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The French Mandate to Spend on Training: A Model for the United States?

Abstract

American employers and workers underinvest in employer training. Underinvestment occurs because training generates externalities, because turnover is excessive, because the tax system discourages training investment, and because workers lack access to loans that would allow them finance heavy investments in training (Bishop 1991). During the election campaign, President Clinton proposed stimulating training by requiring employers to spend some minimum percentage of their wage bill on training or else be subject to a special tax. France has had such a mandate since 1972, so the design of an American training mandate is likely to benefit from a careful examination of the French program. The French have demonstrated that a training mandate is administratively and politically feasible, but their mandate is not optimally designed for U.S. implementation. The paper concludes with some recommendations about how a U.S. mandate to spend on training should be structured.

Keywords

mandate, training, model, United States, French, worker, employer, wage, tax

Comments

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**THE FRENCH MANDATE TO SPEND ON TRAINING:
A MODEL FOR THE UNITED STATES?**

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Working Paper # 93-05

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American employers and workers underinvest in employer training. Underinvestment occurs because training generates externalities, because turnover is excessive, because the tax system discourages training investment, and because workers lack access to loans that would allow them finance heavy investments in training (Bishop 1991). During the election campaign, President Clinton proposed stimulating training by requiring employers to spend some minimum percentage of their wage bill on training or else be subject to a special tax. France has had such a mandate since 1972, so the design of an American training mandate is likely to benefit from a careful examination of the French program. The French have demonstrated that a training mandate is administratively and politically feasible, but their mandate is not optimally designed for U.S. implementation. The paper concludes with some recommendations about how a U.S. mandate to spend on training should be structured.

THE FRENCH MANDATE TO SPEND ON TRAINING

Legislated mandates to spend on formal training are a central component of the French system of continuing education and training. Employers and unions established the foundations of this system with the National Intersectoral Agreement of July 9, 1970 which was later amended to cover managers and professionals on April 30, 1971. This agreement was enacted into law on the 16th of July 1971 and is referred to by that date. Every employer with 10 or more employees was obligated to spend .8 percent of its wage bill on continuing education and training of its employees or pay a tax equal to the difference between its obligated and actual training expenditure. In addition, every employer regardless of size was required to spend .5 percent of its wage bill on apprenticeship training or pay a tax equal to the difference between its obligated and actual training expenditure (Berton and Podevin 1991).

The mandated training tax for continuing training was raised to 1.0 percent of wage bill in 1974, to 1.1 percent in 1977, and to 1.2 percent in 1987. Beginning January 1993, the mandated spending level is 1.4 percent. Since the initiation of the mandate, the share of the wage bill spent on formal training has risen substantially, from 1.35 percent in 1972 to 3.14 in

1990. Firms are required to develop a training plan and present it to the firm's labor management committee (these committees were already required by French industrial relations legislation). This committee's role is advisory only, however. Management generally decides which skills are to be taught, who is to be trained, and when. Other times employees take the initiative. The government is not involved in these decisions and bureaucracy has been kept to a minimum. The auditing of company reports of training expenditure requires a staff of only 120 controllers for the entire nation.

Eligible expenditures: The obligation to invest in continuing education and training can be fulfilled by five different types of expenditure:

- * the firm's own formal training programs (These must have a curriculum, develop a skill that is useful at more than one firm and be located away from the trainee's normal work station.),
- * external training (often cooperative programs organized by groups of employers),
- * training insurance funds agreed to by management and labor,
- * government approved training programs for unemployed youth who have no qualifications (Within the overall 1.4 percent mandate, firms are required to spend at least 0.3 percent of their wage bill on these programs or be subject to the tax),
- * wages and tuition of employees taking courses at schools and colleges (Firms are required to spend at least 0.15 percent of their wage bill on in-school training of employees or be subject to tax. This is the only mandate that firms with fewer than 10 employees are subject to.

The first panel of Table 1 indicates how firms of different size allocated their eligible training expenditures in 1988. Internal training accounted for 28 percent of the eligible training expenditures reported to French authorities by all firms. Large firms spent heavily on this kind of training, small firms did not. Training programs organized by outside vendors, many of which are provided by organizations formed by industry councils and other groups of employers, accounted for another 35 percent of eligible training expenditures. The firms with 50 to 2000 employees were the heaviest users of this kind of training.

Union-management training insurance funds accounted for 37 percent of the eligible training expenditure of firms with 10-19 employees, but only 4 percent of the expenditures of the largest firms. Contributions to government

approved training programs for unemployed youth accounted for 25-27 percent of training expenditures by firms with under 50 employees and 13 percent of the training expenditures of firms with 2000+ employees. Wages and tuition for employees attending schools and universities accounted for 7 percent of training expenditures.

