

ITEM FOR FINANCE COMMITTEE

HEAD 40 – EDUCATION DEPARTMENT
Subhead 317 Mortgage Interest Subsidy Scheme
Subhead 325 Direct Subsidy Scheme

Members are invited to approve –

- (a) the following modifications to the Direct Subsidy Scheme –
 - (i) a revised income banding system for the Scheme; and
 - (ii) allowing ex-aided schools which would otherwise receive less recurrent subsidy after joining the Direct Subsidy Scheme to continue to receive subsidies as if they were aided schools for a period of five years; and
- (b) a modification to the scope of the Mortgage Interest Subsidy Scheme to allow Direct Subsidy Scheme school employees who are formerly serving in aided schools and are already beneficiaries of the Mortgage Interest Subsidy Scheme to remain in the Scheme when they join Direct Subsidy Scheme schools.

/PROBLEM

PROBLEM

We need to improve the terms of the Direct Subsidy Scheme (DSS) to encourage the development of more DSS schools so as to provide more choice and diversity to the education system.

PROPOSAL

2. With the support of the Secretary for Education and Manpower, the Director of Education (D of E) proposes to implement the following proposals starting from the 2001/02 school year –

- (a) the DSS income banding system should be revised such that a DSS school will continue to receive full recurrent subsidy from the Government until its fee level reaches $2\frac{1}{3}$ of the average unit cost of an aided school place (referred to hereafter as X). Beyond this level, Government will not provide any recurrent subsidy. If a school charges a fee between $\frac{2}{3}X$ and $2\frac{1}{3}X$, then for every additional dollar charged over and above $\frac{2}{3}X$, the school should set aside fifty cents for scholarship or financial assistance schemes for needy students (paragraphs 5 and 6);
- (b) ex-aided schools which would receive less recurrent subsidy after joining the DSS will continue to receive recurrent subsidy as if they were aided schools for a period of five years. During this period, these schools may, like other DSS schools, charge fees according to the proposed income banding system in paragraph 2(a) above (paragraphs 8 and 9); and
- (c) the rights of existing beneficiaries of the Mortgage Interest Subsidy Scheme (MISS) in the aided school sector should be preserved when their schools change to the DSS or when they join a DSS school (paragraph 10).

JUSTIFICATION

3. In the light of operating experience and feedback from school sponsors of DSS and aided schools, we have recently completed a review of the terms of DSS. We see the need for improvement in a number of areas.

/Income

Income banding system

4. The recurrent subsidy for a DSS school is payable on a per student basis. The amount of subsidy a DSS school receives for each student is derived with reference to X (i.e. the average unit cost of an aided school place) and the school fees charged by the school. The spirit is that a DSS school which charges higher school fees will receive less subsidy. Under the current system, if a DSS school wants to receive full recurrent subsidy from the Government for each student it admits, it can charge school fees up to $\frac{1}{3}X$ ^(Note 1). If the school fees exceed $\frac{1}{3}X$, the recurrent subsidy would be progressively reduced by fifty cents for every additional dollar charged. When the school fees reach $2\frac{1}{3}X$, the DSS school will no longer receive any recurrent subsidy. (Enclosure 1 provides an example illustrating how the existing system operates.)

5. The problem with the existing income banding system is that some DSS schools are reluctant to charge school fees beyond $\frac{1}{3}X$ as they do not wish to see a reduction in the government subsidy. This goes against the objective of allowing DSS schools more flexibility in the charging of fees so as to increase income for the purpose of improving the quality of education. We therefore propose to revise the system such that a DSS school will continue to receive full recurrent subsidy from the Government until its fee level reaches $2\frac{1}{3}X$, subject to the condition set out in paragraph 6 below. Beyond this level, Government will not provide any recurrent subsidy.

6. We further propose that if a school charges fees between the range of $\frac{2}{3}X$ and $2\frac{1}{3}X$, then for every additional dollar charged over and above $\frac{2}{3}X$, the school must set aside fifty cents for running scholarship or financial assistance schemes for needy students. Under the existing system, these resources will have been clawed back by Government in the form of reduced subsidy. The proposed arrangement will in effect ensure that the schools, while continuing to receive full subsidy from the Government, will devote more resources for scholarship or financial assistance schemes, thereby making DSS schools more accessible to students from less well-off families. (Enclosure 1 provides an example illustrating how the proposed system works.)

