Fulfilment of performance agreements of higher education institutions

What has happened in the financing of higher education?

Report of the National Audit Office to the Riigikogu, Tallinn, 8 August 2012

The objective of the audit was to assess whether the changes made to the higher education financing system, which are supposed to make the financing of institutions of higher education depend on measurable performance goals, have contributed to the provision of state-commissioned education and the achievement of the state's priorities in the development of natural, exact and technological sciences.

The National Audit Office analysed whether the problems in the provision of state-commissioned education that were highlighted in the audit "State-commissioned Higher Education" that was completed in 2008 have been resolved and whether the performance agreements introduced in 2009 have proven to be successful. The problems that could be resolved by the new financing system that will be implemented in 2013 were also assessed.

Institutions of higher education will be paid 117.5 million euros from the state budget of Estonia in 2012 to cover the state-commissioned education and other activities set forth in the performance agreements, which is 23.8% of the budget of the Ministry of Education and Research. Activities related to the provision of higher education are also financed from EU programmes (e.g. mobility grants, development of cooperation between institutions of higher education and e-learning), and institutions of higher education are given money for investments from the state budget as well as EU support (approximately 145 million euros will be given from 2007 to 2013 for updating the learning and working environment infrastructure of institutions of research and development, institutions of higher education and institutions of professional higher education).

The National Audit Office is of the opinion that the transfer to financing institutions of higher education on the basis of performance agreements in 2009 has not brought about significant changes in the activities of the Ministry of Education and Research or institutions of higher education. The failure to provide state-commissioned education, high dropout rate and insufficient cooperation between universities are still problems. Performance indicators have not been the deciding factors in the allocation of funds. The administrative burden, however, has increased and will increase further.

The nature of performance agreements has been specified in the new Universities Act, but several important issues still have not been resolved. It is unclear how the amendments to law help achieve the goals announced by the Minister of Education and Research, which is "to increase the quality and performance of higher education, increase the responsibility of institutions of higher education, and reduce the fragmentation of higher education".

Key observations made in the audit:

■ **The number of institutions of higher education has decreased and the number of students is decreasing.** However, these changes cannot be directly tied to the changes in the financing system. The decrease in the number of institutions of higher education by five was mainly caused by the closure or merger of private schools as result of the transfer assessment of study programme groups and the negative accreditation of Doctoral study programmes. The number of students has decreased by ca. 500 when compared to 2008, mainly on the account of students who pay for their studies. The number of students whose studies are financed by the state, however, has increased. The share of students admitted to the specialities of natural and exact sciences has increased the most. However, social sciences, business and law remain the most popular choices, but whilst the share of students who started to learn social sciences was 38% of all admitted students in the 2007/2008 academic year, then their share had decreased to 30% in the 2011/2012 academic year, mainly due to the decrease in the number of students admitted to student places not financed from the state budget. These changes comply with the strategic goals of the state.

■ **The state still does not receive the agreed number of graduates**. Although the provision of state-commissioned education has improved somewhat when compared to 2008, guaranteeing the required number of graduates is still a problem at all levels of education. The goals of state-commissioned education cannot be met even with the inclusion of graduates whose studies were not financed from the state budget. Guaranteeing the required number of graduates is a problem primarily in the areas that are a priority for the state, such as natural and exact sciences, technology, production and construction. The main reasons of this failure are the lack of new students and the dropout rate (15.1% of students on average drop out). The reasons why students drop out are the inability to cope with the studies and economic difficulties. The dropout rate is the highest in the natural and exact sciences – almost one-fifth of all students. The statistics that illustrate state examination results do not suggest an increase of students in these specialities.

■ **The higher education financing system that is based on ordering graduates has not started to function well.** The National Audit Office highlighted in its audit completed in 2008 that the financing system, which is based on state-commissioned education, does not work in real life, as universities cannot guarantee the required number of graduates.
The number of graduates does not depend on the work done by the universities alone, and financing just the number of graduates may cause a decrease in the quality of education.
In practice, it is also impossible for the ministry to reduce financing in the subsequent period on the account of the graduates that were not received, because it would considerably deteriorate the ability of schools to provide quality education. As the number of students has already decreased due to demographic reasons, it means that a financing system that is mainly based on the number of graduates threatens the ability of universities to cope economically. This is why the Ministry of Education and Research was forced to change the higher education financing system.
The ministry has been trying to resolve this problem since 2009 by entering into performance agreements with institutions of higher education, where it was planned to agree in other performance indicators in addition to the number of graduates.

■ **Performance agreements still have not been properly established.** The reality is that the performance of institutions of higher education has still been mainly assessed on the number of graduates, and no other performance indicators have been added to the contract. Only a few additional activities have been listed (e.g. promotion of natural and exact sciences, or further training activities). Performance agreements have also failed to contribute much to cooperation between institutions of higher education, although the Ministry of Education and Research has tried to support the creation of joint study programmes.
It is still possible to study 68% of all fields of training in more than one educational institution (according to study programmes belonging to the same group of study programmes). Approximately one-third of all fields of training were taught in more than two educational institutions.

