Beyond “Free” versus “Loan”: Towards a Fiscally Sustainable, Income-Contingent Student-Financing Model for South Africa

[2237 words, excluding references]

Undergraduate Entry

INTRODUCTION

South Africa has never spent more on student support, yet its universities have rarely felt more fragile. Fee-free higher education for households earning under R350,000 a year, announced in December 2017 and phased in from 2018, turned the National Student Financial Aid Scheme (NSFAS) into a predominantly grant-based system (Mail & Guardian, 2017). Treasury has budgeted R54.3 billion for it in 2026/27 (National Treasury, 2026). The Minister of Higher Education now calls the model "unsustainable", citing a shortfall of about R15 billion that could reach R33 billion by 2029 (IOL, 2026). NSFAS also received a disclaimer of opinion from the Auditor-General for 2024/25 and was placed under administration in May 2026 (Mail & Guardian, 2026).

The access gains are nonetheless real: the Minister reports that NSFAS-funded students complete at rates roughly ten percentage points above the general cohort (Inside Education, 2026a). The question is therefore not whether to abandon free access, but how to finance it sustainably. Government's own answer, before Cabinet and targeted for 2027, is a four-tier framework: full grants for the poorest, income-contingent loans (ICLs) for the "missing middle", bursaries for scarce skills, and a reformed tier of private contributions (Business Day, 2026).

This paper argues that such a hybrid will be fiscally sustainable and access-enhancing only if it gets three design choices right: an explicit, budgeted subsidy; a repayment mechanism that is income-contingent, tax-collected and legislated against political tinkering; and an administrator with the data and capacity to run it. It draws on Australia, England, Chile and Kenya, with the Nordic countries as a benchmark, and focuses on financing design rather than fee-setting politics. Section 1 sets out an evaluative framework, Section 2 diagnoses the South African position, Section 3 distils international lessons, Section 4 proposes design rules for the 2027 framework and Section 5 assesses risks.

1. EVALUATIVE FRAMEWORK

1.1 Why the state must be involved

Students cannot borrow against future earnings: human capital is not collateral, so private lenders ration credit or price it prohibitively, and the poorest are excluded first (Barr, 2012). Yet graduates also capture substantial private returns, which justifies cost-sharing between taxpayers and graduates in proportion to private and public benefit (Johnstone, 2004). Income-contingent repayment follows from this logic: it insures borrowers against low earnings while still recovering costs from those who gain (Barr et al., 2019).

1.2 Criteria

Any model is judged against four criteria:

1. **Access and equity:** does it let capable students from poor and "missing middle" households enrol and complete?

2. **Fiscal sustainability:** are long-run costs, including write-offs, affordable within a realistic budget?
3. **Incentives:** does it reward completion and sensible choices by students and institutions?
4. **Administrative feasibility:** can South Africa's institutions actually run it?

The fourth is often neglected but, as Section 2 shows, is currently the binding constraint.

2. THE SOUTH AFRICAN PROBLEM

2.1 An access success with a fiscal price tag

The state now pays tuition for about 62% of undergraduates, while the block grant funding academic salaries has grown below inflation and university student debt has swollen to roughly R23 billion, much of it unrecoverable (Inside Education, 2026a). NSFAS's annual shortfall has grown from R2.5 billion in the policy's first year to an estimated R15 billion (IOL, 2026), in a fiscus where debt-service costs absorb 21.3% of revenue (National Treasury, 2026).

