

DATE: February 21, 2012
TO: Interested Parties
FROM: Kyle I. Jen, Deputy Director
RE: University Funding Policy

Section 266 of Article IV of Public Act 62 of 2011, which contains the FY 2011-12 Higher Education budget, states the following:

It is the intent of the legislature that, in subsequent budget years, public university operations funding appropriated by the legislature shall be allocated to each university using a formula developed and enacted by the legislature. Such a formula shall incent universities to provide, in a cost-effective and timely manner, postsecondary opportunities for students that are both accessible and affordable and that result in a highly skilled workforce.

This memo provides background information on past initiatives to create a permanent university funding policy in Michigan, provides links to resources regarding university funding policies in other states, and discusses major considerations that would need to be addressed in order to adopt such a policy in Michigan.

Past University Funding Policy Initiatives

Currently, the State of Michigan has no permanent funding policy for allocating funding for operational support to the state's 15 public universities. Decisions about changes to university appropriations are made by the Legislature on a year-to-year basis. The priorities expressed by the Legislature through those decisions have shifted over time.

Under the appropriation structure that has evolved, the amounts of funding received by the 15 universities on a per-student basis vary widely, ranging from a low of \$2,351 to a high of \$7,341 in FY 2011-12 (see the attached chart).¹ Universities at the higher end of the per-student funding spectrum tend to provide more instruction at the graduate level and/or in higher-cost program areas and conduct higher levels of externally-funded research, but the correlations are not precise.

Over the last two decades, there have been frequent initiatives to establish a permanent university funding policy in Michigan:

- The Student Equity Plan proposed by Senator Bill Sederberg in the late 1980's. This plan was based on a calculated state share of undergraduate instructional costs.
- A single per-student funding floor to recognize enrollment growth for universities at the bottom of the funding spectrum. A funding floor has been utilized to allocate a portion of funding increases in a number of budget years over the last two decades, and boilerplate language

¹ Per-student appropriation amounts are calculated using FY 2010-11 total fiscal year equated students (FYES). At the undergraduate level, one FYES is equal to 30 credit hours. FYES is the most appropriate enrollment measure for comparing costs of direct instruction, which is the largest category of university general fund expenditures. Student headcount may be more appropriate for comparing some non-instructional costs at universities (e.g., student services).

stating intent for a funding floor of \$3,775 per student was included in the annual budget act from FY 2006-07 to FY 2010-11 (somewhat higher floor amounts had been specified in previous years).

- The tier system proposed by Governor Engler in the early 2000's. This system placed the 15 universities into four to five groups based on the extent to which each university provided larger amounts of instruction in higher-cost program areas and established tiered per-student funding thresholds for each group. If the system had been implemented, universities funded below their particular funding thresholds would have received priority for larger funding increases. A previous tier proposal had utilized the university classification system the Carnegie Foundation releases every five years for research purposes.
- A funding model proposed by the House Republicans in 2005 and 2006. This formula calculated university appropriation amounts based on university enrollments, degree completions, and federal research funds. The degree completion component was weighted to reward completions in higher-cost program areas.²

None of these proposed policies was successfully implemented on an ongoing basis. Instead, changes to university appropriations have generally been made on an across-the-board basis, with limited amounts of funding devoted to a single per-student funding floor or other data-based funding elements in some years. Changes in the relative amounts of per-student funding received by universities over time have been driven, therefore, more by enrollment changes than by appropriation changes.³

In the Community Colleges budget, two formulas have been utilized by the Legislature in the last three decades:

- The Gast-Mathieu formula, which calculated a "net need" for each college based on certain assumptions regarding instructional and non-instructional costs, deducting assumed amounts from tuition and property tax revenue.
- More recently, an incentive-based formula that allocates a limited subset of college funding based on enrollment and degree completion figures.

In both cases, the formulas have generally been utilized only to allocate a portion of annual funding increases, rather than redistributing existing base appropriation amounts for the colleges.

University Funding Policies in Other States

The Gast-Mathieu formula is comparable to cost-based funding formulas for postsecondary institutions utilized in a number of other states. The degree to which formulas are adhered to rigidly, as opposed to systems that allow for more legislative discretion in determining annual funding increases, varies across the states. A 1999 report by the Southern Regional Education Board described major funding formula concepts utilized by states in that region of the country:

http://publications.sreb.org/1999/99E23_PrimeronFundingHigherEd.pdf.