Subsidy for schools with a longer history of establishment

7. Schools with a longer history may incur higher operating cost, largely due to higher salary expenditure for more experienced teachers and higher maintenance cost. This is not a problem for aided schools since the grants they

/receive

^(Note 1) The school fee ranges from about \$9,000 to \$16,000 in the 2000/01 school year. The actual amount depends on the level a student is studying at.

receive are paid on a deficiency basis, i.e. the Government will provide subsidies with reference to the actual expenditure of the school according to the relevant Code of Aid. This could be a problem, however, for DSS schools which receive recurrent subsidy on a per student basis at a fixed rate based on the average unit cost of an aided school place. In view of this, we have, since the 1999/2000 school year, put in place a two-tier system that takes into account the higher operating cost of DSS schools with a longer history. Under this system, the full recurrent subsidy for a DSS school with 16 years history or more is pitched at the average unit cost of a place in aided schools with a comparable history. Those DSS schools established for less than 16 years are benchmarked against the average unit cost of a place in aided schools with less than 16 years' history. As a result, DSS primary schools which have been established for 16 years or more now receive, on average, an additional \$1,100 (or 6%) recurrent subsidy per student per year when compared to that for the "younger" DSS primary schools. For the "older" DSS secondary schools, the corresponding figures are an additional \$1,600 or 5.5% recurrent subsidy per student per year.

8. Even with the two-tier system, however, some aided schools would still receive less subsidy if they join DSS. These schools would either have to suffer an operating deficit or charge higher fees than they would have wished. To overcome this, we propose to allow ex-aided schools which would receive less recurrent subsidy under DSS to continue to receive the same amount of recurrent subsidy as if they were aided schools for a period of five years after joining the DSS. This arrangement should give an ex-aided school more lead time to adjust its cost structure during the initial years of its DSS operation. At the end of the five-year period, the full recurrent subsidy for these ex-aided schools will be calculated in accordance with the average unit cost of comparable aided schools.

9. An ex-aided DSS school in receipt of the financial subsidy proposed in paragraph 8 above may charge school fees in accordance with the new income banding system proposed in paragraphs 5 and 6 above.

Preservation of MISS benefits for employees of the aided sector upon their joining DSS schools

10. With the approval of the Finance Committee, the MISS was introduced in 1993 to assist employees in the subvented sector (schools, health, and welfare organizations) to achieve home ownership. Under the scheme, aided school employees including teachers may apply for subsidy to pay their mortgage interests. As at April 2001, about 4 500 aided school employees are receiving MISS subsidy. Non-aided school employees, including those employed by DSS schools, are not eligible to join the MISS. Accordingly, aided school employees who are beneficiaries of MISS have to leave the scheme when their schools change to the DSS, or when they join a DSS school. This creates a disincentive for aided

/school

school employees to join DSS schools, and for aided schools to become DSS schools. To remove this disincentive, we propose to preserve the rights of existing beneficiaries of the MISS in the aided school sector when their schools change to the DSS, or when they join a DSS school. To achieve this, we need to modify the scope of the MISS to include ex-aided DSS employees who are already beneficiaries of the MISS upon their joining the DSS schools. Details of the proposed arrangements are at Enclosure 2.

Encl. 2

FINANCIAL IMPLICATIONS

11. The proposal to revise the income banding system (paragraphs 5 and 6 above) will not lead to additional government expenditure in that the maximum amount of subsidy a DSS school is entitled to receive remains unchanged. As far as the existing DSS schools are concerned, the Government does not have to grant additional recurrent subsidies as a result of the proposal as these schools have been and are charging fees at a level which entitles them to full subsidy.

12. The Government will incur additional costs by allowing ex-aided schools which would otherwise receive less recurrent subsidy after joining the DSS to continue to receive subsidies for five years as if they were aided schools (paragraphs 8 and 9 above). However, it is difficult to assess the financial implications at this stage because we cannot predict how many and which aided schools will join the DSS because of the proposed subsidy arrangement. Nevertheless, this cost will have to be incurred anyway if these schools remain aided schools.

13. The proposal to preserve MISS benefits of ex-aided DSS employees (paragraph 10 above) will not lead to any additional financial implications since MISS is operated under a quota system, and since beneficiaries who may switch from being ex-aided school employees to DSS school employees will be counted towards the same quota.

BACKGROUND INFORMATION

14. The DSS was introduced in 1991 with the approval of the Finance Committee. The aim of the Scheme is to encourage the growth of a strong private school sector in the provision of education with a view to injecting diversity and choice in the education system. Under DSS, student choice is the driving force for continuous improvement. Since DSS subsidy is payable on a per student basis, and because Government will not allocate students to a DSS school unless the students choose the school, DSS schools have to attract students on the basis of their

/characteristics

characteristics and the quality of education. They are given greater freedom (vis-à-vis aided schools) in curriculum design, charging of school fees, use of resources, admission of students and terms of employment for staff. The flexibility enables DSS schools to accommodate diverse student needs and to offer different types of programmes which meet the diverse demands in the community.

