood about how to fold this within an accountability system. Many state attempts at performance funding and other forms of financial accountability have been discarded within a few years. With such a blemished history, is accountability really possible in higher-education finance?

This chapter considers the role of higher-education finance in accountability systems by discussing how an effective financing system, tied to improving productivity and learning outcomes, might be designed. The chapter begins by reviewing how we currently measure funding streams and the degree to which it is possible to determine how colleges and universities spend their resources. Then, I outline other key elements and considerations of accountability systems based on higher-education finance. The following section gives an overview of past experiences with performance funding in several states and summarizes some of the lessons learned. Finally, I lay out the key questions and criteria for designing financing systems that could be tied to improve both institutional productivity and student outcomes.

The Difficulty in Measuring College Spending

A first step in the implementation of any accountability system based on higher-education funding is to adequately measure the finance side of institutions. Such measures provide the necessary baseline and follow up information to judge the behavior of colleges. However, the real focus of higher-education finance accountability must be on the expenditure side of higher-education finance: how much and in what ways the institution uses its resources.

Problems Inherent in Measuring Higher-Education Costs

Before going deeper into the specifics of how college expenditures are measured, it is first worth noting several features of higher education that make a full and complete accounting of costs especially difficult. The first is the problem of joint products. Institutions have multiple missions (e.g., education, research, public service), and these missions overlap and may even be reinforcing. For example, a professor's research may contribute to his or her teaching. To address each of these multiple missions, there are fixed costs, such as administration and operations, which are shared. While the primary focus of accountability evaluations is often to isolate the costs of one particular function, this can be difficult because of the joint nature of the missions. The goals are not easily separable from each other, and therefore parsing out which costs go with each mission can be impossible. This is partly a problem of aggregation, but more importantly, given the overlap between those missions, it would be difficult to determine the relative cost of each even with a more detailed data collection. In the case of the professor whose research is used in his or her teaching, how should the costs between the research function and the teaching function be divided?

Further, higher education does not fit the traditional economic model in which a firm uses a combination of inputs in a production process to make its outputs. Typically, inputs are entirely

separate entities from the outputs, and with regard to accountability efforts, one would focus on the costs of the inputs as well as how an institution chooses to use those inputs in the production process. However, in education, students complicate this basic framework. Students are not only the outputs of the process (i.e., an educated college graduate) but also important inputs. Peers have been shown to influence each other's academic and social outcomes.[8] Unfortunately, there is no good, systematic way to measure the value added by one student to another. Institutions implicitly compensate some students for their positive peer effects by giving them merit-based financial aid, but this is an imperfect measure, given that there are multiple motivations for giving merit aid (e.g., attracting students with high test scores with the hope of rising in the college rankings), and measures of institutional financial aid are also flawed.[9] To summarize, there is no convention on the best way to incorporate students' costs or benefits into finance models.

Concerns about How to Define Certain Costs

While there are inherent difficulties in accurately and completely measuring college costs, efforts continue. Still, expenditure studies are only as good as the underlying data. As summarized by Dennis Jones of the National Center for Higher Education Management Systems, full cost analyses "start with accounting data and rely on adjustments to, and allocations of, these financial data to yield final answers. As a consequence, the results are influenced heavily by the purposes, conventions, and limitations of such data."[10] Before even starting the process, one must first determine how to define certain costs using the available data. In studies of college finances, researchers have developed a variety of cost models and approximations of expenditures on educational activities, but the analysis is never straightforward because of the assumptions that must be made and the availability of data.

One issue that must be resolved when measuring institutional expenditures concerns is how one should deal with direct versus indirect costs. Early cost models suffered from the fact that the calculations of one institution might include a battery of indirect cost formulas while another institution might use an entirely different set of formulas. The recently established Delta Project on Postsecondary Costs, Productivity, and Accountability focuses on what it calls education and related spending per full-time equivalent (FTE) student rather than the previous convention to highlight "instructional costs."

Another complication in cost accounting involves not a definitional issue but, instead, how measurements are reported because of the limits of data. College expenditures are often reported per student or credit hour to standardize across institutions of different sizes. These estimates, in essence, give the average cost within the system, and so they mask differences in the resources one student might receive versus another.

National Information on Expenditures

The primary source of information on college finances nationally is the Integrated Postsecondary Education Data System (IPEDS). Institutions that participate in any federal student-aid program are required to complete the IPEDS survey annually, and the finance data collection includes institutional revenues by source, expenditures by category, and assets and liabilities. The information is reported in aggregate terms, and so it is difficult to isolate the costs of particular activities to get a true sense of costs, spending efficiency, and funding streams. Still, because the coverage of IPEDS is extensive, it has been the foundation of multiple large-scale efforts to understand college expenditures. For example, as part of the 1998 Amendments to the Higher Education Act of 1965, Congress required that the National Center for Education Statistics (NCES) conduct studies on expenditures in higher education.[11]

More recently, the Delta Project examined college spending for nearly two thousand public and private colleges from 2002 to 2006. In its report, *Trends in College Spending* (January 2009), the Delta Project researchers found substantial variation in the resources available to institutions. [12] Most students attend colleges that have very limited budgets, while the richest institutions appear to be getting richer. Second, much of the new money to higher education outside tuition increases is restricted, meaning that it can only be used for special functions. Meanwhile, tuition increases are only partially making up for reductions in state appropriations at public institutions. Finally, efforts to investigate changes in productivity were hampered by a lack of outcomes and quality measures. However, they did find that the relationship between spending and the number of certificates and degrees produced has changed little in recent years. For several types of institutions, there is some evidence of a lower cost per credential, but this analysis is not definitive.