Impacts: French leaders believe the training mandate has stimulated the growth of formal training, professionalized it and aided French competitiveness. Hillary Steedman, a British economist who has done extensive field research on the productivity and skills of French workers, also believes that the mandate has significantly stimulated investment in training and improved worker skills. The two human resource executives of American multi-national corporations operating in France I have interviewed about the mandate also praised the system.

Studies have found that individuals receiving training are significantly more likely to receive internal promotions and 2 to 3 times more likely to transition from unskilled to skilled occupations. This is just as true for training initiated by the worker as for training initiated by the employer. For those who were in unskilled jobs in 1980, individuals who initiated their own training in the next 5 years had a 58 percent probability of being in a skilled job in 1985 and those who took training at the behest of their employer had a 55 percent chance of being in a skilled job. Those who received no formal training between 1980 and 1985, by contrast, had only a 20 percent chance of moving up to a skilled job by 1985 (Berton and Podevin 1991).

Who Gets Trained? As in other nations, formal training is more extensive at large firms and for more skilled workers (see Table 1). In 1990, firms with 10-19 employees spent 1.30 percent of their wage bill on formal training, barely more than the 1.2 percent mandate. By contrast, firms with more than 2000 employees spent 4.99 percent on average on formal training, more than three times the mandate. Those receiving training averaged about 46 hours during the year. This varied little by firm size and skill level. The incidence of training, however, varies substantially. Slightly over one-half of supervisors, technicians, managers and professionals receive formal training each year. One in four craft, sales and clerical workers and one in

eight unskilled operatives receive formal training each year. The incidence of formal training is considerably higher in France than in the United States.

Advantages: The French mandate to spend has some important advantages:

- * Employer needs for skill upgrading determine the allocation of funds so the risk that people will be trained for jobs that don't exist or in skills that do not increase productivity is small. Trainees get to use the skills they develop.
- * Decisions are made by managers and workers on the shop floor.
- * Training generally occurs at the work site where it is both more effective and more convenient.
- * Trainees are more motivated because promotions often depend on their success in training.
- * Training of both the employed and unemployed is encouraged.

Disadvantages: The French system also has some important disadvantages:

- * Six-million of the 9 million French workers employed by firms subject to the training tax are at firms which regularly exceed the mandated amount. The training mandate clearly has no effect on the incentive to train these 6 million workers. Since 1984, firms which increase their training budget from one year to the next are eligible for a tax credit equal to 25 percent of the increase in training expenditure (Luttringer 1991). For firms already spending more than the mandated 1.4 percent of wage bill, the tax credit, not the mandate, is probably the primary inducement for expanding training.
- * Another 27 percent of workers are employed at firms which report spending exactly 1.2 percent (the mandate that applied in 1990) of wage bill on training. While some of these firms increased their training expenditure to the required minimum because of the mandate, program administrators report that many smaller companies simply stop keeping track of their training expenditure once they reach the tax threshold. It is not clear, how much of the response to the mandate is creative accounting and how much is real behavioral change.
- * Firms whose expenditures on formal training would have been below 1.4 percent of payroll in the absence of the mandate, save in taxes the full amount of any increase in expenditures on training. Some administrators of the French program fear that this has induced a careless attitude toward costs and reduced the efficiency of training.
- * Expenditures on formal training reduce the firm's tax liability; but the costs of informal training do not. In the United States formal training accounts for less than 15 percent of the time that new

employees at small and medium size companies spend learning their job; informal training and learning by watching others accounts for the rest. This feature of the mandate generates a strong incentive to substitute formal training for informal training despite the fact that there is no evidence (either of an empirical or theoretical variety) establishing that formal training is more cost effective than informal training (Bishop 1991).

- * Formal training is subject to substantial economies of scale, so small firms are put at a disadvantage. The kind of training which small companies excel at--close supervision and informal training by the owner--is not eligible for subsidy. Small firms must join together in cooperative efforts to achieve the scale necessary to make formal training feasible.

Most of these problems can be avoided, however, by modifying its structure.

HOW SHOULD AN AMERICAN TRAINING MANDATE BE DESIGNED?

