EDUCATION FUNDING REFORM

Conceptual Framework for Performance Funding

ExcelinEd Policy Toolkit - 2018

OVERVIEW

This paper sets forth a conceptual framework for performance funding, where funding of districts depends to some degree on how well their students are doing. It supplements a modeling tool developed by Excel*in*Ed to help policymakers understand the financial implications of performance funding, as well as an issue brief that explains the tool and its significant findings. These materials were prepared with the help of Dr. Larry Miller, the nation's foremost expert on performance funding in K-12 education, and with the generous support of the Jaquelin Hume Foundation.[1]

This paper is written for state policymakers and state education department administrators to assist them in developing a performance funding system for their states. The performance funding conceptual framework is structured around nine big questions about performance funding. In response to each question, the conceptual framework:

- Defines concepts and introduce new terminology;
- Provides examples of performance funding systems in practice across all levels of education, from early childhood through colleges and universities;
- Identifies the critical implementation choices states must make; and
- Describes some of the benefits and costs of the most common policy alternatives.

What Is Performance Funding?

Performance funding means that some portion of funding is allocated to schools based on how well students perform academically. Performance funding is a generic term that we prefer, knowing that states may modify the term to support their strategic priorities and goals. Performance funding is practiced from cradle to college by early learning systems, primary and secondary schools, and state colleges and universities. It is different from traditional funding which, regardless of how well students do academically, sets funding levels based on the number of students enrolled and how frequently they attend school.

Same System, Different Name

The name *completion-based*, or *competency-based* funding, is sometimes used in K-12 schools when the performance standard is the completion of student assignments or mastery of competencies. *Outcome-based* funding is used in higher education circles to denote an emphasis on funding a specific outcome like graduation or employment rates. Whatever you choose to call it, when a state makes funding contingent on student performance, it is a *performance funding* system.

Under performance funding, a school's funding level is determined by comparing specific indicators of performance (e.g., high school graduation rates, college attendance rates, pass rates on state exams) with the state's performance standards (e.g., minimum level of achievement required, minimum growth rate demonstrated, a composite score of several indicators using a points and weighting scheme). More funding is provided to schools with better performance on these indicators. The source of performance funding funds can be drawn from base funding, a new pool of funding, or a combination of the two. The funding source

How High Are the Stakes?

Performance funding can be modified by adding the terms *high-* or *low-stakes*, which are used to differentiate between states that provide partial funding for partial success and states that only provide full funding when the performance standards are met.

[1] To download the tool, see *Performance Funding Model Tool*. For the issue brief, see Excel*in*Ed, *Issue Brief: Performance Funding*.

can be capped or uncapped, with the latter increasing competition across schools and leaders for a fixed funding amount. School administrators, teachers and ultimately students are expected to work both smarter and harder to earn performance funding to continue operations, innovate, and expand.

Why Should State Policymakers Consider Performance Funding?

State constitutions generally require the state to provide students with a thorough and efficient education, or something similar. Performance funding improves productivity by funding the amount *learned* instead of time served. Funding based on performance encourages administrators and teachers to spend more time and effort assisting more children to be successful, not for personal gain, but to ensure the school and its students are successful. Performance funding improves equity by rewarding schools that close achievement gaps with the extra resources. Performance funding places greater emphasis on results, giving schools more flexibility over how they organize and use resources to meet performance standards.

The share of education spending provided by the state has increased dramatically over the past century. As a state's fiscal role increases, performance funding empowers the state to hold schools financially accountable for student performance. Performance funding provides the state with the credible threat of reducing (or increasing) funding for missing (or meeting) performance standards, as local voters are able to do through school district budget referenda.

To What Types of Performance Measures Can Funding Be Attached?

Performance funding can focus on formative measures of student learning, summative measures of completion, or they can rely on external market-based indicators, like labor market outcomes.

A formative approach funds schools when students complete assignments, pass exams or demonstrate mastery over a competency. The advantage to this approach is that schools may have more control and influence over student performance on formative measures. The disadvantage is that policymakers and voters may not want to invest in formative outcomes; instead, they may want to invest in rewarding schools that produce more high school graduates that are college and career ready. New Hampshire and Florida implemented performance funding for their K-12 online schools. Both systems base funding criteria on formative data. New Hampshire's program provides funding to schools based on completion of assignments. Florida's program funds schools when students pass classes.

A summative approach funds schools when students are accepted into college, graduate high school or pass a high school exit exam. The advantage of summative approaches is that the state is incentivizing the production of more of the outcomes they want. The disadvantage is that schools may have less direct influence over summative measures of student performance. Formative approaches are more common in K-12 systems; whereas, summative performance standards are typically used in higher education. Florida's higher education performance funding system uses both summative measures and labor market outcomes to set performance funding levels.