There are limits to cost accounting using the national IPEDS data. Even the researchers of the Delta Project recognize that "aggregate data are not a substitute for the more granular analysis that institutions and states need to perform regularly to examine their own spending patterns."[13] Some of the limitations of IPEDS include the fact that it does not distinguish between expenditures by discipline or level (remedial versus undergraduate versus graduate education). Institutional financial aid and tuition discounting are also not reported as spending in IPEDS. Instead, IPEDS uses a measure of "scholarships and fellowships," which is only a fraction of institutional aid. Still, as one of the only sources for national-level studies of higher-education spending, IPEDS is the foundation of much of what is known about college expenditures.

Other Studies of College Spending

The Delaware Study of Instructional Costs and Productivity was also developed in response to the 1998 mandate by Congress to study college costs and prices. The report focuses on direct instructional expenditures at four-year colleges and universities using data from multiple cycles of the Delaware Study of Instructional Costs and Productivity, which was begun in 1992 by the Office of Institutional Research and Planning at the University of Delaware.[14] The data contain information on teaching loads by faculty category, instructional costs, and externally funded scholarly activity, all at the level of the academic discipline, for over three hundred four-year institutions. Therefore, compared to IPEDS, much more detailed analysis is possible, taking into account teaching and differences across disciplines. However, because participation was voluntary, the data do not give a national picture of college instructional expenditures. This also raises the issues of nonresponse bias, and the authors of the study acknowledge that institutions that participated in the study were more likely to have at least five thousand students and be organizationally complex.

The focal measure in the Delaware study is the direct instructional cost per student credit hour taught. This was defined as total direct instructional expenditures divided by total student credit hours taught for 1998 to 2001. While the Delaware study provides an example of how costs can be measured, the true aim of the study was to explain why there are cost differences across institutions. The researchers conclude that multiple factors are related to cost differences, and importantly, relative to the accountability debate is the fact that they identify factors that have nothing to do with the effective or efficient use of resources. For example, the authors conclude that most of the variance in cost is due to differences in the mix of disciplines across institutions. Carnegie classification, which captures some of the differences in institutional

missions, was another important factor in differences in costs. The authors surmise that the Carnegie classifications are associated with different faculty responsibilities; for example, faculty at research universities are expected to teach fewer student-credit hours so that they can be more engaged in research activities.

Documenting the important role of disciplinary mix, Carnegie classification and other factors suggests the need for nuance in comparisons across colleges and universities. Differences in mission, student body characteristics, and environment are important, but so too is the academic mix of departments, the number of credit hours taught, faculty characteristics, as well as the role of research. It is also worth noting that researchers found "no apparent relationship between the level of instructional expenditures at an institution and the tuition rate charged by that institution."[15] This is counter to the issues that were originally raised by Congress to motivate the need for such a cost study. They caution not to use price (i.e., tuition) and cost (i.e., institutional expenditures) as interchangeable constructs because price appears to be much more related to revenues than expenditures. As the Delaware study points out, "it is not practical for an institution to charge engineering majors a tuition rate three times that charged to sociology majors" just because of the differences in instructional costs.[16]

Other Key Considerations for Higher-Education Finance Accountability

After collecting the appropriate data, which as noted above is neither straightforward nor easy, one must make a series of additional decisions, including judging what are good and bad uses of funds and how to use cost information in an incentive structure with rewards and/or penalties. Underlying any accountability system, though, is the assumption that money is somehow related to postsecondary results. The goals of accountability include the improved use of funds with the hope that this will relate positively to student outcomes or the more efficient use of limited

resources. In short, in higher education it is important to consider not only the amount of money spent but also how it is spent.

How Should One Judge College Spending?

The National Commission on the Cost of Higher Education called for more detailed data to enable better cost-measurement analysis, and better data would certainly help. However, such measures still require some interpretation and judgment about what are good versus bad uses for resources. As noted by Dennis Jones, accounting efforts naturally result in additional questions: "Even if the total level of resources is the same, the way institutions choose to utilize these resources will vary for reasons of both choice and circumstance . . . one is inevitably drawn to the next set of 'whys.'"[17] There are multiple ways resources could be used due to the situation and preferences of the institution. However, what is not clear is if the way in which the funds are allocated in one scenario versus another is better or worse.