The source of most of the problems with the French training mandate is the 100 percent offset of training expenditure for tax obligation. It is this feature that results in a few firms (those spending below the mandated level) having little incentive to train efficiently and most other firms facing no incentive to increase training above the level they would have chosen in the absence of the program. An American training mandate can avoid these problems by offering only a 20 or 25 cents reduction in tax for every dollar of training expenditure. This generates strong incentives to use cost effective training techniques. It also means that the tax rate can be low and yet an incentive to expand training is generated even for companies that normally spend 4 percent of their wage bill on training.

All employers--profit making, nonprofit, and governmental--should be subject to the training tax. As an administrative convenience, the mandate should not apply to very small organizations. Furthermore, it should set proportionately higher training targets for larger firms. This can be accomplished by making the training tax progressive. For example, there might be no tax on the first \$40,000 of the firm's wage bill, a 0.5 percent tax on the next \$5,000,000 of the wage bill, a 0.75 percent tax on the next \$5,000,000 of wage bill and 1.0 percent on all wages paid above that. Taxes paid would go into a dedicated training trust fund that would be a source of federal funding of technical assistance to firms considering expanding their

training programs, JTPA, apprenticeship programs, school based vocational training and research and development into improved training techniques.

With a 20 cents on the dollar tax offset, a 1 percent tax rate implies that the very largest firms would not be released from paying tax until they were spending over 5 percent of their wage bill on formal training programs. Once accountants are given the task of identifying the full costs of their existing formal training programs (including the time of trainees), this will not be a difficult target for most companies to meet. The average French firm with more than 2000 employees currently spends this proportion of their payroll on formal training.

Quality control: As a quality control measure, firms would be required to give certificates describing the skills taught and competencies achieved to trainees at the completion of training. These certificates would make the individual more marketable at other firms and strengthen worker incentives to engage in training. As a further quality control measure, companies above a certain size would be required to develop a training plan and present it to a training advisory committee that contains worker representation. Public companies would be expected to describe their investments in formal training in their annual report. In order to avoid a conflict of interest in the allocation of training investments, tax offsets would not be available for training received by the owner and top managers.

Initially, the categories of training expenditures that could offset the tax would be similar to those in France: apprenticeship training programs, industry training funds, labor-management training funds, tuition reimbursements for job-related training, contributions of materials or staff time to vocational-technical institutions, the employer's share of JTPA OJT training expenses and the firm's formal training programs for new and continuing employees.¹ The costs of certain types of informal training (as specified in Department of Labor regulations) would also be used to offset the training tax. Apprenticeship programs for 16 to 21 year olds for high skill jobs generate particularly large externalities, so it would be desirable to structure the mandate to give special encouragement to this kind of training. This could be done by offering a larger tax reduction (eg. 40 cents per training dollar rather than the 20 cents per training dollar) for expenditures

on apprentice training programs that meet quality standards promulgated by industry associations and approved by the Department of Labor. Other types of training (for example, training which awards industry recognized credentials or academic credit) might be similarly encouraged by offering a better tax offset ratio.²

Encouraging Informal Training: The major drawback of the system described so far is its tendency to promote formal training programs at the expense of job rotation and other more informal methods of learning and training on the job. Japanese workers are better trained than American workers not because they are more likely to take company sponsored courses (expenditure on such courses is in fact lower in Japan than in the US and France, Dore and Sako 1989), but because they receive continuous upgrading training through job rotation and the Kaizen process. It is very important for an American training mandate to promote informal learning on the job through job rotation, obtaining assistance from coworkers, self study and learning by doing. The Department of Labor should be tasked with the job of writing regulations which would accomplish this.³

One strategy that needs to be investigated would be to award training tax offsets for learning outcomes rather than for training expenditure. The McAllister Commission is considering whether the Department of Labor should promote the development of a nationwide skill certification system for industry and occupation specific skills. If the Department of Labor decides to go ahead with such a program, employer use of the certification system could be insured by awarding training tax offsets to firms which train their workers to industry standards and arrange for them to be tested and certified. Incentives to engage in self study could be enhanced by giving those who demonstrate their competence a small monetary award along with their skill certificate. Without such a system of incentives to attract workers and firms into the skill certification process, I doubt that a skill certification system will gain the scale necessary for sustainability.

When designing a training mandate there will be a temptation to become overly prescriptive about the type of training that is to be allowed to offset the tax. The failure of prescriptive regulation of schooling inputs to produce quality outcomes is a lesson that the designers of a training mandate

need to take to heart. There is substantial evidence that employer training often yields very high returns, but the number of studies that have measured the productivity outcomes of training is very small. The research base is presently too thin to form a basis for government picking and choosing amongst types of training or objects of training. The profit motive is probably what has insured training's cost effectiveness in the past. Too many regulations could get in the way of the profitability calculation and reduce training's effectiveness.

