



Performance-based funding for the Commonwealth Grant Scheme

Response to Discussion Paper

February 2019

Executive Summary

The University of Melbourne is pleased to contribute to the consultation on the Government's proposed performance-based funding framework for Commonwealth Grant Scheme (CGS) funding.

The University acknowledges that the Commonwealth Grant Scheme represents a major public investment in Australia's higher education system. In view of the scale of this investment, we support the Government's commitment to accountability and transparency concerning the outcomes achieved through this funding. Institutions in receipt of this support have a responsibility to Government, students and the public to demonstrate the value that our universities deliver for students and for broader society and for its economy.

The following submission is structured in two parts. Firstly, we identify the considerable problems with the proposed approach to performance-based funding, and discuss the possibility of more holistic reform of the CGS to advance some of the Government's key aims. Secondly, we note design principles that ought to inform any performance assessment framework, and respond to some of the Consultation Questions included in the Discussion Paper.

Performance funding and the CGS freeze

While the University endorses the policy objective of establishing a means through which institutions can demonstrate accountability for the financial investment they receive, there are inherent problems with performance-based funding, and we urge the Government to reconsider this particular approach. The primary issue concerns the proposal to use the funding freeze, announced in MYEFO 2017, as the mechanism by which performance-based funding allocations are to be delivered. The funding freeze is a funding cut in real terms. This generates an incentive for universities to enrol fewer Australian students, with additional enrolments only viable in areas where the HELP contribution (retained by the University) outweighs the Commonwealth's. This brake on growth will ultimately undermine rather than promote institutional performance and the extent to which the sector advances national interests.

The University of Melbourne urges the Government to consider more thoroughgoing reform of the CGS. In 2011, the Department of Education and Training raised the option of introducing a system of 'funding envelopes', in which institutions would be provided with a given amount of funding for Commonwealth supported places, and would be permitted a degree of autonomy in distributing that funding across course levels and discipline areas. This approach would allow Government to manage budget expenditure, while encouraging sector diversity and specialisation by allowing CSP allocations to be made in accordance with distinct institutional missions. Performance targets relating to study outcomes could be integrated into this approach, for example by tying future funding growth to a set of targets agreed upon by Government and institutions.

Comment on the design of performance-based funding

The University of Melbourne does not support the Government's proposed performance-based funding framework, as it is currently conceived. There are significant challenges associated with any attempt at linking funding to institutional performance, including ensuring that performance-based assessment is: (i) sensitive to the diversity of Australia's universities; (ii) drives genuine improvement in institutional performance; (iii) minimises administrative costs; and (iv) does not create perverse incentives or generate unintended consequences. Nonetheless, should the Government proceed with its proposal, the University offers general comment on how a performance-based funding framework might be designed in a way that is sensitive to these challenges.

For further information, or to discuss this submission, Dr Julie Wells, Vice-President Strategy and Culture can be contacted at julie.wells@unimelb.edu.au or (03) 8344 2639.

Recommendations

Performance funding and the CGS freeze

The University of Melbourne recommends that the Government consider reforming the CGS, to introduce a system of funding envelopes, supporting institutional diversity by allowing institutions greater flexibility to allocating CSPs across course levels and setting performance benchmarks.

Comment on the design of performance-based funding

If the Government proceeds with its approach to implementing a performance-based funding framework, the University of Melbourne recommends that the Government:

- Adopts a two-stage process involving quantitative assessment of raw outcomes, followed by expert review that assesses the extent to which any given institution's results are adversely impacted by factors that are beyond its control.
- Considers the use of broad-banding to assess institutions, rather than sector rankings or specific scores.
- Avoids labelling performance outcomes in a way that misleadingly suggests that institutions are under-performing.
- Ties funding increases to local (rather than national) population growth, and ensures that funding increases are aligned with growth in demand arising from increased numbers of school-leavers.
- Ensures that additional (performance-based) funding from 2020 is added to an institution's MBGA for subsequent years.
- Uses a small set of measures to assess student experience, graduate outcomes and equity performance.
- Ensures that any loss of funding to a particular institution arising from performance-based assessment is reallocated within the sector.

1. Performance funding and the CGS freeze

The Government proposes to use the Minister of Education's power to set a 'maximum basic grant amount' (MBGA) for non-designated courses to allocate CGS funding on the basis of institutional performance from 2020. The Minister has already exercised this power in 2018 and 2019, setting a MBGA for most institutions at the dollar amount received in 2017 i.e. freezing funding. From 2020, institutions will be eligible for funding increases in line with population growth, subject to institutional performance.