The true difficulty in higher-education finance accountability is judging what is an "effective" (in terms of bringing about positive student outcomes) and "efficient" use of resources, as the focus of many of the calls for accountability have been in response to feeling that colleges are wasteful and/or fail to focus on producing good results. Because there is no clear standard for what these two key criteria mean in absolute terms, they can only be measured relative to other institutions or changes within an institution over time. For example, in comparison to other schools, if two institutions have the same outcomes but one spends more, all else equal, then one might conclude that the school with higher expenditures is not using resources as efficiently or effectively. Likewise, over time one would expect to see better outcomes as institutions spend more money. However, these comparisons across institutions and over time are still unsatisfying as measures of efficiency and effectiveness. For instance, these

types of comparisons do not give one a sense of how close institutions are to using resources in the *most* effective way possible. Moreover, accountability systems have to deal with the added difficulty of being applied to institutions with differing missions, student bodies, and goals. This further clouds our understanding of spending patterns and standards for what might be effective or efficient.

Sticks Versus Carrots: What Kinds of Incentives Should Be Used?

Accountability systems are based on some combination of sticks (i.e., penalties) and carrots (i.e., rewards). Central to this balance is the question of why there is a problem in the first place. In other words, *why is there a need for some kind of higher- education accountability based on finance?* The answer has implications for what types of incentives might be most appropriate.

One possible response is that accountability is needed because colleges and universities are not using their funds effectively due to laziness, intentionally wasteful behavior, and/or the lack of consequences for spending resources in an irresponsible way. For example, as Vedder opines, "The only thing missing so far is a will to change . . . American universities have made our nation a better place. But their inefficiency and indifference to costs could in the end bring them down."[18] If true, the implication is that an accountability system should focus on closely monitoring college finances and creating a set of penalties that punish colleges for being wasteful. The key to this view is that colleges and universities are capable of doing a better job, but they fail to act because of a lack of urgency or negative consequences.

Another possibility is that the lack of strong performance is because colleges do not have sufficient funds to meet the standards demanded by stakeholders. There is clearly a great deal of variation in the expenditure patterns and amount of resources available to different kinds of institutions. In particular, colleges that focus on serving students with the most financial and

academic needs have much less to spend relative to their more selective counterparts. Therefore, there is a case to be made that the problem for some parts of higher education is that institutions need additional resources. The implication is that rewards might be the best type of incentive to use in an accountability system. If an institution demonstrates that it is using its limited funds in effective and efficient ways, then it could be given additional resources to help meet its needs.

Yet a third viewpoint on the key problem is that colleges and universities do not perform better because they lack a clear sense of best practices in terms of spending, and so the failure of schools to work more efficiently is because of ignorance. Certainly, research on this issue is scant, and there is little information about the educational process of colleges. In general, the production of higher education is largely considered a "black box," in which a number of inputs hopefully mix together to produce high-quality outputs. As Key points out, much more needs to be understood about the "science of higher learning," meaning how students learn, which teaching tools are the most effective, and how institutions can help even those with lower academic performance succeed.[19] Without such information, it is difficult to know how to improve teaching and student outcomes in higher education even with an influx of additional resources. If one believes the lack of professional guidance is the true problem, then one might consider creating incentives and opportunities for the constant evaluation of funding practices linked to outcomes and then compare these across institutions to establish a set of best practices. Another option would be to provide grants to help institutions develop and evaluate new and innovative practices.

In all likelihood, the true problem in higher education is a combination of all three scenarios. There are examples of institutional wastefulness, cases in which institutions have too few resources, and challenges that lack a clear set of solutions. When considering the design of

any accountability system, one must consider which of the views is best supported by the available data and seems to apply to the target set of institutions.

State Efforts to Link Finance with Accountability

While the previous section highlighted several research studies that focused on college costs nationally, there are limits with any type of national comparison. In contrast, states have more specific budget information to understand the costs of their public institutions, and with a better understanding of the particular context, they may be better able to measure and interpret cost estimates. States have experimented with various forms of finance accountability for many years. The examples below showcase the range of decisions states have made regarding their policies, from the criteria used to how they have evaluated college performance, to the type, size, and timing of incentives. Table 4.1 summarizes some of the key decisions states have made. Although not an exhaustive list, the cases highlight the diverse actions and experiences of systems across the country.

Judging the Performance of Colleges and Universities

Performance funding or other types of finance accountability are usually not the first attempt by a state to engage with postsecondary institutions about their activities. When choosing indicators with which to judge the performance of colleges and universities, some states have based the criteria of their accountability systems on previous goals and priorities. For example, Missouri had long discussions about the importance of assessment, and the 1991 creation of the Missouri Assessment Consortium served as a precursor to the state's later approach to performance funding. The criteria used in the accountability system were marked by their direct links to previous planning priorities, and as noted by Burke, using these familiar measures helped the state avoid extreme reactions from colleges and universities.

Even if the idea of assessment is not new, when it is time to link performance indicators to finances, states must make concrete decisions about exactly what will be evaluated. Beyond the types of criteria, they must decide how these measures will be applied. Table 4.1 highlights some of the options and the decisions several states have made regarding the criteria used. Some have chosen to apply similar criteria to all college and universities, regardless of level or mission. For example, from 1994 to 1997 Arkansas judged colleges, using six major sets of criteria. As shown in table 4.1, retention measures received the most weight (39 percent), followed by quality indicators (e.g., exam passage rates), program efficiencies, workforce development, diversity of the faculty and staff, and graduation rates. Because the indicators were applied to two- and four-year colleges alike, they were widely criticized.[20]

Other states have, instead, developed criteria that differ by institutional level. In Florida, for instance, two- and four-year colleges were judged using a different set of indicators. Table 4.1 details the criteria for each level. The community colleges were evaluated based on degree awards, graduates from particular backgrounds (e.g., required remediation, economically disadvantaged, or disabled), the time to degree completion, and numbers on placements and transfers. In contrast, the four-year colleges were judged on their graduation rates (six-year rate for first-time students and four-year rate for transfer students), the percentage that graduated with credits close to the degree requirement, the percentage that went on to graduate school in Florida, and the ratio of external research funds to state research funds.