Over the past several decades, a number of states have shifted a portion of the funding they provide to postsecondary institutions to a performance incentive funding system. One recent example is a

² For a complete technical description of the final version of the House Republican funding model see the following memo: <http://www.house.mi.gov/hfa/PDFs/funding%20model%20memo%20house%20sub.pdf>.

³ For further historical background on university funding, see the 2006 HFA report, "State University Appropriations": <http://www.house.mi.gov/hfa/PDFs/fiscalfocus11-06.pdf>.

system currently in place for the State of Indiana that provides funding based on six or seven data-based criteria:

[http://www.in.gov/portal/news_events/files/101214_RELEASE_CHARTS -
_Performance_Funding_Formula.pdf](http://www.in.gov/portal/news_events/files/101214_RELEASE_CHARTS_-_Performance_Funding_Formula.pdf)

The number of states utilizing performance funding policies for public universities or colleges has fluctuated over time. A recent report by the American Association of State Colleges and Universities noted, "Between 1979 and 2007, 26 states enacted performance funding, while 14 abandoned their programs (two states, however, re-established programs)."

http://www.congressweb.com/aascu/docfiles/Performance_Funding_AASCU_June2011.pdf

A recent briefing released by the National Conference of State Legislatures reports that six states have recently taken steps toward implementing performance-based funding systems:

<http://www.ncsl.org/?tabid=12899>

In each of the six cases, however, the state legislature has not yet specified precise performance funding criteria, with a statewide board or executive branch department charged to determine those criteria at some point in the future.

Performance funding programs adopted in other states have usually been implemented in conjunction with existing cost-based funding policies. Generally, performance funding has been limited to 25% or less of total state funding for postsecondary institutions.

Major Considerations for Adoption of a Funding Policy

Any permanent university funding policy adopted in Michigan would be based, at least implicitly, on a broader Higher Education policy (or policies), since universities would face incentives to alter their behavior in order to maximize state funding. Potential policy considerations include the following:

- Whether, and to what extent, to reward enrollment growth.
- Whether to reward universities that offer more instruction in higher-cost (and generally higher-demand) program areas: health care, engineering, technical fields, hard sciences, etc.
- Whether to reward universities that conduct large amounts of federally-funded research (which tends to increase faculty salary levels).
- How heavily to weight degree completion measures, as opposed to basic enrollment figures.
- Whether to include some consideration of university tuition/fee levels, which tend to correlate inversely with state funding levels at both the statewide and institutional levels.
- Whether to recognize differences in the academic or socioeconomic profiles of university student populations, which tend to significantly influence postsecondary educational outcomes.
- How to balance undergraduate and graduate instruction.
- How to treat enrollment of out-of-state students.
- How quickly to phase in the use of outcome measures to allocate funding, given the lag between the adoption of new university practices and changes in outcomes.

In order to establish a credible, long-term funding policy, formula components would need to be based on reliable, auditable data to ensure that funding amounts were consistent with real changes in university activities or outcomes.

From a broader perspective, there would be two fundamental issues to consider in developing a permanent university funding policy. The first decision would be whether to construct a new funding system from the ground up (like the 2005/2006 House Republican funding model) or work from the current appropriation structure and make incremental changes when funding increases are available (like the funding floor approach or tier system). A third scenario, utilized in some other states, would be to reduce each university's appropriation by a certain amount and then restore some or all of the overall reduction on a formula or incentive basis. (This third scenario was utilized for the FY 2011-12 Community Colleges budget.)

Incremental changes tend to be the norm when new funding policies are proposed. While the House Republican funding model built a new appropriation structure from the ground up, it proposed to phase in the changes from the existing structure to the new structure over a more extended period of time. Assuming a fixed level of total university funding, any entirely new funding system adopted by the state would create substantial winners and losers among the 15 universities.

The second broad decision is whether the 15 universities would be treated uniformly or whether they would be separated into different groups based on differing missions. A system that treated all the universities uniformly could result in "mission creep," with an arguably excessive number of universities pursuing higher-cost instruction or large amounts of research in response to funding incentives. On the other hand, a system that effectively required universities to maintain their activities within their existing missions could potentially limit innovation and market-driven adjustments.

Finally, the ongoing shift in the balance between state appropriations and student tuition—the two main sources of university general fund revenue—would affect how a university funding policy is constructed. In FY 2000-01, state appropriations provided nearly half of university general fund revenue; in FY 2011-12, state appropriations provide an estimated 22% of general fund revenue. That shift reduces the potential magnitude of any financial incentives built into a funding formula in the context of broader university financial decision making.

Attachment

FY 2011-12 University Appropriations per FY 2010-11 Fiscal Year Equated Student