The changes that will be implemented in 2013 will make the financing of institutions of higher education more complicated and increase the administrative burden. Many problems in higher education, however, are likely to remain unsolved. With the transfer to activity support that is based on performance indicators, the Ministry of Education and Research has started to resolve the problem that the system of state-commissioned education does not work in reality. However, the ministry still has not experience in how to distribute money to higher education on the basis of several performance indicators.

All of the stipulated indicators cannot be assessed with sufficient assurance (e.g. employment of graduates), or the performance indicators do not coincide with the purpose for which the activity support is used (e.g. the number of foreign students and lecturers if the allocated activity support is meant to support higher education in the Estonian language). It is still unclear whether and how the state will interfere with the creation of student places in different specialities. The National Audit Office therefore sees the threat that the new financing system will increase the administrative burden of the institutions of higher education and the ministry, but it is not transparent and does not contribute to substantive changes in higher education. The state will still not get the expected number of graduates, because many problems of higher education stem from general education and the situation on the labour market, which cannot be resolved by reforming the manner in which higher education is financed.

■ **The financial situation of public universities is generally satisfactory, but their future is unclear.**
In accounting terms, the expenditure of universities has actually exceeded their revenue, mainly due to the wear and tear or depreciation of their buildings and other fixed assets. Large investments contain the threat that as a result of depreciation, the operating result will also remain negative (expenditure exceeds revenue) in the future. A short-term negative operating result does not mean that universities do not cope with managing themselves.
However, if the operating result remains negative for a long time, it reduces the ability of universities to improve their property and guarantee the preservation of assets. The economic situation of the Estonian Academy of Art and Tallinn University is the most complicated. The financial difficulties of the Estonian Academy of Art were mainly caused by the failures in the construction of the new building. The problems of Tallinn University are mainly associated with rapid expansion and the resulting fast increase in expenditure. However, all universities are optimistic in their forecasts, because the Ministry of Education and Research has promised them more money. Regulation of the assumption of financial obligations by public universities and the state's role in the resolution of financial difficulties has not been sufficiently clear.

As the decision to start using activity support that is based on performance indicators in financing higher education was made with the amendments to the Universities Act and other acts that were adopted this year, then the National Audit Office made several recommendations about the implementation of the selected system. The National Audit Office advises the Minister of Education and Research to do the following:

■ Avoid using such performance indicators in performance agreements the performance of which cannot be objectively assessed (e.g. employment of graduates). The performance indicators used in financing institutions of higher education should relate to the goals of financing. The activities of institutions that provide higher education should not be assessed on the basis of certain criteria if the activity support is not aimed at the performance of these criteria (e.g. foreign lecturers, foreign students and studying abroad). The proposal to initiate amendment of the Universities Act and other acts should be made to the Government of the Republic if necessary.

■ Establish clear principles on which the state requests student places from institutions of higher education and how the state's needs for student places should be clarified in the future.

■ More attention should be paid to cooperation between institutions of higher education when activity support is allocated, and the institutions of higher education where the best scientists teach in the respective area of study should be preferred.

■ The resource intensity of the collection of such data must be considered when performance indicators are developed. Avoid performance indicators that are not used in making financing decisions or in collating statistical data, and where collating and collecting data are too resource-intensive.

■ Clearly stipulate the conditions on which activity support is decreased or increased in implementation acts and the contracts to be entered into.

■ Initiate the amendment of the Universities Act in cooperation with the Minister of Finance and the Minister of Justice in order to provide a clearer regulation of the assumption of financial obligations and the consequences of the failure to perform them (e.g. establish a limit for the net debt burden or the obligation to obtain the approval of the Government of the Republic for taking a loan). The transfer of the assets and liabilities of public universities in the event of their dissolution must also be more clearly regulated.

The **Minister of Education and Research** informed the National Audit Office that it agrees with the conclusions made in the audit report. The organisation of higher education financing needed amendments, and the recommendations will be beneficial in the transfer to the new financing system. There are plans to consider the needs of society in negotiations about performance agreements, and to also establish quantitative goals in certain areas. However, the minister emphasises that the setting of goals cannot be too detailed. The minister believes that there is no need to review the list of financing indicators established with the amendments to the Universities Act, the Institutions of Professional Higher Education Act and the other acts that were adopted in the Riigikogu on 10 May 2012.

Although the minister claims that several observations made by the National Audit Office were considered in the preparation of the higher education reform, the National Audit Office does not see that the ministry prepared the reform as thoroughly as necessary or considered the problems that were pointed out. The Government of the Republic had not accepted the regulation on the implementation of the new financing system by the time this audit report was completed. The exact bases of financing will become clear only in the course of performance of agreement negotiations with institutions of higher education.

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