Table 4.1 Here

While the criteria chosen by Florida acknowledge differences between community colleges and four-year colleges or universities, other states have allowed the criteria to vary at a finer level. There are several examples in which states have used a combination of common

indicators with other criteria chosen by the institutions or their local stakeholders. In Illinois, for instance, the community colleges all had to address five state-wide goals related to student satisfaction, educational advancement, success in employment or graduate school, the proportion of the population served, and the success of academically disadvantaged students. In addition, each community college was also subject to a goal that could be related to its local district. Each institution had to select one of the following areas on which to focus: workforce preparation, technology, or responsiveness to a local need. Virginia allowed even greater institutional autonomy. Although the state requires public institutions to gauge and report their own performance in a range of areas, it left it up to the individual institutions to decide which measures to use.

Allowing institutions to choose their criteria can sometimes backfire. For example, in Kentucky, the Higher Education Review Commission chose twenty-six criteria that all campuses had to have, but the campuses were allowed to select the weights applied to each indicator. Some institutions set such low standards that their targets were below then-current levels of performance. What resulted were several years of negotiation between the commission and university presidents, but by the time there was some agreement, politicians no longer believed the policy would be successful in bringing about meaningful change.[21]

Kansas is an example of a state that has asked colleges and universities to think not only of how to showcase their past performance but also set goals for the future. The state instructed institutions to draft goals that were then linked to new funding. “Each institution proposes its own performance contract, complete with proposed goals, proposed performance measures, and proposed performance targets. The Board requires that the goals included in the proposed agreements be ‘stretch’ goals that truly challenge the institutions to step up from business as

usual."[22] Institutions earn increases in year-to-year funding only if they meet certain percentages of the goals.[23]

After choosing criteria for an accountability system, states have also had to decide how to apply those indicators and make judgments about the performance of institutions. Some have done this by comparing how an institution has done in a given year relative to its own prior performance. This appears to be the preferred method by institutions as other designs pit one institution versus another. For example, in Arkansas, because the funds not claimed by low-performing schools went instead to high-performing institutions, the campuses felt it created an unhealthy atmosphere of competition.[24] The community colleges in Florida also criticized a plan that measured a college's performance improvement against that of other colleges.[25]

The Role of Incentives in Finance Accountability Policies

In an accountability system focused on higher-education finance, the role of incentives is particularly important. The type, size, and timing of the incentives created by the policy are major factors in the determination of whether the system can spur better performance by institutions. Table 4.2 provides examples of the various decisions states have made regarding the incentives they have put as part of their policies. First, states must determine whether the policy will incorporate rewards for meeting standards, just maintain funding levels for doing so, or enact penalties for failing to perform adequately. Then, the timing of when the reward or penalty is executed can be important to how institutions respond. Finally, the size of the incentives must be enough to encourage the intended behavior among colleges and universities.

Tennessee is an example of a state that uses rewards as incentives in its accountability program. As noted in table 4.2, institutions can earn up to 5.45 percent of their state operating appropriations. Quoting the state's performance-funding Web site, "This program is a rare

incentive opportunity for institutions to earn resources above and beyond formula-based appropriations."[26] Instead of introducing new resources, Missouri designed its accountability system to reward institutions with an inflationary increase in their funding. Put another way, institutions that met standards had their funding maintained with an adjustment for inflation. The policy was meant to be a change in philosophy: inflationary increases were no longer automatic.[27] Starting in 2005 in Kansas, colleges and universities that did not meet performance goals lost money from the pot of new state funds. In 2006 all but three schools received full funding. As shown in table 4.2, one lost two-thirds of the funding, while two institutions lost all their funding. In making these decisions, the state board takes into account the school's level of compliance with its performance agreement and the funds available for distribution.[28]

Regardless of whether the incentives are in the form of rewards or penalties, the timing of the incentive also matters. The experience of Florida emphasizes the importance of providing the incentives in a timely fashion. In that state, the community colleges criticized one accountability program, the Workforce Development Education Fund (WDEF) because of the way it left schools uncertain about their funding.[29] Given the importance of planning in the administration of colleges, uncertainty could undermine the incentive created by a policy.

