

Legislative Council Panel on Education

RECURRENT FUNDING FOR THE UNIVERSITY GRANTS COMMITTEE- FUNDED INSTITUTIONS IN THE 2001/02 TO 2003/04 TRIENNIUM

Introduction

This note provides supplementary information on the key issues raised by members of the Finance Committee and members of the public regarding the recurrent funding for the University Grants Committee (UGC)-funded institutions for the 2001/02 to 2003/04 triennium.

Agreement on Unit Cost Reduction

2. In its report on “Higher Education in Hong Kong” published in 1996, the UGC considered that as the sector entered a consolidation phase, the sector should be able to achieve a 10% reduction in unit cost by the end of the 1998/99 to 2000/01 triennium without detriment to quality. In recommending the cost savings, the UGC took note of the fact that during a period of consolidation, institutions should be able to turn their energies from expansion to productivity and quality. They will also be able to reap the benefits from savings associated with economies of scale and the abandonment of ‘front-end loading’¹. Furthermore, certain tasks associated with expansion will no longer be necessary and institutions will be able to improve management procedures.

3. The Administration accepted the UGC’s advice, and agreed that the following parameters should form the basis for determining the funding requirements for the UGC-funded institutions for the current triennium:

- (a) The target 10% reduction in student unit cost should be achieved **gradually** over the 1998/99 to 2000/01 triennium. In line with this spirit, the Administration has accepted the UGC’s proposal to have a point-to-point² reduction, rather

¹ Front-end loading means the additional resources required during the start-up phase of an institution or an academic programme.

² Point-to-point reduction means cost savings achieved day-by-day along a sliding slope from 0% reduction at the starting point of the 1998/99 academic year to 10% reduction by the end point of the 2000/01 academic year. A diagrammatic illustration is at **Annex**.

than the normal year-on-year reduction. The savings achievable under the former approach (which we adopted) are some \$370m less than the latter.

- (b) Half of the savings should be ploughed back to the UGC in support of new developments such as Areas of Excellence Scheme and other quality assurance initiatives.
- (c) As the Hong Kong Institute of Education (HKIEd) is a new institution that came under the aegis of the UGC in 1996/97, HKIEd should be exempt from the student unit cost reduction.

4. The above agreement was made in 1996, and was promulgated through various documents including a Legislative Council brief (EMB CR 3/21/2041/89 V in November 1996) and a press release. The principles were reiterated in item for Finance Committee (FCR(97-98)111 dated 27 March 1998), and formed the basis for Finance Committee's approval of the recurrent funding for the UGC-funded institutions in the current triennium. Based on the above agreement -

- (a) the net savings to be delivered by the UGC-sector is 5% overall; and
- (b) the 5% savings to Government will be delivered over two triennia. In other words, the savings delivered in the 1998/99 to 2000/01 triennium are only **2.5%** of the total UGC recurrent expenditure in that triennium, or **\$1,115m** in money terms (in 1997-98 price). The remaining **2.5%** savings, or **\$1,166m** (in 2000-01 Estimates price), will only be delivered in the next triennium. A diagrammatic illustration is at **Annex**.

5. Since we finalised the funding for the 1998/99 to 2000/01 triennium in late 1997, the Government launched an Enhanced Productivity Programme (EPP) with a target savings of 5% of baseline expenditure. We have exempted the UGC sector from EPP in view of the student unit cost reduction. With only a total of 5% savings to be returned to Government over a period of six years, the UGC sector is in fact doing no more than what the entire public sector (including the Hospital Authority, the Vocational Training Council and the welfare sector) is required to achieve in terms of efficiency gains.

Implementation of the Agreement

6. We note that the institutions have been making efforts to control costs and achieve productivity gains. As a result, we expect cash-flow surpluses to the order of some \$5 billion in the entire UGC sector by the end of the triennium, representing 13.9% of the institutional grant for this triennium. Of this amount, about \$3.5 billion (or 9.7%) is intended for specific purposes, such as maintenance of buildings, replacement of equipment or deferred payment of staff costs. The amount of unappropriated surplus should still be substantial, amounting to about a third of total. Indeed, it is in view of this situation that we have proposed a mechanism to allow institutions to carry unspent funds from one triennium to the next, to increase the institutions' flexibility in financial management and to encourage longer term planning. A significant feature of the new mechanism is that the reserve will not affect the calculation of student unit cost for the purpose of determining the level of Government funding or the level of tuition fees. In other words, the amount of reserve will not be used to offset the level of Government funding as determined by the established methodology.

