

## **LegCo Panel on Education**

### **Modifications to Direct Subsidy Scheme**

#### **Purpose**

This paper briefs Members on our proposals to modify the terms of the Direct Subsidy Scheme (DSS)<sup>(Note 1)</sup>.

#### **Background**

2. Government's policy is to foster the development of a vibrant DSS school sector so as to inject diversity and choice in the education system. We see the following merits in the DSS –

- (a) Since DSS subsidy is payable on a per student basis, and because Government will not allocate students to a DSS school unless the students so choose, DSS schools have to attract students on the basis of their characteristics and the quality of education. Student choice is a driving force for continuous improvement.
- (b) DSS schools enjoy a high degree of freedom in curriculum design, admission of students, and use of resources. The flexibility enables DSS schools to accommodate diverse student needs and to offer programmes which meet the changing demand of the workplace and the community.
- (c) As the community becomes more affluent, there is demand for better quality education. DSS schools have more freedom in charging fees so as to provide above-standard facilities. However, they are required to offer scholarship for needy and deserving students.

3. In the Legislative Council Brief "Review of Private School

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<sup>(Note 1)</sup> The DSS was introduced in 1988 to provide recurrent subsidy for private secondary schools while allowing them greater freedom (*vis-à-vis* aided schools) with regard to the curriculum, school fees, entrance requirements and terms of employment for the staff, so as to enable them to develop into a viable alternative to Government and aided schools. The recurrent subsidy is on a "per head" basis, and the amount based on the average unit cost of aided school places. Thus, the more students a DSS school can attract, the more subsidy the school will receive. A DSS school also receives subsidy for major (including slope) repairs.

Policy” issued on 16 March 1999, Members were informed of a series of initiatives to support, amongst others, the growth of the DSS school sector. A summary of the follow-up actions taken are at Annex A.

4. In the light of the Education Commission’s recommendations on the education system for the 21<sup>st</sup> century, we have recently completed another review of the DSS and proposed further modifications as set out in the following paragraphs.

## Proposals

### (i) Income banding system

5. The recurrent subsidy for a DSS school is derived with reference to the average unit cost of an aided school place(X) and the school fees charged by the school. The spirit is that a school which charges higher school fees will receive less subsidy. Before 1999, the recurrent DSS subsidy was based on a three-band system having regard to the fees charged by the school<sup>(Note 2)</sup>. According to the formula, if the fees charged by a school were between  $\frac{2}{3} X$  and  $1 \frac{5}{12} X$ , then for every additional dollar charged in school fees, the DSS subsidy would be reduced by the same amount. Hence, schools had no incentive to charge fees falling within this range. This meant that schools would be “driven” to charge either very low fees (below  $\frac{2}{3} X$ ) or very high fees ( $1 \frac{5}{12} X$  or more). (Section A of Annex B provides an example in dollar terms illustrating how the old system works.)

6. To provide DSS schools with some scope to charge a “middle of the road” fee range, Government introduced in March 1999 a two income-banding system for implementation as from the 1999/2000 school year to replace the old three income-banding system. Under the new system, if a

<sup>(Note 2)</sup> DSS schools were paid a government subsidy based on a three banding system as follows :

<u>Band</u>	<u>Fee</u>	<u>Subsidy</u>
I	0 to $\frac{2}{3} X$	X
II	between $\frac{2}{3} X$ and $1 \frac{5}{12} X$	Between X and $\frac{1}{4} X$
III	$1 \frac{5}{12} X$ or more	$\frac{1}{4} X$

X = the average unit cost of an aided school place ranges from about \$27 000 to \$48 000. The actual amount depends on the level a student is studying at.

DSS school wants to receive full recurrent subsidy from Government for each student it admits, it can charge school fees up to  $1/3 X$ <sup>(Note 3)</sup> instead of  $2/3 X$ <sup>(Note 4)</sup> as allowed under the old system. If the school fees exceed  $1/3 X$ , the recurrent subsidy would be progressively reduced by fifty cents for every additional dollar charged. When the school fees reach  $2\ 1/3 X$ , Government will no longer provide any recurrent subsidy to the school. (Section B of Annex B provides an example in dollar terms illustrating how the existing system operates.)