Table 4.2 Here

If incentives are not large enough to elicit a response, the policy will fail. There are many examples. As summarized in table 4.2, in Arkansas the reward for performance was only a modest share of total state appropriations. In Florida, performance-based budgeting (PBB) encompassed only about 1 percent of state appropriations to community colleges, or $8.3 million in 2000.[30] Likewise in Illinois, the accountability system only put at stake 0.4 percent of state appropriations to community colleges in 2000–2001. These funds were in addition to the funding

schools received, based on an enrollment-based formula. Minnesota serves as a fourth example: schools that met their performance indicators and standards could only get up to a 1 percent increase in their noninstructional budgets. One reason for the lack of strong incentives has been that most systems have avoided putting base funding at risk. Instead, funding in accountability efforts such as performance funding has most often been confined to new sources of money.[31]

There are also state models with large incentives. As noted above, Florida had WDEF for several years. Its incentive ranged up to 5.6 percent of state appropriations, and the state could withhold up to 15 percent of the prior year's workforce appropriations. In Missouri, over time, the FFR program resulted in an increase of $66 million in funding to the core budgets of postsecondary institutions.[32]

Over time, the size of the incentive may grow in importance. If institutions continually do better and better, they may expect that their reward will also grow over time. Funding for the accountability system in Florida did not grow, thereby drawing criticism from the community colleges who wanted additional rewards for their improvements.[33]

The Sustainability of State Accountability Efforts

Although there have been many state experiments with accountability linked to higher-education finance, programs are often cut after several years, and few are around longer than a decade. There are a number of reasons for this. In Ohio during the mid-1990s, the state legislature adopted performance funding for the community colleges. However, it ended due to a myriad of problems. As noted by Burke: "It suffered from too little funding, vague objectives, and uneven implementation."[34] For other states, there is a key problem that caused the termination of an accountability policy. Table 4.3 summarizes some of the main explanations and gives examples of states for each issue.

Table 4.3 Here

Foremost, budget cuts have been the blame for the dissolution of many state accountability systems. When there are budget cuts, colleges often prefer to cut incentive funding rather than core, formula-based funding. Such was the case in Florida. Illinois and Missouri also cut their programs during the recession of the early millennium. While fiscal crises explain the demolition of several accountability policies, economic booms can also be a culprit. In Minnesota, when the economy improved and state appropriations to higher education increased, there was less interest in performance funding, and the incentives were dwarfed relative to the main pot of money. Performance funding was then replaced by performance reporting.[35]

Declining political support has also been the reason why some finance accountability policies have been eliminated. In Florida, after a few years, the legislators who had originally championed WDEF were no longer around, and so support for the program disappeared. Likewise in Illinois the key champions of the accountability effort on the state community college board were no longer there after a while. Because the new governor was not interested in performance accountability, the policy ended. Other key constituents, such as the legislature and business, also had little interest in the topic.[36] Instead of a lack of political support, sometimes the relative power of college presidents can derail accountability efforts. In Kentucky, for instance, campus presidents and local boards of trustees were able to garner greater influence on education policy after a new law limited governors to one term. As noted by Burke, this shift in power helped to kill the accountability program.[37]

Impatience can also have a negative effect on the sustainability of a policy. It is not clear how quickly colleges can and should respond to incentives with improvements in performance,

but the political time frame is short. As discussed in a previous section, the Higher Education Review Commission and university presidents in Kentucky spent several years negotiating appropriate criteria for the performance plan. In the meantime, however, the governor created the Task Force on Postsecondary Education and resolved that "efforts to implement a meaningful system of performance funding have been ineffective, and efforts to improve the formula for funding higher education have not resulted in meaningful change."[38]

Lessons Learned from the States

While research has not shown definitively that finance accountability can have positive effects, and the low rate of success among states remains disconcerting, there are, nonetheless, lessons that can be learned. First, the size of the incentive matters a great deal. If it is not large enough, it will not have an effect. For example, if the size of the incentive is dwarfed by other sources of state funding, then the accountability program will not have much of an effect. Second, to ensure sustainability, the funding for accountability systems must be maintained and from a source not susceptible to easy reductions. There are several examples of states that cut their programs during fiscal crises. Sustainability is also threatened by changes in political power. Over time, policies often lose their original champions or become the victim of growing power among the colleges and universities. The above examples also highlight criticisms about how colleges are evaluated, whether they all face the same criteria or are pitted against each other. Uncertainty about funding also can wreak havoc on the reactions of postsecondary institutions.

The literature highlights other lessons from the experiences of states. The first focuses on a major problem many systems have faced: the lack of good information. Without informative basic indicators and a system that helps to interpret that information, it is difficult to believe that an accountability initiative would have much success.

The measures chosen can also be problematic. Ultimately, states hope that their investments in higher education yield public and private benefits such as the production of degrees (i.e., human capital) along with the new information that might be beneficial to society and the local economy (i.e., innovation). However, in their approaches, states have tended to focus on aggregated measures, such as the total number of degrees awarded or the average credits taught by faculty. As emphasized by Carey, very little attention has been paid to what one hopes underscores these measures: student learning.[39] On the other hand, the positive side of the accountability movement of the 1990s is the fact that nearly every state now has institutions publicly report information on some aspects of its activities. However, more information has not necessarily translated into greater understanding of institutional performance or how that ties to higher-education finance.

Higher-Education Finance and Accountability: What Is Possible?

Is it possible to design a strong accountability system focused on higher education? Stated another way, to what degree could postsecondary finance systems be aligned with an accountability policy? As shown in this chapter, there are many challenges that would make one pessimistic about the chance for true higher-education finance accountability. States that have tried to accomplish this have most often met with failure, and even the "successful" cases have little proof of the beneficial effects of their policies.