There are considerable problems with attempting to implement a performance-based funding framework in this way:

1. *The funding freeze is a funding cut in real terms.*

Given inflation, the decision to freeze funding at the dollar amount institutions received in 2017 is, in real terms, a funding cut. Institutions received less funding in 2018 than they did in 2017, and will receive less again in 2019. Since per student CGS funding levels remain subject to indexation, freezing MBGAs at 2017 levels essentially means that institutions need to enrol *fewer* students to utilise their CGS allocation.

Under the proposed changes, funding increases in line with population growth of 18-64-year-olds (roughly 1.2 per cent) will be provided in 2020 to institutions that meet "specified performance requirements" (p.5). Since the population growth rate is typically lower than inflation, even an institution that is "rewarded" with a nominal increase in its MGBA will suffer a further cut in real terms, albeit a smaller cut than an institution whose MGBA is not (nominally) increased. As the same approach would be repeated indefinitely in future years, the policy proposes to lock in ongoing funding cuts for undesignated, bachelor level places.

While the presumed intent is to accommodate demand by tying performance-contingent funding growth to population growth, it is clear that the policy will fail to achieve this, as it reduces the viability of Government-funded places and will discourage growth.

2. *The freeze generates a funding bias against STEMs disciplines.*

While maximum CGS allocations have been frozen at 2017 levels, student contributions remain uncapped. Consequently, the incentive for institutions to reduce enrolments is stronger in funding clusters where the CGS subsidy makes up a relatively large share of the total resourcing a university receives per Commonwealth supported student, and weaker in clusters where the CGS subsidy makes up a relatively small share of the total resourcing. Significantly, this places STEM fields at a disadvantage from a funding perspective.

To demonstrate, for CSPs in 'Law, accounting, administration and commerce' (funding cluster 1), only 16.5 per cent of total resourcing consists in CGS subsidy, compared to 69.0 per cent for Nursing (funding cluster 6) and 66.5 per cent for 'Science, Engineering or surveying' (funding cluster 7) (See Chart 1). Consequently, the CGS funding freeze has a far bigger impact on those clusters where a greater share of funding comes from the CGS. Chart 2 (below) illustrates this, comparing the relative loss of funding per EFTSL over time due to the funding freeze for clusters 1, 6 and 7. It demonstrates that:

- a) Funding clusters 6 and 7 are far more heavily impacted than funding cluster 1; and
- b) The differential impact across clusters grows over time i.e. the longer the proposed funding settings are held in place.

Note that the assessment assumes that EFTSL is held constant across each of the years, and that the institution is provided with performance-contingent nominal increases to its MBGA each year from 2020. The situation will therefore be worse than depicted in Chart 2 if the institution were to increase its EFTSL, or if it were not provided with growth funding in 2020 (or in a subsequent year).

Chart 1: Share of per student resourcing that comes from the Commonwealth contribution