7. The problem with the existing income banding system is that DSS schools are not willing to charge school fees beyond  $1/3 X$  as the amount of subsidy will be reduced correspondingly. This goes against the objective of allowing DSS schools to retain resources to improve the quality of education. We therefore propose to revise the income banding system such that a DSS school will continue to receive full recurrent subsidy from Government until its fee level reaches  $2\ 1/3 X$ . Beyond this level, Government will not provide any recurrent subsidy.

8. We further propose that if a school charges a fee between the range of  $2/3 X$  and  $2\ 1/3 X$ , then for every additional dollar charged over and above  $2/3 X$ , the school should set aside fifty cents for scholarship/financial assistance schemes. Under existing system, these resources will have been clawbacked by Government in the form of reduced subsidy. (Section C of Annex B provides an example in dollar terms illustrating how the proposed system works.) This will reduce the burden on DSS schools to provide scholarship/financial assistance which is a condition in the service agreement and helps to make DSS schools more accessible to students from poorer families. The school fees charged can then be more fully deployed for improving the quality of education.

(ii) Insufficient subsidy for schools with a longer history of establishment

9. Schools which have a longer than average history in general 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 are paid on a deficiency basis. For DSS schools, recurrent subsidy is on a per student basis. The amount of subsidy is the average unit cost of an aided school place.

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<sup>(Note 3)</sup> This 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.

<sup>(Note 4)</sup> This ranges from about 18 000 to \$ 32 000 in the 2000/01 school year. The actual amount depends on the level a student is studying at.

Before the 1999/2000 school year, the per student subsidy rate for all DSS schools was the same. As from the 1999/2000 school year, we have put in place a two-tier recurrent subsidy to take into account that DSS schools with a longer history of establishment may also have a higher operating cost. DSS primary schools which have been established for 16 years or more now receive, on average, \$1 100 more (or 6% more) recurrent subsidy per student per year than those with less than 16 years of operating history. For DSS secondary schools, the corresponding figures are \$1 600 and 5.5%.

10. To allow aided schools to make up any operating deficit and to build up a reserve, we propose to allow schools which will receive less recurrent subsidy under the two-tier system described in paragraph 9 above to continue to receive the same level of recurrent subsidy as if they were aided schools (i.e. irrespective of student number) for a period of five years after joining the DSS. During this period, the school may charge fees according to the proposed two-band system (paragraphs 7 & 8 above) and will have total discretion in using the subsidy for educational purpose. (In other words, it will be a one-line subsidy.) After gaining more experience in operating as DSS schools, these schools should be able to make ends meet.

(iii) Mortgage Interest Subsidy Scheme (MISS) benefits for ex-aided teachers

11. The MISS was introduced in 1993 to assist employees in the subvented sector (schools and health and welfare organizations) to achieve home ownership. Under the scheme, eligible school employees<sup>(Note 5)</sup> including teachers may apply for subsidy to pay part of their mortgage interests. As at September 2000, about 4 000 aided school employees are receiving MISS subsidy ranging from about \$25 to \$6 000. Non-aided school teachers, including those employed by DSS schools, are not eligible to join the MISS. It would cause hardship to aided school teachers already receiving mortgage interest subsidy if they ceased to be eligible when their schools joined the DSS or if they themselves joined a DSS school. We therefore propose to preserve the rights of existing

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(Note5) All full-time employees of aided schools will be eligible for MISS subsidies if they are paid the equivalent of MPS Point 22 or above and have a minimum of ten years of continuous service, or if they are paid less than MPS Point 22 and have a minimum of 20 years of continuous service. A quota is set aside for aided school employees every year under MISS. Priority for admission into the scheme will be based on the length of service in excess of the minimum qualifying service. Where two applicants have the same length of service in excess of the minimum, priority will be given to the one older in age.

beneficiaries of the MISS in the aided school sector when their schools change to the DSS or when they join a DSS school. Details of the proposed arrangements are at Annex C.