Moving forward it is essential that states and systems are thoughtful about the particular obstacles they face along with acknowledging the lessons from the past. To be successful, accountability systems must consider the following:

1. Foremost, good information systems need to be created. Recent research such as that undertaken by the Delta Project underscores the holes in current finance

data systems. A finer level of detail is necessary to better gauge how money is being spent and to what end. Aggregating instructional expenditures to the school level tells us little; instead, one might want to learn about the multiple forms and types of instruction, by whom, for whom, and in what subject. Standard methods of categorizing the educational enterprise are needed to start such a data collection with some understanding of the diversity of missions of postsecondary institutions. Because significant costs are also spent on other functions, such as administration, operations, and research, methods of categorizing these expenditures at a finer level is also necessary.

2. With more information, institutions must do a better job explaining how these resources relate to specific goals, populations, and outcomes. Mississippi is a state that changed the conversation about budgeting from the typical set of requests to the more fundamental issue of how all resources are being used. The Board of Trustees of State Institutions of Higher Learning discusses with institutions how spending in major functional areas does or does not match with priorities. If spending appears to be out of line with a stated goal in comparison to other Mississippi colleges or national peers, then there is a discussion about changes that should be made. The board has also used information on spending to review expenditures for administrative and support functions, and as a result, they have made reductions in energy and purchasing.[40] As shown in Mississippi, even the simple exercise of checking to make sure that institutional priorities are reflected in spending levels can be informative and helpful. Core to such discussion is examining what spending practices are based on old assumptions or decisions no longer applicable. It is no longer sufficient to justify spending patterns based on the adage that what was done last year is appropriate for this year.

3. There must be real commitment from the state in the form of adequate incentives. While accountability efforts will certainly require the involvement of institutions, state governments must also be committed to the goal. The incentives must be large enough to justify colleges and universities working toward better outcomes but not create unduly destabilizing uncertainty in

college finances. As such, the sponsoring organization must be prepared to put at stake sufficient funds in the accountability system. The appropriate benchmark will differ, depending on the state, current funding sources, and levels of support, but examining such patterns should yield good estimates of adequate incentives that can be adjusted over time.

4. The commitment to making accountability work must be held by multiple stakeholders and sustained. The goal of improving higher-education efficiency and effectiveness must also be held by multiple stakeholders so support for the initiative does not decline over time with changing leaders or economic conditions. The experience of the University System of Maryland is an example of this principle. In 2000 the chancellor began an "effectiveness and efficiency" initiative with the goal of attacking the perception that the campuses did not pay enough attention to fiscal stewardship. Multiple stakeholders worked together to develop a set of system-wide goals, including optimizing the use of resources. Wellman writes that the system has increased teaching loads and limited funding to 120 credits for baccalaureate programs. The system estimates that it has saved $40 million during the last three years, and as a result, tuition increases have been mitigated and political leaders have been willing to fund additional enrollments. According to Wellman, "Maryland is an example of a place where transparency about spending has directly paid off in increased public credibility for higher education and a growth in state support when other states were reducing funding or raising tuitions."[41]

While there are certainly great challenges ahead, the accountability movement is not without examples of practices that might hold promise for future, better-designed accountability policies. The need and desire to find a way to improve postsecondary efficiency and effectiveness continues to be strong, and success is possible. Given the past history, it is worth noting that the expectations for success are low among many, and initially it may be better for states to go after the "low-hanging fruit." What inefficiencies are evident in even the incomplete data that we are currently limited to analyzing? Like Maryland, Wisconsin has also targeted

credit accumulation above what is necessary for a bachelor's degree with positive effects.[42] Still, with the vast amounts spent on higher education and the substantial and continual growth rate of costs, widespread change may be necessary. While the answers are not clear, higher education is a business in which researchers work for years to uncover what once seemed inconceivable or impossible. That may also be the case in terms of accountability. Each year, each discussion, and each new dataset refines what is understood about higher-education finance and college performance.

Table 4.1 Examples of Criteria Used in State Performance Funding Systems

TYPE	STATE EXAMPLE	
Same criteria for all institutions	ARKANSAS (with weights listed for each category) Retention (39%), including overall, minority, and transfer Quality (29.625%), including rising Junior exam and licensure/exit exams by discipline Efficiencies (17.25%), including program productivity Workforce Development (6.75%) Diversity of Faculty/Staff (4.875%) Graduation Rates (2.5%)	
Different criteria by college level	FLORIDA	
	Two-year colleges Number of degree completers Completers who fit special categories (e.g., required remediation, qualified as economically disadvantaged, were disabled, were placed in a job identified as critical for the state's workforce needs, etc.) Time to degree Placements, transfers, and partial completers	Four-year colleges Six-year graduation rate for first-time students Four-year graduation rate for AA transfer students Percentage of students graduating with total credits less than or equal to 115% of the degree requirement Percentage who enroll in graduate schools in the state Ratio of externally sponsored research and training grant funds to state research funds
Some shared criteria; some developed by localities or institutions	ILLINOIS (applied to the public two-year colleges) Statewide Goals Student Satisfaction Student advancement (number who earned a degree or certificate, etc.) Student success in employment/continued pursuit of education Proportion of population served Academically disadvantaged students' success District-wide Goal Choose one of the following: Workforce preparation; technology; or responsiveness to local need KENTUCKY Twenty-six common indicators (mandatory), including the quality of educational outcomes, student advancement, the use of technology in student learning, the preparation of PK-12 teachers, and educated workforce development. Institution-specific (including mission-specific) indicators: effective use of resources, global perspectives in academic programs; review of gender issues; cooperative academic degree programs; alternative educational delivery; level of gifts, grants, and contracts funding; EEO plan implementation.	
Criteria includes setting goals	KANSAS Institutions instructed to draft "stretch" goals linked to new funding. Institutions can only earn increases in year-to-year funding if they meet certain percentages of goals.	