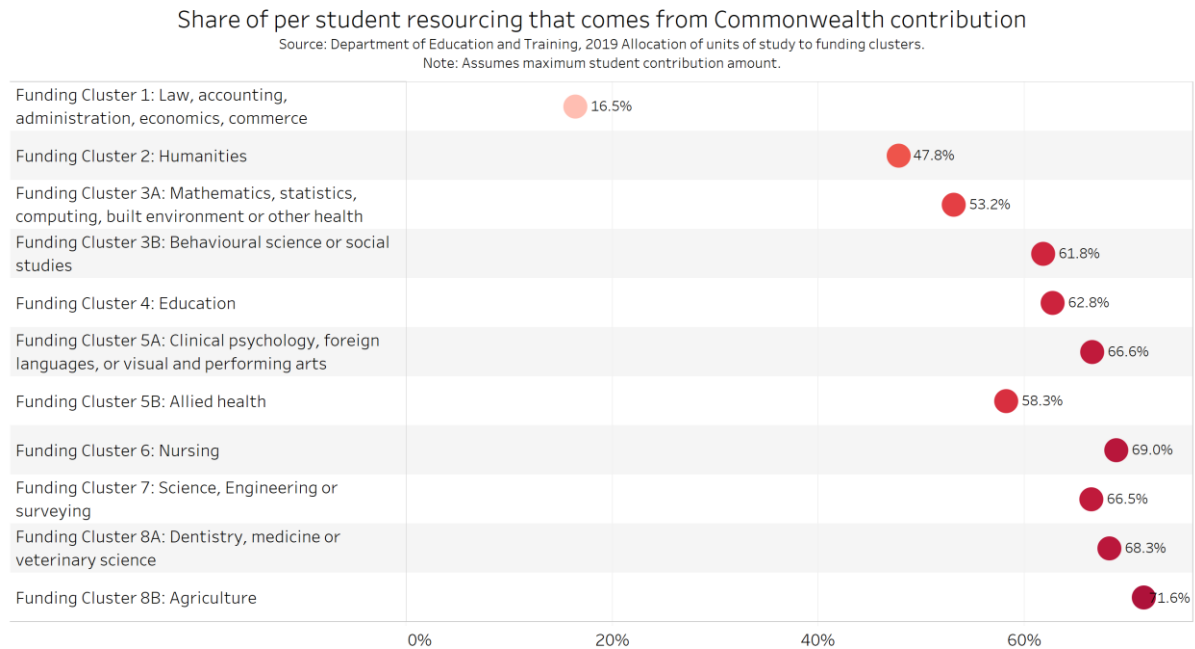
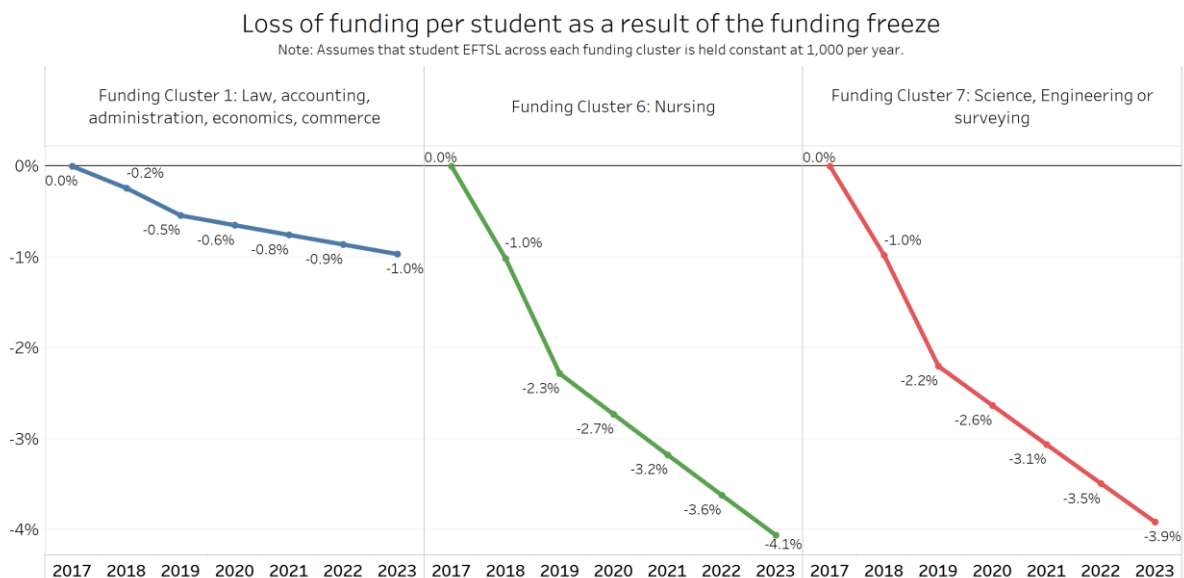


Chart 2: Loss of funding per student as a result of the funding freeze¹



¹ Chart 2 compares the total funding (Commonwealth and student contributions) an institution would receive with no funding freeze in place with what it would receive under the Government's proposed policy. The loss of funding per student is the percentage difference between the two, holding EFTSL constant. It assumes indexation of funding cluster amounts at 1.9 per cent per year from 2020, and an increase of 1.2 per cent to MGBA from 2020. It assumes the institution receives the maximum student contributions across each funding cluster.

In short, the changes entail a disincentive for universities to grow the bachelor-level enrolments, inhibiting the sector's capacity to deliver upon the skills needs of the Australian labour market. The changes will also create an incentive to skew student numbers away from study areas more heavily affected by the funding freeze.

Alternative reform of the CGS: funding envelopes

These problems are symptomatic of the *ad hoc* approach to changes to the CGS program, with piecemeal reforms that target one outcome delivering a series of unintended consequences.