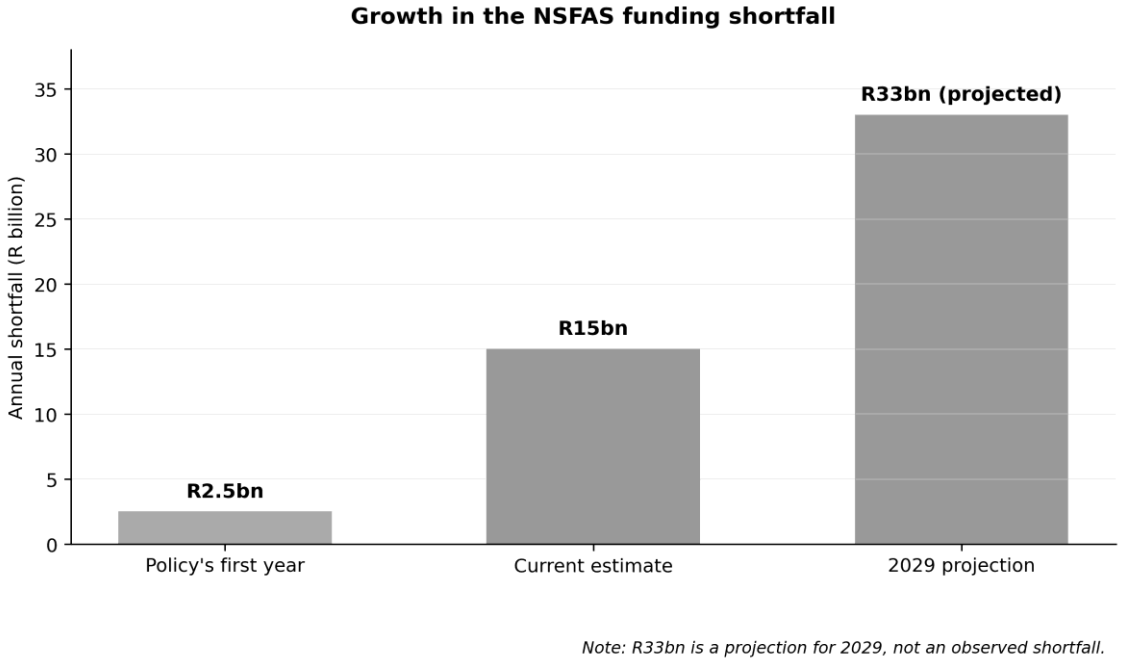


Figure 3: Growth in the NSFAS annual funding shortfall.

Source: IOL (2026). The R33 billion figure is a projection for 2029, not an observed shortfall.

The Heher Commission had warned in 2017 that universal fee-free education was unaffordable. It recommended ICLs for all students, sourced from commercial banks with a state guarantee, with SARS collecting repayments (The Presidency, 2017; Business Report, 2017). Government chose grants instead (Mail & Guardian, 2017); the present debate is the fiscal consequence.

2.2 The missing middle: a small, slow scheme

Households earning R350,000–R600,000 have been served since 2024 by an NSFAS loan scheme capitalised with R3.8 billion (R1.5 billion from the National Skills Fund and R2.3 billion from SETAs). This was enough to fund 47% of an estimated 68,446 eligible students, with 70% of funds reserved for STEM fields (Current Affairs ZA, 2024). Conversion has been weak: for 2026, 53,575 students applied but only 3,102 have been assessed as eligible (Daily News, 2026). A scheme that converts under 6% of applicants cannot close the gap, whatever its design on paper.

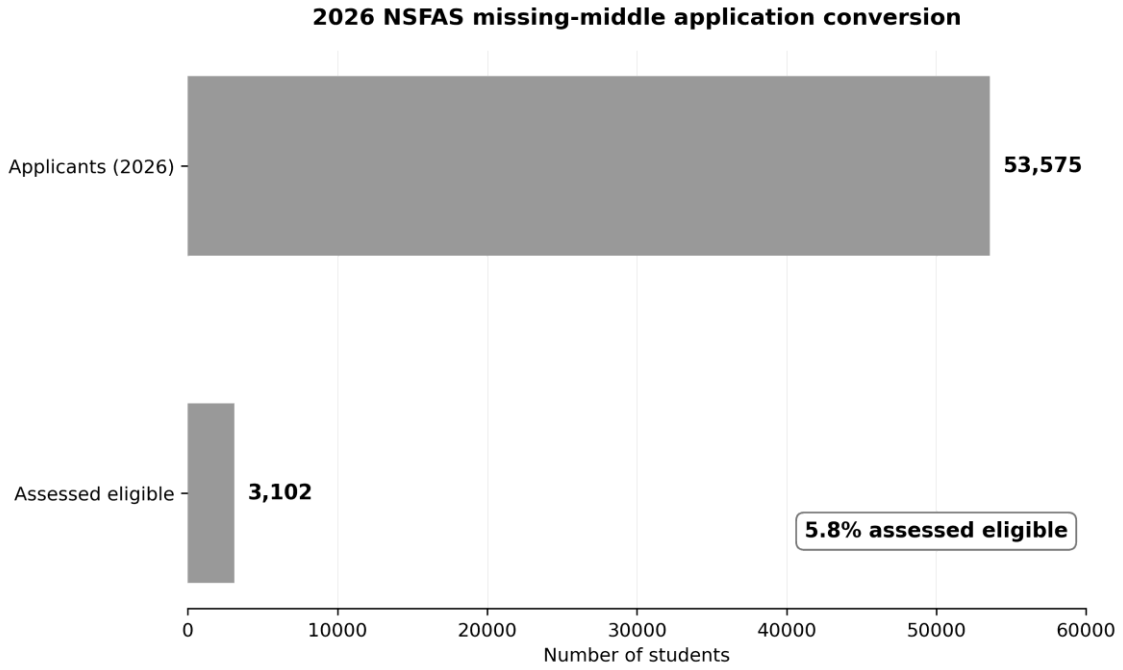


Figure 2: 2026 NSFAS missing-middle applicants and students assessed as eligible.