Labor market outcomes are emerging as a performance funding measure. For example, in the Texas State Technical College system, funding is based on the earnings of graduates for five years after graduation. The advantage of this approach is that funding allocation decisions are determined by the labor market, meaning that programs and colleges that produce graduates who earn the highest wages will earn the most revenue. The market is the ultimate judge of a graduate's knowledge and skills, and therefore higher placement rates, wages and retention rates for graduates from one school over another reflect differences in program performance. The disadvantage is that the low wage of a graduate may reflect a problem with the economy or labor market, not anything about the performance of a specific institution. Many industries pay very low wages but are important to the regional economy, including early childhood educator salaries. A college seeking to increase revenue from this type of performance funding system might eliminate important programs because their graduates earn low wages. Wage rates vary regionally and need to be adjusted to

make apples-to-apples comparisons across the state. Wage rates are also influenced by macroeconomic trends, like recessions and globalization, that could drive higher education funding levels up or down regardless of how well the school performed and how much the student learned.

Comparing Three Approaches to Performance Measurement

Performance Measures	Formative Measures	Summative Measures	Labor Market Outcomes
Also Known As	• New Performance Funding • Performance Funding 2.0	• Old Performance Funding • Performance Funding 1.0	• Old Performance Funding • Performance Funding 1.0
Performance Measure Examples	Submitting assignments, passing an end-of-course exam	Graduation rate, retention rates	Wages, placement rates, retention
Advantages	Instructors and administrators have the most influence over formative performance measures.	Holds the entire institution accountable rather than just faculty.	Positive market outcomes are what state policymakers and voters want to invest in. The results are determined by the market and less likely to be gamed by the school.
Disadvantages	Policymakers do not want to reward schools when students complete their homework. They want to fund outcomes.	Risk that the standards will be lowered to meet performance standards.	Low wage may reflect economy and labor market, not program quality.
Exemplars	Florida Virtual School, Virtual Learning Academy Charter School (New Hampshire)	Florida State Colleges and Universities (partially)	Texas State Technical College System, Florida state colleges and universities (partially)

What Thresholds of Student Performance Can States Recognize?

States have several options in performance thresholds, including setting an absolute minimum, rewarding student growth and recognizing partial success.

States can set minimum performance thresholds and only fund schools when students meet the performance criteria. Florida's performance funding policy for the Florida Virtual School (FLVS) fits nicely into this "all or nothing" approach to performance funding. FLVS earns 1/6th of the per-student allocation when the student passes the course. If a course has an end-of-course exam, then that exam score must account for a minimum of 30 percent of the student's final grade in the course. If a student fails the course, the funding is lost. The strength of this approach is that it provides maximum accountability by only funding schools when students successfully pass high stakes, end-of-course exams. The disadvantage is that teachers may be discouraged by their perceived lack of influence over the success of their students on high-stakes exams. State policymakers may prefer this model as it is easier to implement and only rewards schools when their students succeed.

Alternatively, states can adopt a growth-based performance funding system that rewards schools for all of the learning gains a student demonstrates, even if the student does not pass the class or exam. If a student starts a course well behind her peers but earns a 60 on the final exam, she may have learned the most in that classroom this year in spite of not passing the exam. A growth-based model would fund the school for her learning, albeit at 60 percent of the full-

rate. School leaders and teachers may prefer this system because they can earn funding for all of the learning in their classrooms, and resources levels are not tied to student test performance. Teachers may be less likely to sidestep very low performers in a growth-based performance funding system.

Similarly, states can choose to fund schools based on the number of segments a student completes in a given course, or the percentage of work a student completes. Completion-based funding systems provide partial funding for partial success and can provide additional funding when students accomplish more than expected in a semester or school year. New Hampshire's performance funding system allows its statewide virtual charter school (VLACS) to earn partial funding. If a student completes 50 percent of his assignments, the school receives 50 percent of the funding, and the student must continue working in the course to earn credit. When a student completes all of the assignments in a course, the school can invoice the state for that student at the full rate, even if there is time left in the school year. Should the student complete more work in that same school year on the next course in the sequence, the school can invoice the state for that progress as well. In this way, the state is incentivizing the school to accelerate student learning. It is easier to implement in an online environment.

Performance Funding Budgeting Tips

- Allocate a significant portion of total revenue to encourage schools to respond.
- Use base funding to signal this is a long-term effort.
- Use unrestricted funds to encourage innovation.
- Use weights for at risk students to ensure equity of outcomes.

What Proportion of a State's Education K-12 Budget Can Be Allocated Via Performance Funding?

The size of the state's performance funding budget signals to school leaders the magnitude of the impact on the school's budget and the amount of additional funding available for improved performance in the following year. School leaders will respond proportionally to the size of the opportunity to earn new funds and the amount of current funding that performance funding puts at risk. States can set the performance funding budget very high and allocate all funding based on performance. The amount of revenue made available to schools for meeting the performance standard will rise accordingly, and leaders can expect bigger performance gains in response. Design flaws are more likely in the first few years of implementation, and a higher performance funding budget could produce bigger unintended consequences. There may be legal limits on some funding sources that prevent them from being allocated on a performance basis. Some categorical budgets have allocation formulas written into statute or rule and may be difficult to allocate via performance funding early on. Alternatively, states can set the performance funding budget very low and only allocate a small percentage of funds on performance. They can expect performance gains to be muted in response but will be able to modify the policy over time to strengthen the design so that it produces the intended results and steadily increase the performance funding budget over time.