The University of Melbourne suggests an alternative approach to CGS reform, that likewise seeks to improve the sector's overall performance, but addresses reform in a holistic or comprehensive manner.

In a 2011 public consultation on the allocation of postgraduate CSPs,² the Department of Education and Training raised the option of introducing a more flexible approach to CGS funding. Under this approach, institutions would be provided with 'funding envelopes' for CSPs each year, allowing them some flexibility to allocate those CSPs across different course levels, e.g. bachelor level places could be traded off for additional postgraduate places. As the Department noted at the time, "this option could provide universities with greater flexibility to mix and match their undergraduate and postgraduate programs, and recognises the requirements of different disciplines' professional pathways."³

The University of Melbourne urges the Government to again consider this approach to distributing CGS funding. Funding envelopes represent a means of addressing a range of pressing issues in the arrangements for funding of domestic places in Australia. Under a system of funding envelopes, the Commonwealth Government possesses a lever to manage growth in higher education expenditure while ensuring funding remains linked to demand. It would provide a way of dealing with the tension between the need for an equitable system with consistent settings across the sector and the need for greater institutional diversity.

The Government's aim to tie funding allocations to institutional performance could be advanced through the introduction of CGS funding envelopes. While funding allocations across the sector would be indexed, the Government could make additional funding available to accommodate population growth, contingent upon an institution's teaching and learning outcomes. Consistent with the Government's basic aim, additional funding (and, by extension, Commonwealth supported places) would over time be allocated to parts of the sector that are performing well by meeting genuine student demand and labour market skills needs. This would incentivise performance improvements for institutions looking to grow their domestic student numbers.

In summary, this approach promises considerable benefits, including addressing many of the tensions arising from previously uncapped CSPs for bachelor level courses existing alongside finite allocations for all other course levels:

- Government would have greater control over total CGS expenditure, as the budget would accommodate managed growth of CSPs for bachelor level courses.

² "Consultation Paper: The allocation and funding of Commonwealth supported postgraduate places" November 2011.

³ *Ibid.* p.12.

- The approach would provide a mechanism for tying performance measures into funding arrangements with the possibility of making future funding growth contingent upon meeting performance targets.
- The approach would support institutional diversity and specialisation by affording institutions greater flexibility in distributing places across different course levels and offerings.
- The approach would allow for the managed approach to growing sub-bachelor provision, and would address the funding bias that skews enrolments towards bachelor degrees.
- The approach would support the integrity of funding arrangements, by removing any incentive to re-identify courses at a different course level in order to take advantage of favourable funding arrangements.

Recommendation:

The University of Melbourne recommends that the Government consider reforming the CGS, to introduce a system of funding envelopes, supporting institutional diversity by allowing institutions greater flexibility to allocating CSPs across course levels and setting performance benchmarks.

2. Comment on the design of performance-based funding

The University of Melbourne is concerned about the introduction of performance-based funding, as proposed by the Government. Notwithstanding these concerns, we offer comment on how performance assessment may be designed to best advance positive outcomes, given the Government has signalled its intent to tie growth in CGS funding to performance measures from 2020.

The preceding comments identified serious flaws in the specific mechanism by which the Government intends to introduce performance-based funding. More generally, there are substantial challenges associated with *any* attempt to link funding allocations to institutional performance on teaching and learning. These include:

- Ensuring that performance-based assessment is sensitive to the diversity of Australia’s universities, which vary in size, location, demographic profile, course profile, etc.
- Ensuring performance-based funding encourages genuine improvement in institutional performance, and does not lead to unintended consequences (e.g. system-gaming, an admissions bias against certain cohorts etc.)
- Ensuring that the administrative costs associated with performance-based funding are minimised.
- Ensuring that any reputational damage caused to institutions through negative assessments are minimised.

It is crucial that the design and implementation of a performance-based funding framework is informed by an understanding of these challenges. The following comments point to the design features that will help address these challenges, before responding to some of the consultation questions included in the Discussion Paper.