Source: Daily News (2026). Calculated conversion: 3,102 of 53,575 applicants (approximately 5.8%).

2.3 Weak throughput and weaker governance

Only 42.2% of the 2008 cohort and 47.6% of the 2014 cohort of first-time entrants to four-year contact degrees finished in the minimum time (DHET, 2023, cited in MacGregor & Ross, 2024). Of the 2008 national cohort, 34.6% dropped out, against 22.4% of NSFAS-funded students (Minister of Higher Education, n.d.); funding helps, although selection effects cannot be excluded.

The administrator, however, is failing. The Auditor-General found 822 deceased people recorded as funded, and thousands of ineligible beneficiaries (TimesLIVE, 2026). A court later set aside the May 2026 administration, but the Minister told the reinstated board that the underlying problems remain (Inside Education, 2026b). Any loan scheme built on this base would inherit its data and control weaknesses.

2.4 Returns are high but insecure

Graduates still fare far better in the labour market, with 12.4% unemployment in the second quarter of 2026 against 39.2% for those without matric, but the graduate rate is rising (NYDA, 2026). This supports cost-sharing, while showing why repayment must be income-contingent: a graduate who cannot find work must not owe.

3. LESSONS FROM INTERNATIONAL EXPERIENCE

Country / model	Core design	Lesson for South Africa
Australia (HELP, since 1989)	ICL repaid through the tax system above an income threshold	Efficient and insuring, but indexation shocks forced a 20% debt cut and a new threshold in 2025
England (Plan 5, since 2023)	£25,000 threshold, 9% marginal rate, 40-year write-off	Shifts cost to graduates; later changes to existing loans erode trust
Chile (CAE loans; free tuition since 2016)	Bank-intermediated, state-guaranteed loans; free tuition for poorer students	Fixed repayments and guarantees put risk on borrowers and the state; replacement bill stalled
Kenya (funding model, 2023)	Means-tested bands plus loans	A contested means test brought litigation and payment freezes
Nordic countries	Tax-funded tuition; grants and loans for living costs	High completion, but built on high tax-to-GDP ratios

Table 1: Selected international models of student financing (author's synthesis of the sources cited in this section).

3.1 Income-contingent loans: Australia and England

Australia's HELP is the benchmark. Repayments are collected through the tax system only above an income threshold, which insures borrowers against low earnings (Chapman, 2006). Its recent history is instructive. After inflation pushed indexation to 7.1% in 2023, indexation was capped retrospectively at the lower of inflation and wage growth. In July 2025 Parliament then legislated a one-off 20% debt cut (about A$16 billion), lifted the repayment threshold from A$54,435 to A$67,000 and moved to marginal repayment rates (Australian Government Department of Education, 2025). The lesson is that an ICL is never self-financing, and that when parameters are left to discretion, relief arrives as ad hoc forgiveness that the fiscus pays for.

England's Plan 5 loans, issued since August 2023, carry a £25,000 threshold and a 40-year term (Department for Education, 2025), deliberately shifting cost from taxpayers to graduates. Meanwhile changes to existing Plan 2 loans, including a threshold freeze announced for April 2027 and a 6% interest cap for 2026/27, have drawn sharp criticism (Saga, 2026). Retrospective changes erode borrower trust, so parameters should be settled before the first loan is issued.

3.2 Bank-intermediated loans: Chile

Chile's state-guaranteed, bank-intermediated CAE loans have cost the state more than US$9 billion, according to President Boric (CNN Chile, 2024), while leaving graduates with repayments unrelated to income. A bill replacing CAE with a state-run instrument that excludes banks (the FES) passed the Chamber of Deputies in August 2025 but stalled in the Senate (Radio Universidad de Chile, 2026a), and

by mid-2026 debtors' accounts were being seized (Radio Universidad de Chile, 2026b). The Heher model also relied on guaranteed bank lending. Chile suggests the state ends up bearing the risk, while critics argue the banks capture the gains.

3.3 Means testing under challenge: Kenya

Kenya's 2023 model sorted students into bands using a means-testing instrument. In December 2024 the High Court declared it unconstitutional and discriminatory, freezing disbursements and prompting protests; the Court of Appeal reinstated it in March 2025 pending appeal (Citizen Digital, 2025). South Africa's own R350,000 household-income threshold is similarly blunt, so eligibility rules must be transparent, data-driven and defensible, or litigation will interrupt payments.