Table 4.2 Dimensions of Accountability Efforts—State Examples

ISSUE	STATE EXAMPLE
THE TYPES OF INCENTIVES	
Reward	Tennessee: Institutions are capable of earning up to 5.45% of their state operating appropriations.
Maintenance plus inflation	Missouri: To receive inflationary increases in state funds, schools needed to abide by the "Funding for Results" (FFR) recommendation by the Missouri Coordinating Board for Higher Education
Penalty	Kansas: Schools that do not meet performance goals lose money. In 2006 all but three schools received full funding. The three schools that lost funds were at these levels: Highland Community College lost $80,374 (lost 2/3rd of funding); Independence Community College lost $17,306 (no funding); Salina Area Technical School lost $383,319 (no funding)
THE TIMING OF INCENTIVES	
Timing	Florida: The community colleges criticized WDEH for the way it left colleges uncertain about their funding because of its holdback feature
THE AMOUNT OF INCENTIVES	
Too little at stake	Arkansas: The reward was only a modest sum of total state appropriations. Florida: Performance Based Budgeting (PBB) encompassed around 1% of state appropriations to community colleges ($8.3 million in 2000). The state also had the Workforce Development Education Fund, which was much larger (see note below). Illinois: Funds equaled 0.4% of state appropriations to community colleges in 2000–2001 and were in addition to the main enrollment-based state funding. Minnesota: Up to a 1% increase in the noninstructional budgets of systems that met the performance indicators and standards established by their governing boards
Large enough	Florida: WDEF ranged up to 5.6% of state appropriations. WDEF did not provide additional incentive funding. Instead the state withheld 15% of the prior year's workforce appropriations, and community colleges/tech institutes were then required to earn that money back based on their performances on certain indicators. Missouri: In 1993, the state supported performance funding with $3 million (less than 0.5% of appropriations to higher education), but from FY 1994 to FY 2001, "Funding for Results" (FFR) had an increase to $66 million in funding to institutional core budgets.
Increases over time	Florida: The community colleges criticized the lack of increases in state funding despite improvements in performance.

Table 4.3 Issues with the Sustainability of Accountability Systems—State Examples

ISSUE	STATE EXAMPLES
Budget Cuts	Florida: When there were cuts, the colleges preferred to cut incentive funding rather than enrollment-based funding. Illinois: Program cut due to the state's fiscal crisis in 2002. Missouri: In 2002, due to fiscal stresses, the governor did not fund either inflationary or "Funding for Results" (FFR) dollars.
Incentives become small relative to appropriations	Minnesota: When appropriations to higher education increased because of improvement in the economy, the interest in performance funding declined. It was replaced with performance reporting.
Disappearing political support	Florida: The legislators who had championed WDEF were no longer around. Illinois: Loss of key champions in the state community-college board; new governor lacked interest in performance accountability in higher education; lack of significant support from other key constituents such as legislature and business.
The relative power of colleges	Kentucky: When it was passed that governors would be limited to one term, campus presidents and local boards of trustees gained greater influence on educational policy, and this helped to kill the policy.
Impatience	Kentucky: While the higher-education commission and university presidents debated appropriate criteria for their accountability system, the governor lost confidence that the policy could bring about meaningful change.

[1] Sandy Baum and Jennifer Ma with Kathleen Payea, *Trends in College Pricing* (Washington, DC: College Board, 2008).

[2] Other criticisms focused on the argument that such price controls would lead to the deterioration of college quality. McKeon later revised his proposal by exempting many low-priced colleges from being penalized and delaying when colleges would be penalized for raising prices too much. Stephen Burd, "Republican Introduces Bill to Penalize Colleges for Tuition Increases," *Chronicle of Higher Education*, October 24, 2003.

[3] Frederick M. Hess et al., *Diplomas and Dropouts: Which Colleges Actually Graduate Their Students (and Which Don't)* (Washington, DC: American Enterprise Institute, 2009).

[4] Bridget Terry Long and Dana Ansel, "As Student Debt Increases, Colleges Owe More in Performance," *Connection: The Journal of the New England Board of Higher Education* 21, no. 4 (Winter 2007): 23–24.

[5] Jane V. Wellman, "The Higher Education Funding Disconnect: Spending More, Getting Less," *Change* (November–December 2008).