Design principles

The University of Melbourne endorses the Performance-based funding design principles proposed by the Group of Eight in its response to the Discussion Paper:

1. Clarity	The objectives of the performance-based funding policy are clear.
2. Simplicity	The process underpinning the performance-based funding policy is as simple as possible, with guidelines and outcomes reporting accessible to stakeholders, and the burden placed on providers minimised.
3. Transparency	The process and method are evidence-based and clear to stakeholders.
4. Acceptability	There is broad acceptance of the method applied and the legitimacy of the data used to measure performance aligned with the stated policy objectives.
5. Efficacy	The measures accurately assess provider performance, and the changes in performance, over time.
6. Positive incentives	The selection of performance measurement and funding measures and their application incentivises improvement by providers while discouraging behaviours inconsistent with stated policy objectives.
7. Stability	The approach to performance measurement and funding does not change frequently, giving providers certainty to invest in long-term strategies to improve their performance.

Quantitative assessment with expert review

The University of Melbourne suggests a two-step performance assessment process, in which quantitative assessment across a limited set of performance indicators is followed by an expert review of raw outcomes.

The diverse environments in which Australia's universities draw into question the fairness of any performance-funding framework. An institution's unadjusted results on a given measure may be (in part) caused by its location or equity profile rather than by the nature and quality of its teaching activity. There is therefore a need to contextualise raw results so that an institution is not punished (or rewarded) for external factors that are outside of its control. Failure to address this problem will result in perverse incentives and in outcomes that are unfair and that do not meet student and labour market needs.

However, some of the potential ways of dealing with this issue are in themselves problematic. For example, there are problems associated with the attempt to make *quantitative* adjustments to raw results that accommodate contextual factors. Such an approach inevitably increases the complexity in the assessment process, adding to the administrative costs and making the process less transparent. Similarly, including a qualitative component (e.g. in the form of written case studies) will contribute to the administrative burden entailed in the performance-based funding framework.

The cleanest way of addressing this issue is to institute a two-step process involving quantitative assessment followed by expert review that assesses the extent to which a given institution's results are adversely impacted by factors that are beyond its control. The University of Melbourne suggests using a small number of indicators that are available through existing data collections. In order to avoid the complexity associated with attempting to modify outcomes in view of external factors, assessment should in the first instance be based on raw (i.e. unadjusted) outcomes. An expert panel with a sound understanding of how various factors influence teaching and learning outcomes could then make a judgement on whether an adjustment to an institution's results is warranted.

Use of broad-banding rather than sector rankings

The University of Melbourne suggests using broad-banding to measure institutional performance, rather than sector-wide rankings or an institution's specific 'score' on a given metric. Broad-banding has a number of advantages over rankings or specific scores:

- The use of rankings can send a false signal that institutions that are ranked at the lower end of the sector are performing poorly. Since the sector as a whole performs well across most indicators, being placed towards the bottom end should not imply underperformance.
- The use of specific scores can imply a degree of specificity that is inappropriate to the assessment task. Minor differences between institutions, or for an individual institution across multiple years, are often a result of statistical variation rather than institutional performance itself.

Labelling of performance outcomes

Performance-contingent funding brings with it the danger of reputational damage sustained by institutions who have received a negative assessment. It is important that the messaging around assessment outcomes is managed in a way that is sensitive to this. The overall standard of teaching at Australia's universities is very good. This should be reflected in the way that performance assessment is framed for the public.

Response to consultation questions

1. How should the PBF be implemented?

Consideration 1: how to grow a university's PBF amount from 2021

As noted above, tying performance-based funding increases to population growth is already problematic. Since national population growth is lower than CPI, this approach effectively 'rewards' high performing institutions with ongoing funding reductions in real terms.

There are additional challenges associated with the proposed use of population growth of 18-64-year-olds to determine funding increases. As the Discussion Paper notes, population growth is not evenly distributed across different parts of Australia. Victoria, for example, is growing far more quickly than other regions. Uniformly applying the national figure across the sector will result in funding constraints – and by extension a shortage of bachelor-level places – in more heavily populated parts of Australia.

A further issue relates to the age-bracket used to measure population growth. Since most undergraduate students are at the younger end of the 18-64-year-old bracket, the proposed approach will mask increases in demand that come with a spike in the number of Australians who are aged between 18 and 25 years old. The first half of the coming decade will see significant growth in the number of school leavers. There is a danger that many of those school leavers will be locked out of the university system by provisions for funding growth that are inadequate.

Consideration 2: how to treat a university's PBF amount from 2021

If the Government is to proceed with the proposed approach of managing bachelor-level CGS allocations through MBGAs, then any funding increases should be added to the MBGA for subsequent years. Keeping funding increases separate – so that the additional funding received in one year remains at risk for subsequent years – will exacerbate the problems noted above. Institutions will be effectively discouraged from increasing domestic enrolments due to the lack of certainty of funding to accommodate those additional enrolments.