4. DESIGN RULES FOR THE 2027 FRAMEWORK

The four-tier framework is sound in outline. Its sustainability will depend on six rules.

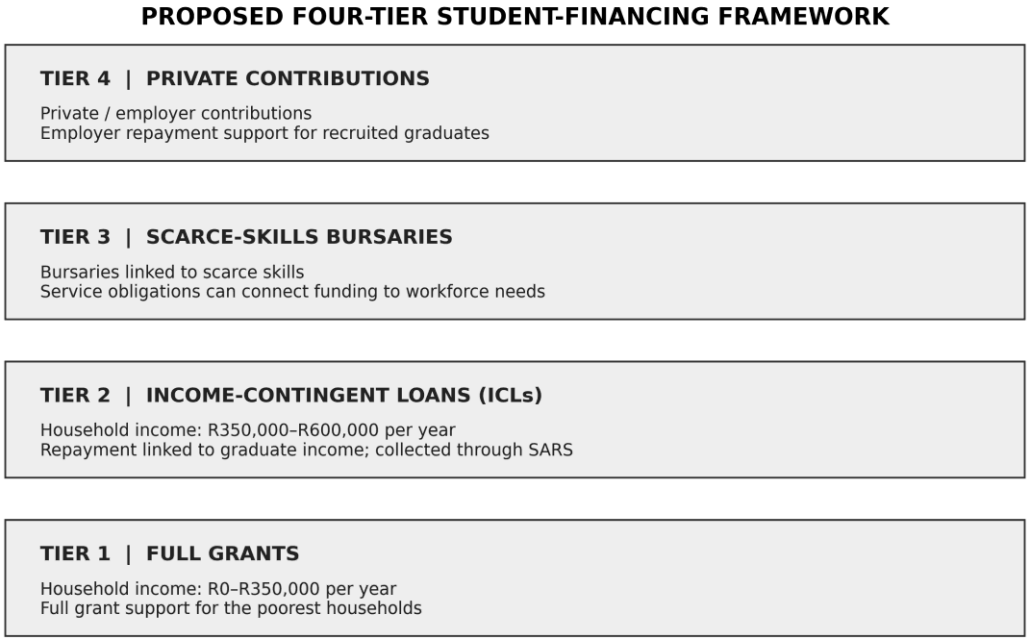


Figure 1: Proposed four-tier student-financing framework for South Africa.

