How South Africa could fund steeper higher education costs

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Recent student protests over tuition fees, university staff and curricula, university autonomy and outsourcing have highlighted a number of issues facing South Africa. The agreement not to increase fees in 2016 has left the country with a short-term education financing gap. The increasing demands for free university education leave it with a longer-term, and much bigger, financing issue.

Can South Africa meet the funding shortfall in 2016? Yes.

Can it afford free education for all? No. Someone will have to pay.

The impact of no fee increases

In the short term, the impact of the 0% increase is unlikely to raise eyebrows, if it is indeed a once-off. Cost estimates range between R2.6 billion and R4.2 billion, depending on the methodology used.

One fairly objective estimate of the cost is based on the weights from the consumer price index, where the cost of education accounts for 2.95% of consumer spending (basic and secondary education account for 1.72% and tertiary education accounts for 1.23%). GDP is now forecast at R4.35 trillion, which corresponds to R2.7 trillion in consumer spending. Applying the 1.23% weight to consumer spending gives an estimate of the cost of tertiary education.

Between 2009 and 2015, tertiary institutional fees escalated at around 4% to 5% above the rate of inflation. Similarly, student numbers increased over that period, suggesting the weights above need to be adjusted upwards. For that reason, we assume a 1.5% consumer weighting.

Thus, the cost of university fees (excluding bursaries) would be close to R40 billion per annum. Given that the student protests were sparked by a 10% increase, that implies R4 billion is needed. If that is the only cost, the budgetary impact will be small.

If funded by government, without using the contingency reserve (only R2.5 billion has been budgeted for the 2016 contingency reserve), the knock-on effect on the budget deficit would be no more than 0.1% of GDP (R4 billion from R4.35 trillion GDP, yields 0.092% of GDP).

Is free university education affordable?

Using the same values above, free university education would require a minimum injection of R40 billion from the public purse. Such an injection implies that the deficit would increase by nearly 1% of GDP, if not funded from alternative arrangements.

The amount could be raised through borrowing and monetising that deficit. But monetising leads to inflation, which is bad for the poor. Thus, tax revenues, either current or future, would need to rise.

Also, fees are not the only cost to university attendance. To attend a residential institution, students need "study-friendly" accommodation near the institution and adequate nutrition. The overall cost to the fiscus could be as high as R100 billion per annum. Due to the fact that reduced tuition disproportionately benefits the wealthy, it is unlikely that free education will be made available for all.

For this analysis, we assume a cost of R60 billion, which includes the R40 billion and a back-of-the-envelope estimate of the additional amount needed by the state-owned student lender, the National Student Financial Aid Scheme (NSFAS). For 2014-2015, NSFAS received R8.8 billion, which was between one-half and one-third what was required. We round the amount to R20 billion.

Raising an extra R60 billion in a depressed economic environment through taxation is a daunting task. The Medium-Term Budget Policy Statements suggest that South African Revenue Services still has scope to raise further revenues from clamping down on tax avoidance.

In addition, the government will look to clamp down on the use of transfer pricing by multinational companies as a means of avoiding tax. But these improvements in collection will not cover the additional costs.

Other options include an increase in value-added-tax (VAT), personal or corporate income taxes or the siphoning of funds from some other activity. The VAT rate at the moment is 14%.

On the basis of simulations we have done, VAT would have to go up by around 0.6% to 14.6% to raise revenue by R60 billion. For personal income tax, the feasible increase rate would lie between 1%-5%, depending on the degree of bracket creep and spread assumed. On the other hand, the public sector wage bill is in the range of R450bn, and increases of 7% were recently agreed.

How about a higher education tax?

The government could also consider the introduction of new taxes, such as a carbon tax, wealth tax or higher education tax.

A higher education tax, as in the UK, has appealing elements. It is imposed on those who have earned a higher education degree, can be scaled to earnings, and a set number of years.

The tax could also be applied retroactively. According to the 2011 census, there were 3.6 million individuals aged 20 and older holding a higher education qualification. If a higher education tax was applied to all 3.6 million, the average higher education tax would be about R16,667 per degree recipient per annum.

The actual average would be subject to whether or not every degree holder pays, payments are limited to a certain number of years post completion and whether the type and level of degree are also factored in. The average would also depend on how it is scaled to income, the total number of students in the system and the number of students that complete and find jobs.

For the most part, graduate unemployment rates are much lower than for the rest of the population. But emigrants would disproportionately benefit from such a tax, potentially exacerbating brain-drain, and the tax could also create disincentives to the immigration of skilled labour.

Despite potentially exacerbating brain-drain, a higher education tax is a practical solution. It allows for both "private" returns to education and "social" returns to education. For example, social workers are paid less, and, therefore, could be taxed at a lower rate, while accountants earn more, and could be taxed at a higher rate.

Furthermore, it embodies the concept that education is an investment in our future.

But many potential pitfalls to "additional taxes" remain. Without a doubt, the combination of the required tax increases and the sheer magnitude would substantially erode disposable income. It would also lead to significantly weaker growth.

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