2. What performance measures should the PBF scheme draw upon?

In line with the design principles identified above, the aim should be to ensure that the measures used are broadly fair, and that they incentivise genuine performance improvements, and do not encourage system gaming. Performance assessment should draw from metrics that are already available through existing data collections, in order to minimise the administrative costs.

The University supports the use of a small number of measures across the three broad areas included in Table 1 of the Discussion Paper: 'student experience', 'graduate outcomes' and 'equity'.

Student experience

First-year student attrition is a strong available measure of student learning and engagement. While attrition rates are, of course, sensitive to contextual factors that are outside of an institution's control, this issue is best addressed through a process of expert review outlined above.

The suggested use of 'overall student satisfaction' is highly problematic. While there is agreement that institutions should have a focus on the quality of their students' study experience, there is an insufficient understanding of the factors that influence student satisfaction levels for this measure to be used in funding allocations. The extent to which student satisfaction outcomes are influenced by institutional reputation, disciplinary mix, or by the expectations students initially bring to the program of study – rather than by teaching quality – is unclear. Moreover, the inclusion of survey results on the QILT website provides adequate incentives to focus on this area of performance.

Graduate outcomes

Any use of graduate outcomes should be sensitive to the impact that differing curriculum models have on raw results. For example, due to its graduate curriculum model, the University of Melbourne has lower (relative to other universities) levels of employment for its bachelor-level graduates: a high portion of those who complete a generalist undergraduate program continue on to a postgraduate program, and are enrolled in further study a year after completing.

The University of Melbourne also suggests the use of longitudinal measures of graduate outcomes e.g. the use of the GOS-L rather than the GOS. This better captures the contribution that a university education makes to a student's career in its entirety. Longitudinal surveys conducted by the University of Melbourne indicate very high levels of employment three and five years after bachelor-level completion.

Equity

Any use of equity measures should be carefully considered so as to avoid perverse outcomes, noting that an institution's equity performance can be distorted by the way that data is collected or presented. As the Grattan Institute notes in its response to the Discussion Paper, defining low SES in terms of the lowest 25 per cent of regions by socio-economic status may be too narrow, ignoring educational disadvantage of those outside of the lowest 25 per cent. Using the lowest 50 per cent is arguably a better indicator of the diversity of an institution's student body.

In the interests of measuring equity performance in a way that respects divergent institutional missions, the University of Melbourne argues that institutions should be allowed to select the specific equity measure they are to be assessed on e.g. low SES, regional or remote, Indigenous etc. This would accommodate the divergent equity strategies without introducing a level of administrative complexity to performance assessment.

Finally, the University suggests using a student's 'first address' rather than their current permanent address to measure socio-economic status and regionality. This is a better indicator of a student's origins, and is therefore more reflective of educational disadvantage.

5. Should the PBF funding of unsuccessful universities be redistributed?

Any funds that are withheld from 'unsuccessful universities' should be redistributed to those universities that have received a positive assessment. This reflects the presumed intent of improving institutional performance. The policy should seek to drive performance improvements, and should not be used to further reduce the level of support provided to the higher education sector as a whole. Moreover, failure to redistribute withheld funds would further exacerbate the compounding effect of the funding freeze discussed above.

The University of Melbourne would support the use of 'stretch' targets, as outlined in the Discussion Paper.

Recommendations:

If the Government proceeds with its approach to implementing a performance-based funding framework, the University of Melbourne recommends that the Government:

- **Adopts a two-stage process involving quantitative assessment of raw outcomes, followed by expert review that assesses the extent to which any given institution's results are adversely impacted by factors that are beyond its control.**

- **Considers the use of broad-banding to assess institutions, rather than sector rankings or specific scores.**
- **Avoids labelling performance outcomes in a way that misleadingly suggests that institutions are under-performing.**
- **Ties funding increases to local (rather than national) population growth, and ensures that funding increases are aligned with growth in demand arising from increased numbers of school-leavers.**
- **Ensures that additional (performance-based) funding from 2020 is added to an institution's MBGA for subsequent years.**
- **Uses a small set of measures to assess student experience, graduate outcomes and equity performance.**
- **Ensures that any loss of funding to a particular institution arising from performance-based assessment is reallocated within the sector.**