11. FUNDING THROUGH CONTRACTS

European and Institutional Perspectives

11.1 INTRODUCTION

With the New Public Management (NPM)-doctrine that has swept the public sector since the 1990s (Pollitt et al., 2007), many reforms in the funding of higher education have been implemented across Europe. Together with the introduction of more market-oriented governance approaches, public authorities have started to use contracts and performance-oriented approaches to shape the budgets of national higher education institutions and research organisations. Contracting and performance-based budgeting (PBB) are two trends that emerge in this chapter from the short tour d’horizon of funding mechanisms for higher education institutions. PBB and contracting are reshaping the relationships between the national authorities and budget receiving organisations. Performance-based budgeting seeks to link performance measures to budget allocations and as such it is expected to improve the management and accountability of higher education institutions (HEIs). It is also expected to contribute to a higher degree of cost consciousness and goal orientation in the budgeted organisation. Quoting Herbst (2007):

The rationale of performance funding is that funds should flow to institutions where performance is manifest: ‘performing’ institutions should receive more income than lesser performing institutions, which would provide performers with a competitive edge and would stimulate less performing institutions to perform. Output should be rewarded, not input. (p. 90).

Contracting is another NPM-inspired trend in governance reforms. In addition to emphasising accountability and results, it gives greater attention to differentiated institutional missions. Institution-specific performances and initiatives can be laid down in contracts agreed between budget holders and budget receivers. Salmi and Hauptmann define performance contracts as follows:

performance contracts typically are not legally enforceable documents. Instead, they are more often non-binding regulatory agreements negotiated between governments or buffer bodies and tertiary education institutions which can take a number of forms. The agreements may be with entire systems of institutions or individual institutions. All or a portion of funding may be based on whether institutions meet the requirements in the contracts. The agreements can be prospectively funded or reviewed and acted upon retrospectively. In some
instances, such contracts can be viewed as a punitive instrument rather than as incentives, as failure to meet goals may result in reduced funding. (Salmi & Hauptmann, 2006, p. 17).

Both PBB and contracting have been implemented in the Dutch higher education system – both at the system level and at the level of the individual university. This chapter puts the Dutch developments in a wider, European context and highlights some of the promises and pitfalls of PBB and contracting. The next section (section 2) discusses the four main budget types that can be found in the literature. Section 3 gives an overview of the mechanisms of public funding that are used by national authorities in their budgeting of HEIs. By presenting examples from The Netherlands relating to the national level and the level of the individual university, section 4 discusses issues surrounding PBB and contract funding. In section 5, we present some conclusions, focusing on the advantages and disadvantages of performance-based and contract-based approaches. One tentative conclusion is that funding authorities and university administrators will increasingly use performance contracts, as they realise that their traditional funding approaches and formulas have been very backward looking, resembling ‘steering by looking in the rear view mirror’. A system of contract funding implies a more future-oriented type of funding that allows them to pay more attention to the individual institutions’ specific missions.

11.2 BUDGET SYSTEMS: WHERE DO PERFORMANCE-BASED BUDGETING AND CONTRACTING FIT IN?

In this section, we will present a typology of budget types in order to show where performance-budgeting and performance contracts fit in. Before doing so, it is instructive to present a general input-throughput process-output description of a production process and some its related concepts (Figure 1). The shaded area is where production takes place. It represents the organisation (in our case, a higher education institution), where inputs (resources) are transformed into outputs (products) on the basis of production technology (say process). The organisation tries to achieve particular goals and uses a given budget to obtain the resources (personnel, material resources, capital goods) it needs to reach this objective.

If the organisation operates in a market where its goods are sold, the success of the organisation is reflected in the profits it makes by selling its goods to customers. Ultimately, its budget depends on whether its outputs are sold for a price that covers production costs. In the case of private organisations operating in a market, customers will normally know whether the price of the good or service on offer represents value for money. Private producers will also be aware of the resources needed to produce a given output. This means there is a more or less straightforward relationship between production activities (the processes) and resources (or inputs) and knowledge about the relationship between activities and resulting outputs. In other words, the production technology is relatively transparent – the activities are homogeneous. In the public sector—including higher education—this is often not the case. In higher education, the outputs of the teaching and research activities of universities and colleges cannot be identified in a straightforward way.