Sources of Funding other than the Block Grant

7. In addition to the recurrent block grant, institutions receive other sources of Government funding:

- (a) UGC provides earmarked grants for specific purposes including Earmarked Research Grant, Teaching Development Grant, Language Enhancement Grant and funding for Areas of Excellence Scheme, quality assurance initiatives and other projects. The amount is budgeted to be \$2.5 billion in the 2001/02 to 2003/04 triennium. Within this provision, the Earmarked Research Grant will increase significantly by \$346m (or 27%) over the current triennium.
- (b) Government provides additional funding to implement the UGC Home Financing Scheme (UGC HFS). The amount is estimated at \$689m in 2000-01, or \$1.6 billion in the current triennium.
- (c) Government reimburses the UGC-funded institutions for rates and Government rents on a recurrent basis. The provision for 2000-01 is over \$160m.

- (d) Government provides funding for UGC capital projects. The total capital works expenditure amounts to \$1.1 billion in 2000-01.
- (e) In the past three years (1998-99 to 2000-01), the Innovation and Technology Fund (and its predecessor, the Industry Support Fund) disbursed \$417m to the UGC-funded institutions in support of 127 projects, representing a 77% increase over the allocation of \$235m during the period from 1995-96 to 1997-98.
- (f) The UGC-funded institutions also received \$366m grant from the Quality Education Fund since 1998 in support of 118 projects.

8. Universities are also encouraged to explore new sources of income, such as technology transfer companies, self-financing courses and donations, for the enhancement of the institutions' development. These sources of income will not be counted as 'assumed income' and will not lead to any corresponding reduction in the block grant.

Comparison between the Current and Next Triennia

9. **The Administration has not requested further reduction in the unit cost beyond the agreed 10% target.** Based on the funding allocations, the student unit cost for the next triennium will only be 1% less than the 2000/01 level. This reduction merely reflects the deflation during the current triennium.

	Average student unit cost (Nominal price level)	% Change
1995/96 to 1997/98	\$209,507	
1998/99	\$240,714	+14.9%
1999/2000	\$234,428	-2.6%
2000/01	\$228,544	-2.5%
2001/02 (projected)] \$226,360	-1%
2002/03 (projected)] \$226,360	-0%
2003/04 (projected)] \$226,360	-0%

10. The estimated recurrent funds required by the UGC-funded institutions in the next triennium will be about \$1.9 billion (or 3.9%) less than that in the current triennium. The difference is attributable to the following three factors:

<i>Reasons</i>	<i>Amount (\$ Billion)</i>	<i>%</i>
Full triennial effect of the student unit cost reduction (See para. 4(b) above)	\$1.2	2.5% ³
Deflation during the current triennium	\$0.5	1%
Reduction in student number target	\$0.2	0.4%
Total	\$1.9	3.9%

Methodology in Calculating Cash Limit

11. The established practice, ever since the inception of the UGC system, is to adopt a crude average student unit cost in determining the Cash Limit for the UGC sector. This was consistently used as the basis for the discussion between the Administration and the UGC on triennial funding, and it was on this basis that the Administration has agreed to the overall student numbers and the changes in student load matrices, including a 20% increase in research postgraduate places by the end of the triennium.

12. The UGC has pointed out that the present formula will impose funding constraints on the UGC as we seek a progressive increase in degree and above places to be offset by a reduction in the less costly sub-degree places in the next triennium. The Administration sees the merit in the argument and agrees, in principle, that student mix and student unit cost by levels should be taken into account in determining funding for the UGC sector in future, **subject to the availability of resources**.

Measures to Lessen the Financial Burden on Institutions

13. To ameliorate the possible financial constraints of the UGC-funded institutions in the next triennium -

³ As HKIEd is not subject to the unit cost reduction, the sum is worked out to be close to but not exceeding 2.5%.

- (a) We have recommended to the Finance Committee a new mechanism so that institutions can carry over up to 20% of their recurrent grants to the next triennium. With this, the institutions will be able to keep surpluses amounting to a few billion dollars in total which otherwise would have to be returned to Government. Likewise, with the new mechanism, it will be possible for the UGC to distribute to the institutions any savings it can achieve by the end of the triennium, as additions to the block grant. The UGC expects to have around \$250m available.
- (b) The Administration has agreed that the UGC may retain the savings arising from the lowering of the entry salary scales in the light of the adjustment to the Civil Service Entry Pay for the next triennium. The UGC has taken a decision that for the coming triennium such savings could be kept and deployed by the institutions when achieved. The savings, which are estimated to be in the range of \$49m, could be kept and deployed by the institutions when achieved.
- (c) The Administration will endeavour to identify savings during the next triennium for further allocation to the UGC, should the UGC sector encounter any genuine financial difficulties. The amount cannot be quantified at this moment.

