European Expert Network on
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Inefficiencies in Subsidising Training of Employees

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It is frequently proclaimed that government intervention is needed to stimulate job-related training of the workforce. Various schemes have been proposed, including direct subsidies, individual learning accounts and vouchers. This brief highlights results from recent studies that point to inefficiencies of training subsidies.

TRAINING SUBSIDIES CROWD OUT PRIVATE INVESTMENT

Proposals to implement schemes to stimulate job-related training often ignore or downplay that public subsidies may crowd out private training investments. Three recent studies estimate the proportion of the subsidy that recipients or their employers would have paid themselves if the subsidy would not have been in place. One study deals with the Employer Training Pilots in England, the other two evaluate randomised experiments with Individual Learning Accounts (ILAs) in Switzerland and the Netherlands. All three report that a substantial share of the subsidies merely displaces private investments. The two evaluations of ILAs find that 60% of the subsidies is spent on training that would otherwise have been paid by private parties, in the English study this share is even larger. This means that the government has to spend at least 2.50 euros in subsidies to generate one extra euro of training expenditures.

The high inefficiency of training subsidies and ILAs makes explicit that quite some training occurs without government intervention. Otherwise there would be no private training expenses to be crowded out by the subsidies. The high inefficiency also expresses that the take-up of the training subsidies and ILAs is rather low. All three studies find this. Apparently there is no large unmet demand for training participation. This result is consistent with the finding in the literature that the wage return to private sector training is modest.

ADD THE EXCESS BURDEN OF TAXATION

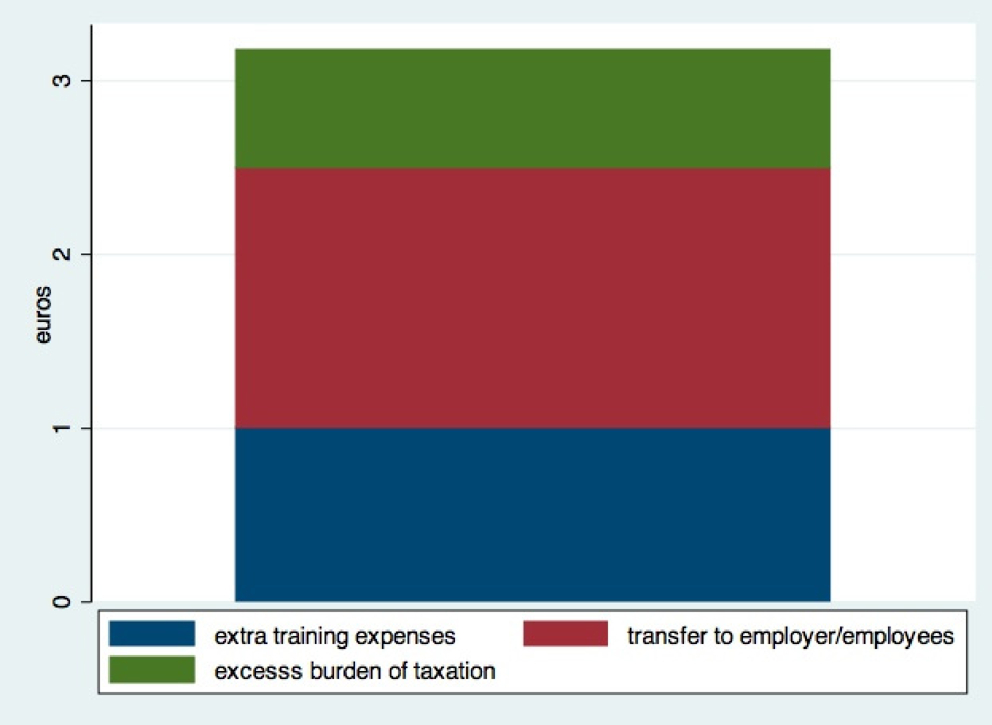
To this crowding out we have to add the excess burden of taxation. To be able to provide subsidies, the government has to levy taxes. This causes inefficiencies in the markets of the commodities or production factors that are subject to the taxation. There is a large academic literature about the magnitude of the excess burden of taxation. A conservative estimate is 20%, but other estimates are as high as 75%.

With an excess burden of taxation of 20%, the total cost to society of 1 additional euro on training expenditures amounts to more than 3 euros (see Figure). With less conservative estimates of the inefficiency of training subsidies and of the excess burden of taxation, the total cost to society of one extra euro of training expenditures is even much larger.

TRAINING SUBSIDIES HAVE A SMALL EFFECT ON UPTAKES

To stimulate lifelong learning activities of adult workers, it is often believed that simply making such activities available at a low price provides insufficient incentives. Instruments such as vouchers and ILAs give potential learners a very explicit confirmation of their increased purchasing power. This should strengthen

The cost to society of one extra euro of training expenses



people's awareness of the availability and importance of learning activities.

The evidence from the Employer Training Pilot in England confirms that simply making training available at a low price (or even for free) indeed does not provide sufficient incentives, at least not to the low-skilled employees at which this program was targeted. Perhaps even more surprising is that this is the case despite the fact the program included an element of information, advice, and guidance to employers and employees.

Reciprocity as alternative mechanism

These results call into question the role for the government in the market for job-related training. On the other hand, employers and employees have ample possibilities to avoid market failures in the market for training. They can for instance use pay-back clauses, smart promotion schemes or base their training decisions on reciprocal attitudes. Pay-back clauses stipulate that employees have to repay training costs if they leave the firm that invested in their training. This protects employers' investment in training. Promotion rules can be designed such that they provide the proper incentives to invest in training; up-or-out rules are an example. And firms may be less reluctant to invest in the skills of employees who are reciprocal because they can anticipate that reciprocal workers are likely to reward firms' investment by not quitting.

Empirical evidence supports that these solutions are actually used. One study finds for instance that workers who are reciprocal (measured as agreement with the statement that "If someone does something that is beneficial to you, would you be prepared to return a favour, even when this was not agreed upon in advance?") are much more likely to participate in training than their non-reciprocal colleagues. Reciprocal workers are 15 percentage points more likely than non-reciprocal workers to attend a training course during a 12 months period.

Main reference: Torberg Falch, Hessel Oosterbeek: *Financing Lifelong Learning: Funding Mechanisms in Education and Training*, EENEE Analytical Report No. 10, September 2011, http://www.eenee.de/dms/EENEE/Analytical_Reports/EENEE_AR10.pdf.

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