[6] One recent alumna sued her college for her inability to obtain postcollege employment. Peter F. Lake, "Will Your College Be Sued for Educational Malpractice?" *Chronicle of Higher Education*, Commentary, August 11, 2009.

[7] Thomas Kane and Peter Orszag, *Higher Education Spending: The Role of Medicaid and the Business Cycle*, Policy Brief 124 (Washington, DC: Brookings Institution, 2003); Michael Rizzo, *A (Less Than) Zero Sum Game? State Funding for Public Higher Education: How Public Higher Education*

Institutions Have Lost (Working Paper 42, Cornell Higher Education Research Institute, Cornell University, Ithaca, NY, 2003).

[8] For example, see Gordon Winston and David Zimmerman, "Peer Effects in Higher Education," in *College Choices: The Economics of Where to Go, When to Go, and How to Pay for It*, ed. Caroline M. Hoxby (Chicago: University of Chicago Press, 2004), 394–421; Michael Kremer and Dan M. Levy, *Peer Effects and Alcohol Use among College Students*, (Working Paper 9876, National Bureau of Economic Research, Cambridge, MA, 2003).

[9] Most data only gives institutional aggregates in terms of financial aid. Even when aid figures are divided into types (e.g., need-based versus merit-based aid), it is clear that aid is often awarded due to a combination of need and merit criteria, and so the categorizations may not be that helpful. Only in rare instances is data available on student-level aid awards.

[10] Dennis P. Jones, "An Alternative Look at the Cost Question," in *Higher Education Cost Measurement: Public Policy Issues, Options, and Strategies* (Washington, DC: Institute for Higher Education Policy, 2000).

[11] Alisa F. Cunningham et al., *Study of College Costs and Prices, 1988–89 to 1997–98* (Washington, DC: National Center for Education Statistics, 2001). It was highly influenced by the National Commission on the Cost of Higher Education's report *Straight Talk about College Costs and Prices* (Phoenix: Oryx Press, 1998).

[12] Delta Project, *Trends in College Spending: Where does the money come from? Where does it go? What does it buy?* (Washington, DC: Delta Project on Postsecondary Education Costs, Productivity, and Accountability, 2009).

[13] Ibid., 6.

[14] Michael F. Middaugh et al., *A Study of Higher Education Instructional Expenditures* (Washington, DC: National Center for Education Statistics, U.S. Department of Education, Institute of Education Sciences, 2003).

[15] Delta Project, *Trends in College Spending*, xi.

[16] Ibid.

[17] Jones, "An Alternative Look at the Cost Question," 50–51.

[18] Richard Vedder, "Colleges Have Little Incentive to Hold Down Costs," *Los Angeles Times*, July 18, 2004.

[19] Lake, "Will Your College Be Sued for Educational Malpractice?"

[20] Joseph C. Burke et al., *Funding Public Colleges and Universities for Performance: Popularity, Problems, and Prospects* (Albany, NY: Rockefeller Institute Press, 2002), 225.

[21] Ibid.

[22] Ernest G. Bogue and Kimberley B. Hall, *Quality and Accountability in Higher Education: Improving Policy, Enhancing Performance* (Westport, CT: Greenwood, 2003).

[23] According to the Kansas Board of Regents' *Performance Agreements Guidelines and Procedures* (2006): "Commencing on July 1, 2005, each postsecondary educational institution's receipt of new state funds shall be contingent on achieving compliance with its performance agreement . . . The state board shall determine the amount of new state funds to be received by each postsecondary institution, taking into account the postsecondary educational institution's level of compliance with its performance agreement and the funds available for distribution."

[24] Bogue and Hall, *Quality and Accountability in Higher Education.*

[25] Kevin J. Dougherty and Rebecca S. Natow, "The Demise of Higher Education Performance Funding Systems in Three States" (Working Paper no. 17, Community College Research Center, Teacher's College, Columbia University), http://ccrc.tc.columbia.edu/Publication.asp?UID=693.

[26] Tennessee Academic Affairs, *Performance Funding*, http://www.tn.gov/moa/strGrp_prefFund.shtml

[27] Burke, *Funding Public Colleges and Universities for Performance*, 118.

[28] Kansas Board of Regents, *Performance Agreements: Guidelines and Procedures* (2006).

[29] Dougherty and Natow, "The Demise of Higher Education Performance Funding Systems in Three States."
[30] For some time, Florida also had WDEF, which was much larger.
[31] Burke, *Funding Public Colleges and Universities for Performance*.
[32] Ibid.
[33] Dougherty and Natow, "The Demise of Higher Education Performance Funding Systems in Three States."
[34] Burke, *Funding Public Colleges and Universities for Performance*, 176.
[35] Ibid., 241.
[36] Dougherty and Natow, "The Demise of Higher Education Performance Funding Systems in Three States."
[37] Burke, *Funding Public Colleges and Universities for Performance*, 230.
[38] Ibid., 235.
[39]Kevin Carey, "Measuring What Matters," *Washington Monthly*, June 2007.
[40] Wellman discusses several examples of promising practices in "The Higher Education Funding Disconnect: Spending More, Getting Less."
[41] Ibid.
[42] Ibid.