15. Over the years, we have been monitoring the performance of the DSS and have introduced various improvements with Finance Committee's approval where appropriate. For example, in 1999, we introduced for DSS schools capital grants for major repairs, including slope repairs, and for the construction of school premises. DSS school sponsors may also apply for government-built school premises or school sites. The DSS sector is emerging as an alternative provider of quality education services. It can help to meet the increasing demand from the community at large and from parents in particular for more choices and diversity in our school system. Our current review takes into account the latest operating experience of the DSS scheme, and our proposals reflect feedback from different sectors of the community including school sponsoring bodies.

16. We shall continue with our effort to encourage quality school operators to develop a vibrant DSS sector. However, in doing so, we remain fully committed to providing nine-year free basic education and a highly subsidised senior secondary education.

17. The Board of Education noted our proposals on 17 November 2000. We consulted the Legislative Council Panel on Education on 20 November 2000. At the meeting, some Members were concerned that the proposed income banding system would encourage school operators to charge higher fees, thus depriving children from less well-off families the opportunity to study in DSS schools. Some questioned why Government should provide full DSS subsidy when the fees charged by a DSS school have already reached 2 1/3 X. As explained in paragraphs 5 and 6 above, in proposing to revise the income banding system, our objective is to facilitate the delivery of quality education by DSS schools and at the same time improve the accessibility of these schools to children from less well-off families. The Education Department will ensure that DSS schools will make full use of the funds to be set aside under the proposed system for scholarship/financial assistance schemes.

**An Example Illustrating how
Income Banding System for DSS Schools Works**

At present, DSS subsidy is based on the average unit cost of an aided school place which in turn varies according to the level a student is studying at. We will in the following use a S.3 place of a DSS school (full DSS subsidy pitched at the average unit cost of an aided S.3 place (referred to hereafter as X), which is \$29,513 in the current school year) as an example to give Members a better idea about how the existing and the proposed income banding systems respectively operate in dollar terms.

Section A - Existing income banding system (c.f. paragraph 4 of the main paper)

If the school fees range from \$0 to \$9,838 ($1/3 X$), the subsidy the DSS school receives will be \$29,513 (i.e. full DSS subsidy).

If the school fees range from \$9,838 ($1/3 X$) to \$68,864 ($2 \frac{1}{3} X$), the subsidy the DSS school receives will be progressively reduced by fifty cents for every additional dollar charged. In other words, the subsidy will be progressively reduced from \$29,513 (X) to \$0.

When the school fees exceed \$68,864 ($2 \frac{1}{3} X$), it will not receive any subsidy from Government.

Section B - Proposed income banding system (c.f. paragraphs 5 and 6 of the main paper)

The subsidy the DSS school receives will be \$29,513 (i.e. full DSS subsidy) until the school fees reach \$68,864 ($2 \frac{1}{3} X$). If the school fees exceed this level, Government will not provide any recurrent subsidy to the school.

If the school fees range from \$19,675 ($2/3 X$) to \$68,864 ($2 \frac{1}{3} X$), then for every additional dollar charged, the school will set aside at least fifty cents for scholarship/financial assistance schemes. In other words, the amount of funds which are required to be set aside for scholarship/financial assistance scheme will range from \$0 (when the fees are \$19,675 or below) to \$24,595 (when the fees are \$68,864).

**Preservation of the MISS Benefits of
Existing Beneficiaries in the Aided Sector**

The proposed arrangements are as follows –

- (a) When an aided school switches to the DSS, its serving employees who are already MISS beneficiaries can choose to stay in the scheme. Alternatively, the employee may opt for a housing benefits scheme (if any) to be offered by the ex-aided DSS school.
- (b) If an employee chooses to remain in the MISS upon his school turning from aided to DSS status under (a) above, and if he subsequently decides to leave the ex-aided DSS school and joins another DSS school, he may choose to stay in the MISS, or opt for a housing benefits scheme (if any) offered by his new employer. If, however, he changes his employment yet again and joins another DSS school, he must leave the MISS.
- (c) When a MISS beneficiary leaves an aided school and joins a DSS school, he may choose to stay in the MISS or opt for a housing benefits scheme offered by the DSS school. If, however, he changes his employment yet again and joins another DSS school, he must leave the MISS.
- (d) For (a), (b) and (c) above, if an employee opts for a housing benefits scheme offered by his new employer (i.e. the DSS school), he is deemed to have departed from the MISS and will no longer be eligible to join the MISS again even if he rejoins an aided school later.