Funding for the Whole Higher Education Sector

14. Government has been investing heavily in education. Education is the biggest public expenditure item. About 23% of the recurrent Government expenditure is spent on education, and of this, one third is devoted to higher education.

15. As announced by the Chief Executive in his 2000 Policy Address, we will support the progressive increase in post-secondary education opportunities. Our target is that, within 10 years, 60% of our senior secondary school graduates will have access to post-secondary education. We envisage that the expansion will come from self-financing programmes outside the UGC sector. In achieving this target, we plan to provide capital assistance to the potential providers and financial assistance to the students. We will present a package of initiatives to the Legislative Council Panel on Education in the first half of 2001. Subject to the Council's approval, additional funds will be provided in support of the post-secondary education sector.

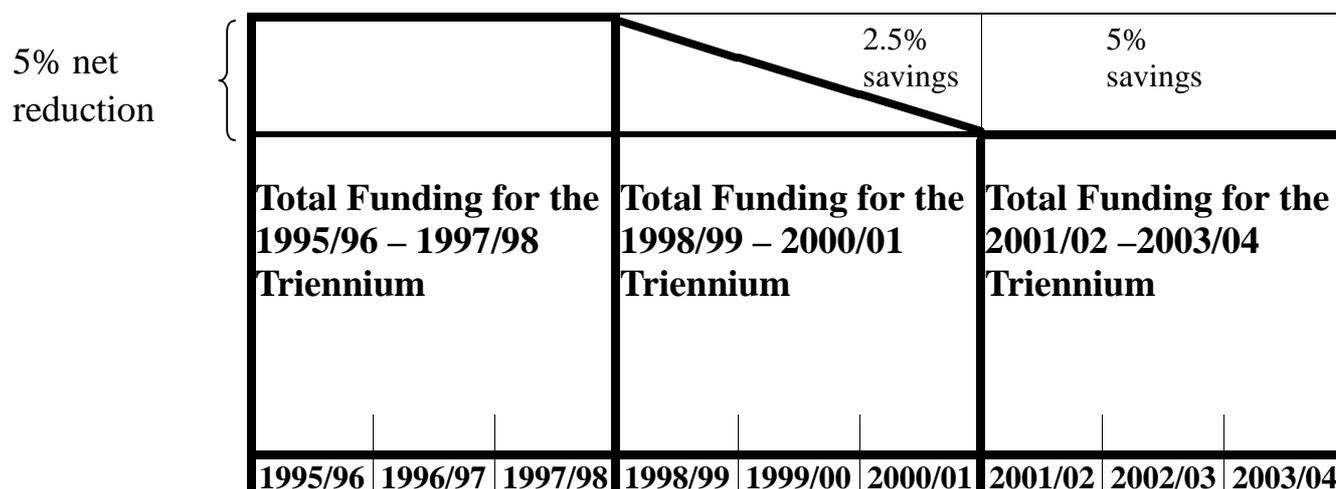
Quality Assurance

16. A prerequisite of productivity enhancement programmes is that quality must not suffer. This is particularly so for the education sector. The UGC takes on itself the responsibility of ensuring this and has introduced various measures towards the goal of quality assurance, for example, the Teaching and Learning Quality Process Review and the Management Reviews. For the next triennium, the UGC has set aside \$700m as Performance-related funding for further distribution to the institutions after a broad-based assessment exercise and further dialogue with the institutions.

17. There have been concerns about the possibility of large classes because of funding constraints. At present, the student-teacher ratio of our local institutions ranges from 10 to 16, with an average of 12.4. This ratio is broadly in line with the tertiary education sector in comparable economies.

Diagram to illustrate the effect of reduction in average student unit cost

Average Student Unit Cost



NOTES

1. For simple illustration, it is assumed that the student number will be maintained at the same level over the three triennia.
2. The Government agreed that half of the savings from the 10% unit cost reduction should be retained by UGC for the development of Areas of Excellence, etc. The net reduction for the entire UGC sector is therefore about 5%.
3. With student unit cost reduced gradually over the current triennium, the total funding provided for the current triennium will be 2.5% lower than the previous triennium. The funding to be available in the next triennium will also be 2.5% less than that of the current triennium.