When states decide what proportion of funds to allocate on a performance basis, policymakers need to recognize that only state revenue will be affected by the policy, while local and federal revenue will continue to be earned on an incremental and grant-funded basis. Those funding sources can serve as financial stabilizers during the implementation of performance funding. It is worth noting that New Hampshire's funding of VLACS is 100 percent performance based.

States can expect bigger performance gains if permanent revenue sources are used for performance funding. Conversely, if performance funds are drawn from temporary revenue sources, like a grant, then state leaders should expect less change in performance. Performance funding systems that are written into state statute compel all school leaders and teachers to respond; whereas, systems implemented by categorial grant requirements or via a pilot program only impact administrators and teachers whose schools or positions are funded by the grant.

How Can Performance Funding Avoid Incentivizing Schools to Lower the Bar for Students?

When faced with the incentives of performance funding, instead of doing the hard work of improving student performance, schools and school leaders could lower the level of rigor to make sure that they generate enough revenue to survive. Doing so would give the illusion that student performance was improving in response to performance budgeting when performance had not really changed. More students were just clearing a lower hurdle. Lowering the performance bar would also ensure continued financial support for schools that did not actually improve student outcomes. There are multiple ways that states can address this concern.

First, performance funding systems that rely on state-administered exams protect against a reduction in the level of academic rigor. Florida requires end-of-course exams for several courses. Florida integrates student performance on end-of-course exams into its performance funding system for FLVS by requiring that at least 30 percent of a student's final grade must be based the results on the end-of-course exam. For states that do not have end-of-course exams or are eliminating them, a high school exit exam may be used in their place.

Second, in courses where a state-administered exam is not available, professional learning communities (PLCs) for assessment may be established with nearby districts. The PLCs could be used to assess and grade student work to ensure that a high standard is met by independent, local professionals. A partnership with a nearby university could establish assessment norms and reliability checks to ensure common proficiency standards are maintained across assessors. A key benefit of the PLC is that it removes the individual teacher from the conflicted position of determining a student's grade, knowing that the decision has financial implications for the school. Assessment PLCs are an added expense that states and districts should consider when deciding on the best approach to maintain rigorous standards.

Third, New Hampshire addressed the threat of lower performance standards at VLACS by keeping performance measures that earn funding distinct and separate from performance measures that award academic credit. VLACS earns revenue when students complete assignments. In other words, VLACS is funded at the state per-course rate times the percentage of homework a student turns in. VLACS students earn course credit by mastering competencies. VLACS can earn full funding for a student who completes all of the assignments in a course, while also not awarding the student credit for passing the course because the student did not master the competencies. The VLACS model removes the inherent conflict of interest between earning revenue and maintaining rigor.

Finally, there are concerns that performance funding systems narrow the focus of school leaders and teachers to academics and high stakes test scores to the detriment of important but untested contributions to society, like grit and social emotional skills, or that they crowd out arts and music education. States can address these concerns by ensuring that their curriculum standards and assessments include these important skills and subjects and that they are incorporated into the performance funding system as well.

How Can Performance Funding Ensure At-Risk Students Receive Necessary Without Merely Shifting Funding to Schools with More Advantaged Students?

To ensure equity in outcomes for all students, performance weights should be established within the performance funding system. Performance weights provide extra funding to schools that meet state performance standards while serving costlier to educate students. States already weight school enrollment based on student characteristics. In a performance funding system, the weight is shifted from an input measure to an outcome measure. States should base their weights on predicted student success. More funding is sent to schools that demonstrate success with students who were less likely to meet standards. Performance weighted funding ensures sufficient revenue is available to pay for the higher intensity or required specialization of resources needed to educate students who are currently low performing to state standards. When performance funding is implemented, policymakers can look at data about equality of

outcomes across a state and increase the weight for student groups that are not doing as well as the rest of their state's students.

To What Extent Will Performance Funding Incentivize and Improve Student Performance?

The best evidence on the impact of performance funding comes from early childhood programs and higher education. Most notably, the Florida Legislature created the Early Learning Performance Funding Project to provide performance-based funding in exchange for demonstrated improvement on program quality and learning outcomes among at-risk children. The evaluation was a joint effort by the Yale Child Study Center and the University of Florida's Lastinger Center and published in 2017. This comprehensive study and report found that children participating in the performance funding program had a 23 percent higher growth rate than children who did not participate (Rodgers 2017). The investigators also studied performance funding's impact on teacher knowledge and program quality and found substantial gains in both areas.

An evaluation of performance funding's impact on higher education outcomes in Tennessee, Ohio and Indiana found a positive relationship in both short-term (credit accumulation and certificate completion) and long-term (2- and 4-year degree completion) outcomes (Research for Action 2017). The authors estimate that Indiana's performance funding program improves the odds of earning a bachelor's degree within four years by 6.6 percent.

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