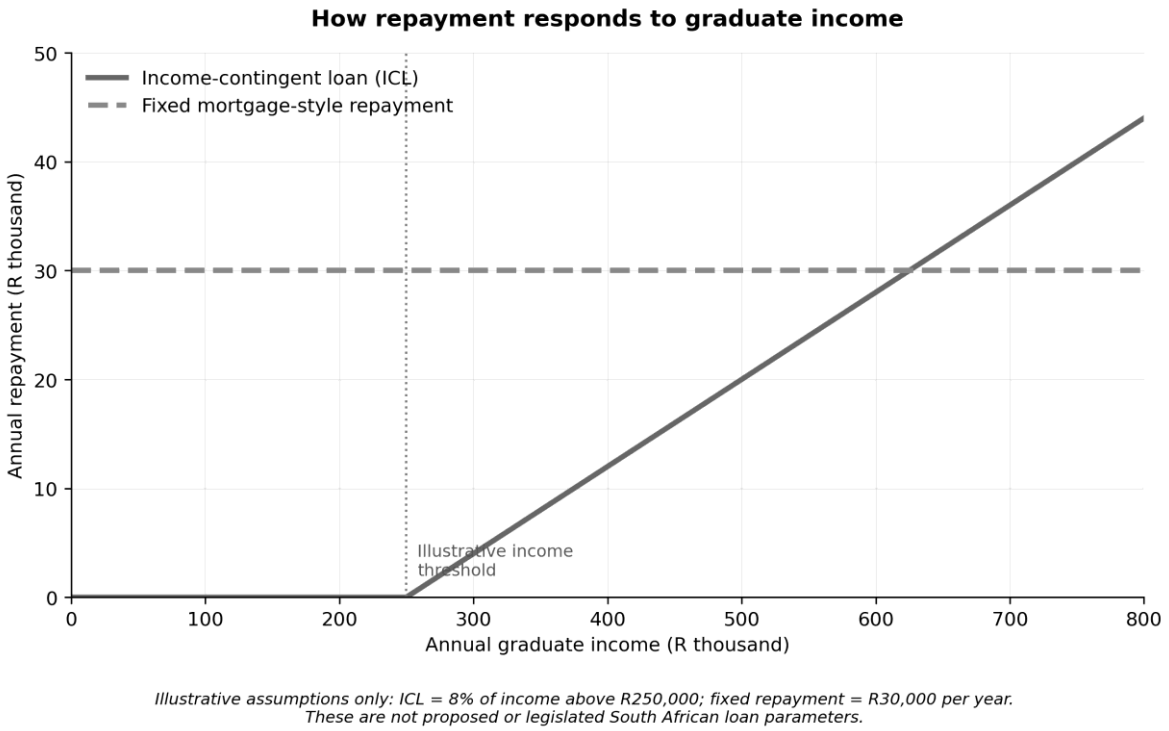


Figure 4: Illustrative annual repayments under an income-contingent loan and a fixed mortgage-style loan.

Source:. Assumptions: 8% of annual income above R250,000 for the ICL; fixed repayment of R30,000. These values illustrate the repayment principle only and are not policy proposals.

1. **Protect Tier 1 grants, but verify and condition them.** The poorest should remain fully funded, with need established through verifiable data (social-grant status and SARS records) rather than self-declaration. Continued funding should depend on progression, paired with academic support, since NSFAS-funded students already complete at higher rates. Allowances and accommodation, where the Auditor-General found irregularities, should be standardised.
2. **Make Tier 2 a genuine ICL and legislate its parameters.** Repayment should start only above a threshold at or above the tax threshold, apply a marginal rate to income above it (as Australia now does, avoiding a cliff-edge), cap indexation at the lower of inflation and wage growth, and end in a fixed write-off. Putting these in statute, not annual discretion, prevents England-style retrospective change and Australia-style forgiveness.
3. **Budget the subsidy honestly.** Every ICL carries a write-off share. An independent actuary should estimate it before launch, and Treasury should fund it as an explicit, annually published transfer. This distinguishes a sustainable scheme from a hidden contingent liability.
4. **Scale and automate the missing-middle tier.** With under 6% of applicants assessed as eligible, the loan cannot close the gap. Eligibility should be determined automatically through the SARS data-sharing agreement the Minister has already directed NSFAS to finalise (DHET, 2026), and capital should be scaled from a ring-fenced pool, such as the National Skills Fund and SETAs that seeded the 2024 pilot.
5. **Regulate fees and tie Tiers 3 and 4 to employers.** Subsidised demand without fee regulation merely inflates fees, so the Minister's proposed regulatory framework to replace the annual compact with vice-chancellors is essential (Inside Education, 2026a). Scarce-skills bursaries

should carry service obligations, and the private tier could include employer repayment of loans for graduates they recruit.

6. **Rebuild the administrator around data.** Separate grant payment from a specialist loan-book function, integrate university (HEMIS), NSFAS and SARS records, and publish audited beneficiary registers. Given the 2026 disclaimer opinion, no tier is sustainable without this foundation.

The reform should be piloted and published before any loan is issued, so that students borrow on terms that will not change.

5. RISKS AND TRADE-OFFS

Tax base and informality. Fewer than ten million of the roughly 26 million registered individual taxpayers file returns, and about four in five assessed taxpayers earn under R500,000 (SARS & National Treasury, 2025; Daily Investor, 2026). Recovery will therefore be slower and lossier than in Australia. The budgeted write-off share must reflect this, and loan sizes should be modest.

Transition cost. An ICL spends before it recoups. In a fiscus where debt service absorbs a fifth of revenue, the rollout must be phased and costed, and not simply added to a grant bill that is already R15 billion short.

Politics. Australia's 2025 debt cut shows how voters push for forgiveness once debts bite, and England shows the cost of retrospective change. After #FeesMustFall, any loan carries risk, which is why the framing matters: Tier 1 preserves free access for the poorest, and Tier 2 replaces the missing middle's exclusion with an income-linked contribution.

Capacity. The binding risk is administrative. A badly run ICL would be worse than none, which is why governance reform must precede, not follow, the loan expansion.

CONCLUSION

South Africa's student-financing problem is not a choice between "free" and "fee-paying" education. International evidence shows that bank-intermediated loans and mortgage-style repayments push risk onto students and the state, while universal grants are fiscally fragile. The government's four-tier framework points in the right direction, but its sustainability will turn on design details: a verified, conditional grant core; a legislated, income-contingent loan collected through SARS and automated for the missing middle; an honestly budgeted subsidy; regulated fees; and an administrator rebuilt around reliable data. If these are in place, the 2018 access gains can be protected, extended to excluded middle-income households and paid for without a recurring fiscal crisis.

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