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CONNECTING STATE AND INSTITUTIONAL FINANCE POLICIES FOR IMPROVED HIGHER EDUCATION OUTCOMES

EXECUTIVE SUMMARY

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JUNE, 2016

Executive Summary

State and institutional finance policies are interrelated and must be well-aligned to maximize student success. Because state colleges and universities rely heavily on state aid, a state's finance policies—especially outcomes-based funding—can significantly influence institutional behavior and in turn directly affect student educational outcomes. Specifically, state finance policies can shape how institutions allocate funding, set tuition, administer financial aid and approach other fiscal and programmatic decisions.

Elements of Postsecondary Finance Policy

Three elements comprise the core of postsecondary finance policy, but can be misaligned or conflicting at the state and institutional levels:

1. **State Appropriations:** The largest finance lever available to state policymakers, direct appropriations historically have been determined through a "base plus" approach in which the prior year's funding is augmented for various cost increases, including inflation and enrollment growth. Institutional policies for allocating state funding vary in ways that can affect higher education outcomes; for instance, some institutions distribute funding according to the number of students enrolled, while others provide differential funding based upon student characteristics.
2. **Tuition:** States can exert considerable influence over tuition levels, allowing steep tuition increases to backfill reduced appropriations or promoting affordability with low-tuition policies that subsidize all students alike. While states generally aim to hold tuition down, institutional policymakers frequently seek to increase it in order to boost system revenue.
3. **Financial Aid:** Financial aid generally takes the form of grants, subsidized loans, work-study opportunities, scholarships and tuition waivers. State financial-aid programs function primarily to promote affordability and allow students significant choice in where they use their aid. Institutional aid is only available to students at a particular college and may have different eligibility criteria and permissible use of funds.

Traditional Enrollment-Based Funding vs. Outcomes-Based Funding

While specific and detailed goals tend to be uncommon, states generally expect colleges to produce graduates that meet the state's workforce needs and to fulfill the personal aspirations of students. Unfortunately, traditional state financing policies are often ineffective for achieving those goals. With a primary aim of expanding access to higher education but little regard for actual performance, enrollment-based funding policies are poorly suited to states' need to promote completion, increase attainment, close equity gaps and otherwise improve education outcomes.

Outcomes-based funding provides a way to direct and provide incentives for institutional performance toward the achievement of defined goals while preserving the autonomy that has historically been accorded to academia. Outcomes-based funding can clarify what is most important to policymakers, measure the extent to which goals are being achieved and promote state goals by creating a direct relationship between attainment of outcomes and receipt of funding.

Done well, outcomes-based funding brings the separate finance strands at the state and institutional levels into harmony. Finance policies aligned in support of student success can include:

- **State appropriations** that allocate funding to institutions based upon demonstrated student outcomes, such as graduation, course completion and learning; and institutional policies that allocate state funding within and among colleges based on evidence and outcomes;
- **Tuition** policies that offer partial rebates for on-time graduation or encourage students to focus on degree-applicable coursework by imposing a surcharge on course units in excess of those required to complete a major; and
- **Financial aid** policies that encourage continuous, full-time enrollment, satisfactory grade-point averages or other practices associated with student success.

Recommendations for Policymakers in Crafting Effective Outcomes-Based Funding Policies

More nuanced than earlier efforts linking funding and performance, the best current outcomes-based funding policies are well-aligned with state goals, acknowledge the differential costs of educating various types of students, protect education quality, leverage the expertise and commitment of faculty and staff, and honor the unique missions of different institutions.

Policymakers seeking to develop effective outcomes-based funding policies should:

1. **Create unambiguous, measurable goals** with the assistance of key stakeholders. In so doing, policymakers should recognize institutional incentives and work to avoid unintended consequences.
2. **Identify a trusted, independent organization** to collect, analyze and promulgate data that track progress toward the funding system's goals. Safeguarding data in this manner will help to establish and protect the validity and credibility of the funding system.
3. **Align accountability** for funding outcomes with the parties responsible for those outcomes. For example, a metric that measures institutions' degrees awarded year over year would be better than one that measures statewide attainment rates, which are beyond the direct control of any given institution.
4. **Provide stronger incentives by linking a large percentage of institutional funding to outcomes.** Tying most funding to performance sends a powerful message about the purpose of funding and strengthens incentives to make every dollar count.
5. **Consider alignment among finance strands.** Policymakers should evaluate all finance strands—state support, tuition policy and student aid—and how they interact with each other. Ideally, the policies are mutually reinforcing and aligned to the state priorities of access, affordability and student success and completion.