(iv) Evaluation of schools' performance

12. Ex-aided DSS schools are required to sign a 10-year service agreement with Government. Renewal of the agreement on its expiry will be subject to evaluation by the Education Department (ED) with reference to performance targets stated in the agreement. ED may also periodically review the performance of the school during the 10-year period and advise the school of the need to make improvements to overcome identified problems. In exceptional cases, e.g. the school repeatedly refusing to accept ED's advice to make improvements, Government may terminate the service agreement during the 10-year period.

13. There are some internationally recognised bodies providing evaluation services for schools. For example, the English Schools Foundation appoints advisers from the Office for Standards in Education of the United Kingdom to evaluate the performance of its schools. Given that DSS schools are expected to offer alternative curricula, they should be given the flexibility to engage outside bodies to evaluate whether the performance targets as stated in service agreements have been achieved. Evaluation by an independent third party would also avoid unnecessary dispute.

14. Thus, we propose that DSS schools may engage outside experts to work with ED in performance evaluation, as long as:

- (i) the experts are recognised by ED for the purpose;
- (ii) ED will participate in the evaluation exercise;
- (iii) the school will submit the evaluation report to ED, together with any improvement plan; and
- (iv) the DSS school will pay for the cost of engaging the experts.

ED will determine, on the basis of the evaluation report, whether to renew the service agreement with or without modification to the agreement

terms.

### **Financial and Staffing Implications**

15. The proposal for revising the income banding system (c.f. paragraphs 7 & 8 above) has notional financial implications. In practice, none of the DSS schools at present charges fees at a level which triggers the clawback arrangement. In any case, the maximum amount of subsidy a DSS school is entitled to is still the average unit cost of an aided school place.

16. The proposal to allow ex-aided schools with longer history of establishment to continue receiving subsidies for five years (c.f. paragraph 10 above) as if they were aided schools may also have financial implications. However, it is difficult to assess the financial implications at this stage because we cannot predict how many (and which) aided schools eligible for the subsidy arrangement will join DSS. Nevertheless, this cost will have to be incurred anyway if these schools were to remain aided.

17. The proposal to preserve MISS benefits of ex-aided DSS teachers (c.f. paragraph 11 above) will not lead to any financial implications since it is operated under a quota system and only existing MISS recipients will continue to receive interest subsidy under the scheme.

18. None of the proposals has any staffing implications.

### **Way Forward**

19. Where appropriate, we will be seeking the Finance Committee's approval of our proposals. Subject to any comment which Members may have, we propose to implement the modified DSS starting from the next school year.

**Summary of Government initiatives and Follow-up Actions**

In the 1999 School Allocation Exercise<sup>(Note)</sup>, we received a good number of applications for operation of DSS schools, and four government-built school premises were allocated. Another five Government-built school premises were allocated to DSS school sponsors in the 2000 School Allocation Exercise. Two other sites were allocated for construction of DSS schools. Given the encouraging response and the positive reaction from the education sector and the public, we will continue to allocate Government-built school premises and/or sites to DSS school sponsors in future exercises.

2. We also introduced the following modifications to the DSS in March 1999 –

- (a) Only non-profit-making DSS schools will be eligible for the enhanced subsidy for the Scheme.
- (b) DSS schools could choose what they consider to be the most suitable medium of instruction (MOI) for different subjects in their curriculum.
- (c) Schools which are operating from premises with a lease may be considered for conditional admission. They will be required to secure their own premises within five years after admission. The conditional admission could be renewed if they are able to continue the lease for the premises beyond the five-year period.
- (d) Non-recurrent capital grant will be provided to schools for slope repairs and major repairs.
- (e) One-off cash grant will be provided to schools for upgrading

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<sup>(Note)</sup> This is an annual exercise conducted by the Education Department to allocate Government-built school premises or school sites to aided, DSS and Private Independent School (PIS) school sponsors. A School Allocation Committee (SAC) chaired by the Director of Education and comprising government representatives and non-official members was formed to consider applications from school sponsors.

schools facilities.

