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STRUCTURING STATE POLICY FOR STUDENT SUCCESS: APPLYING INCENTIVES IN THE VOLUNTEER STATE

EXECUTIVE SUMMARY

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Executive Summary

For many years, state funding to public colleges and universities in Tennessee and across the nation was distributed based primarily on enrollment, rather than degree production or efficiency. This led or allowed institutions to seek more funding through efforts such as boosting enrollment and engaging in mission creep, with little incentive for completion. To address this ill effect and promote better outcomes tied to state goals, Tennessee has implemented two primary types of direct economic incentives for institutions: performance funding (1979) and an outcomes-based funding formula for public higher education (2010). Under these initiatives, institutional performance, as measured by the funding model, leads directly to the institution's amount and share of state appropriations for institutional operating expenses.

In Tennessee's experience, incentives work. This experience is pertinent to other states because: with only 36 percent of its adult residents holding a postsecondary certificate or higher, Tennessee has a long way to go in terms of educational attainment; it has made substantial strides in a short time; and it shares enough characteristics with enough states to make its experience relevant across a variety of state contexts.

1979 to the Present: The Performance Funding Program

In 1979, Tennessee became the inaugural state to formally implement a Performance Funding program. With support from a handful of external sources, the state sought "to explore the feasibility of allocating some portion of state funds on a performance criterion" (Bogue, 2002). From this modest objective arose a program that stood the test of time, spanning five governors (three Republicans and two Democrats), and serving as a model for many state and some international higher education systems.

Under the program, a small portion (up to 5.45 percent) of state higher education operating appropriations to public campuses is awarded on the basis of performance indicators, which have been revised every five years. Over time, a consensus developed within the higher education community that the program was not the game-changer that institutions hoped it would be, given: 1) the program's ineffectiveness in attracting new state appropriations; 2) the small share of institutional operating revenues (from tuition and state appropriations) it put at risk; and 3) the lack of differentiation between institutions when performance points were tallied. Therefore, in its current iteration, Performance Funding ceded the traditional productivity measures of progression and graduation rates to the state's newer outcomes-based funding formula in order to become the "quality control" counterbalance to that more productivity-focused formula.

Although two studies found that it had little effect on institutions' performance, the Performance Funding program served several key purposes, keeping institutions engaged and open to the ideas of: 1) public accountability; 2) a culture of ongoing institutional assessment and improvement; and 3) performance funding. In so doing, it set the stage for the major overhaul that was to come in the form of a new funding formula based entirely on student outcomes.

2010 to the Present: Outcomes-Based Public Higher Education Funding Formula

As part of the landmark Complete College Tennessee Act of 2010, Tennessee replaced its enrollment-based funding methodology with an outcomes-based funding formula model that rewards institutions for the production of outcomes that further the educational attainment and degree productivity goals of the state's Master Plan for postsecondary education. Importantly, the outcomes-based formula governs *all* operating appropriations for these institutions except for the approximately five percent awarded under Performance Funding. The metrics chosen represent broad activities that are differentiated across various types of institutions, from research-heavy four-year universities to community colleges filling workforce development needs. These outcome measures are grouped into the categories of student progression, degree production, efficiency, and other important institutional functions. The formula is simpler and more transparent for state government and the public than its enrollment-based predecessor, and is not prescriptive as to how to achieve targets.

In place for four budget cycles, outcomes-based funding has driven a lot of action and innovation in Tennessee. However, it's not yet clear that overall effect of these changes on student completion and attainment. Notably for other states considering outcomes-based funding policies, however, the objections and concerns most commonly heard at the policy's onset—such as that academic standards would be lowered and funding volatility would jeopardize institutional planning—have not come to pass. Instead, outcomes-based funding has given rise to several cultural and qualitative improvements, such as:

1. Changing the fundamental nature of the conversation on campuses, in board rooms and in the state legislature, together with other key state initiatives focused on college completion.
2. Unleashing enormous creativity and innovation at the campus level centered on degree production and efficiency.
3. Providing the state a more efficient way of appropriating state dollars for institutional operations.

Though generally positive, the early data are mixed as to whether the outcomes-based formula and the college completion era have ushered in improvements in degree productivity by Tennessee public postsecondary institutions.

Considerations for Policymakers

Tennessee's lengthy history with performance and outcomes-based funding has led to several tentative conclusions about the use of financial incentives to improve institutional and student success. Following empirical testing over time, confirmation of—or failure to reject—these statements would elevate their status to performance-incentive principles.

1. **Incentives work.** Tennessee's experience has been that people and institutions respond to incentives. Institutions respond most readily to direct economic incentives.

2. **Incentive funding is superior to initiative funding.** The state higher education community has accomplished more in terms of culture change, results and cooperation between institutions and systems in response to the notion of outcomes-based funding than could have resulted from decades of state- or federally imposed initiatives.

3. **Get the money right, and everything else will follow.** This is a corollary to the first and second statements.

4. **Focus on the "what" and not the "how."** Limiting the state-level focus to the "what" and leaving the "how" to the institutions unleashes campus creativity and allows institutional buy-in to build as individual colleges take ownership of the solutions they have tailored to themselves.

5. **Direct economic incentives are a necessary but insufficient policy response to the college completion agenda.** This is true because many non-economic and indirect incentives are byproducts of the outcomes-based formula itself, initiated to give outcomes-based funding greater impact on campus and to help institutions fare better within its parameters. These additional campus tools, initiatives and practices would be less than the sum of their parts without the benefit of outcomes-based funding and might not even exist apart from it.