Influencing Who is Trained: The training mandate outlined above will increase the incidence and intensity of employer training without changing its basic character or its distribution. Employers clearly believe that skilled workers need more formal training than unskilled workers (ie. that profitable opportunities for training skilled workers are more numerous than for training unskilled workers). The result is that managers and skilled workers get more formal training than unskilled workers. Some analysts believe this is a problem that requires government intervention.

A training mandate could be structured with a bias toward training those with less skill. Training received by low wage workers or young workers might generate higher tax offsets. Alternatively, separate training taxes could be imposed on exempt and non-exempt employees and the mandate could apply separately to each group of workers.

Should profit and productivity calculations be the sole determinants of who gets trained? Or should a training mandate favor the training of the firm's least skilled workers? The answer is not clear. While the absence of loan financing of general training and the turnover explanations of underinvestment in training apply most of all to young and disadvantaged workers, the externalities that training is thought to generate--discoveries, artistic contributions, reduced risks of catastrophic errors--appear to arise primarily in high level occupations. How should distributional issues be evaluated? Should the goal be equal opportunity to compete for jobs which offer training or equalizing training outcomes? While evidence about externalities can inform policy choices, the judgement is ultimately a political and moral one.

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Table 1
Formal Training in French Companies
by Size of Firm

	Number of Employees					Total
	10-19	20-49	50-499	500-1999	2000+	
<u>Share of 1988 Training Expenditure for</u>						
Internal Training	1%	2%	6%	17%	50%	28%
Joint External Training	26%	31%	42%	46%	29%	35%
Union-Management Funds	37%	33%	22%	11%	4%	11%
Training of Youth	27%	25%	23%	19%	13%	19%
Time off to Attend School	9%	9%	7%	7%	4%	7%
	100	100	100	100	100	100
<u>Training's Share of the Wage Bill</u>						
in 1974	.66%	.86%	1.14%	1.45%	2.59%	1.63%
in 1990	1.30%	1.45%	2.17%	3.20%	4.99%	3.14%
Hours of Training per Trainee-1990	41	43	41	44	53	46
<u>Share Receiving Training in 1990</u>						
All Employees	8%	11%	23%	39%	53%	32%
Unskilled Operatives	2%	4%	9%	15%	22%	13%
Skilled Operatives	6%	7%	16%	29%	48%	25%
Other Non-Supervisory	8%	11%	24%	37%	46%	29%
Supervisors & Tech.	15%	19%	38%	55%	70%	53%
Managers & Professional	13%	21%	41%	62%	71%	50%
Share of Covered Employment	5%	15%	32%	19%	30%	100%

Source: Centre d'Etudes et de Recherches sur les Qualifications, Statistique de la Formation Professionnelle Continue Financée par les Entreprises: Années 1989-1990.

Tables 13 and Fabienne Derton & Gerard Podevin, "Vingt Ans de Formation Professionnelle Continue: De la Promotion Sociale à la Gestion de l'Emploi," Formation Emploi, No. 34, Avril-Juin 1991, 14-30, Table 2 & 3.

ENDNOTES

1. To ensure that only training gets subsidized and not vacations or motivational sales meetings, eligible expenditures might be defined to exclude: (1) travel to remote sites other than the company's national or the appropriate regional headquarters; (2) housing and food expenses above a specified daily rate; (3) costs of training non-employees, part-time employees working less than 50 hours a month, or employees for whom more than 50 percent of compensation comes from commissions; and (4) payments to speakers or presenters of a training session above a specified amount per contact hour. The costs of developing a training package or system for use in training one's own staff would be an allowable expense.
2. The French promote particular kinds of training by having sub-mandates requiring all firms to spend at least X percent of wage bill on a particular category of formal training. Unless a case can be made that it is undesirable for some firms to specialize in one kind of training (say apprenticeships) while others specialize in other forms of training, sub mandates will be a less efficient way of stimulating particular types of training than varying the tax offset ratio. If it is felt that all workers regardless of where they are employed should have access to certain types of external training, the best way to promote it is to locate it in schools and subsidize its costs there.
3. Boundaries between formal training and informal training are inevitably elastic. Any system of subsidizing training (whether tax credit, mandate or direct subsidy) will induce employers to formalize some on-the-job learning activities that previously did not meet the program's eligibility requirements. The mandate approach to stimulating training is attractive in part because the public is less likely to feel that it is unfair or reprehensible for employers to respond in this way to a training mandate than to a direct subsidy or tax credit.