- (f) The income-banding system will be revised to rationalise the amount of recurrent subsidy payable at each fee level with a view to providing DSS schools with some scope to charge a “middle of the road” fee range.

5. To allay the concern of teachers, the Grant Schools Provident Fund Rules and the Subsidized Schools Provident Fund Rules were amended in April 2000 to enable aided school teachers to remain in the two statutory provident fund schemes when their schools join DSS or when they change employment to DSS schools.



**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 (X) of which is \$30 229 in the current school year) as an example to give Members a better idea about how the previous, the existing and the proposed income banding systems respectively operate in dollar terms.

Section A - Old income banding system (c.f. paragraph 5 of the main paper)

If the school fees range from \$0 to \$20 153 ( $\frac{2}{3} X$ ), the DSS subsidy the school receives will be \$30 229 (i.e. full DSS subsidy).

If the school fees range from \$20 153 ( $\frac{2}{3} X$ ) to \$42 824 ( $1 \frac{5}{12} X$ ), then for every additional dollar charged in school fees, the DSS subsidy will be reduced by the same amount. In other words, the DSS subsidy will be progressively reduced from \$30 229 (X) to \$7 557 ( $\frac{1}{4} X$ ).

If the school fees exceed \$42 824 ( $1 \frac{5}{12} X$ ), the DSS subsidy will remain at \$7 557 ( $\frac{1}{4} X$ ).

Section B - Existing income banding system (c.f. paragraph 6 of the main paper)

If the school fees range from \$0 to \$10 076 ( $\frac{1}{3} X$ ), the DSS subsidy the school receives will be \$30 229 (i.e. full DSS subsidy).

If the school fees range from \$10 076 ( $\frac{1}{3} X$ ) to \$70 534 ( $2 \frac{1}{3} X$ ), the DSS subsidy the school receives will be progressively reduced

by fifty cents for every additional dollar charged. In other words, the subsidy will be progressively reduced from \$30 229 (X) to \$0.

When the school fees exceed \$70 534 ( $2 \frac{1}{3}$  X), it will not receive any subsidy from Government.

Section C - Proposed income banding system (c.f. paragraphs 7 & 8 of the main paper)

The DSS subsidy the school receives will be \$30 229 (i.e. full DSS subsidy) until the school fees reach \$70 534 ( $2 \frac{1}{3}$  X). If the school fees exceed this level, Government will not provide any recurrent subsidy to the school.

If the school fees range from \$20 153 ( $\frac{2}{3}$  X) to \$70 534 ( $2 \frac{1}{3}$  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 \$20 153 or below) to \$25 190 (when the fees are \$70 534 or more).

**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 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 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 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 MISS.
- (c) When an employee of an aided school, who is already a MISS beneficiary, leaves the school and joins a DSS school, he may choose to stay in 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 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 MISS and will no longer be eligible to join MISS again even if he rejoins an aided school later.

- (e) There is a group of aided school employees who have not yet received MISS subsidies but are already eligible<sup>(Note)</sup> or will become eligible some time later if they were to remain in the aided school sector. We have considered whether to allow these employees to maintain their eligibility after they have left the aided school sector (either because their schools turn DSS or they themselves join DSS schools). Our proposal is that they should not remain eligible. The prime reason is that doing so, the number of prospective applicants for MISS will have not been reduced as it should be. This may raise the objection of the employees remaining in the aided school sector.

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<sup>(Note)</sup> All full-time employees of aided schools will be eligible for MISS subsidies if they are paid the equivalent of MPS Point 22 or above and have a minimum of ten years of continuous service, or if they are paid less than MPS Point 22 and have a minimum of 20 years of continuous service. A quota is set aside for aided school employees every year under MISS. Priority for admission into the scheme will be based on the length of service in excess of the minimum qualifying service. Where two applicants have the same length of service in excess of the minimum, priority will be given to the one older in age. As at September 2000, the estimated number of teachers who have met the relevant eligibility criterion for MISS benefits but have not yet joined the scheme is over 16 000.