

Low-Wage Lessons from the Wealthy World

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Introduction

Over the last two decades, high --and, in some countries, rising-- rates of low-wage work have emerged as a major policy challenge. According to the Organization for Economic Cooperation and Development (OECD), in 2009, about one fourth of US and Korean workers were in low-wage jobs, defined as earning less than two-thirds of the national median hourly wage (**Figure 1**).¹ About one fifth of workers in the United Kingdom, Canada, Ireland, and Germany were receiving low wages by the same definition. In all but a handful of rich OECD countries, more than ten percent of the workforce was in a low-wage job.

If low-wage jobs act as a stepping stone to higher paying work, then even a relatively high share of low-wage work may not be a serious social problem. If, however, as appears to be the case in much of the wealthy world, low-wage work is a persistent and recurring state for many workers, then low-wages may contribute to broader income and wealth inequality and constitute a threat to social cohesion.

This short paper provides an informal summary of five lessons we have learned about low-wage work from the experiences of the United States and other rich economies in the OECD.²

Five Lessons

Lesson 1: Economic growth is not a solution to the problem of low-wage work.

Countries do not appear to "outgrow" low-wage work. Higher levels of GDP per capita, for example, are not associated with a reduction in the share of low-wage workers. As **Figure 2** demonstrates, the relationship between the level of per capita GDP and the low-wage share is weak (R-squared, 0.050). If anything, a higher GDP per capita is associated with a slightly higher incidence of low pay. Nor is rapid growth associated with a shrinking low-wage share. As **Figure 3** shows, the relationship between real growth in a country's GDP per capita over the period 1980-2010 is not meaningfully related to a country's low-wage share in 2009 (R-squared, 0.081). Once again, if anything, more rapid growth is associated with a somewhat higher share of low-wage employment.

Lesson 2: The "inclusiveness" of a country's labor-market institutions appears to lead to lower levels of low-wage work.

As Appelbaum et al (2010) have argued, "...the most important influence on the observed differences in low-wage work is the 'inclusiveness' of a country's labor market institutions." (pp. 6-7) In their view, "inclusive" labor market institutions: "have formal --and sometimes informal-- mechanisms to extend the wages, benefits, and working conditions negotiated by workers in industries and occupations with strong bargaining power to workers in industries and occupations with less bargaining power." (p. 7)

The most obvious of the inclusive labor-market institutions is collective-bargaining coverage. **Figure 4** shows a strong relationship in our sample between collective-bargaining coverage and low-wage work (R-squared, 0.317).

Collective bargaining, however, is not the only "inclusive" labor-market institution. Other important potentially "inclusive" institutions include minimum wages, employment protection legislation, the enforcement of national labor laws, and the benefit systems for the jobless and low-income households (see Bosch, Mayhew, and Gautié, 2010). **Figure 5**, for example, demonstrates that

1 See OECD (2011), Table I; data for Belgium, France, Italy, Portugal, and Spain refer to 2008. Data for France and the Netherlands are from Mason and Salverda (2010), Table 2.1, and refer to 2005.

2 In what follows, to maximize economic comparability and for reasons of data availability, the paper focuses on the OECD countries excluding: the emerging and eastern European countries; Iceland and Luxembourg; and Sweden and Switzerland (for which, the OECD does not have recent data on the prevalence of low-wage work).

higher shares of GDP devoted to public social expenditures are also strongly associated with lower shares of low-wage employment. More generous social expenditures may reduce low pay by forcing employers to raise wages to compete with social benefits. Or the social expenditure effect may, in fact, simply reflect the high correlation between social expenditures and union power, with union power acting to increase social expenditure and decrease the low-wage share through extending collective-bargaining coverage to otherwise low-wage workers.

Lesson 3: The United States is a poor model for combating low-wage work.

The United States has the highest share of low-wage work in the OECD countries we analyze here. Moreover, the incidence of low-wage work in the United States has been rising for at least three decades, from just over 20 percent in 1979 to just under 30 percent in 2010 (see **Figure 6**). The United States, therefore, seems a poor model for those seeking to reduce low-wage work. The US experience, however, may still offer some lessons in the negative.

The United States has two principal policies designed to address the problem of low wages: the minimum wage and the Earned Income Tax Credit.³ The US experience with each of these policy tools provide some specific lessons.

Lesson 3A: The US minimum wage is set too low to reduce the share of low-wage work.

The United States has had a federal minimum wage since the Great Depression. In principle, the minimum wage can have an important impact on the share of low-wage work. A minimum wage set at or near the threshold for low-wage work (two-thirds of the median hourly wage) can substantially reduce the incidence of low pay. In France in the mid-2000s, for example, the minimum wage was set near the country's low-wage threshold and that country had among the lowest levels of low-wage work in the OECD.⁴ The implementation of the national minimum wage in the United Kingdom in 1999 may have contributed to the leveling off in the 2000s of the low-wage share, which had been rising almost continuously from the end of the 1970s.⁵

Over the last three decades, however, the minimum wage in the United States has been set at a level that is well below the threshold for low-wage work (**Figure 7**). As a result, the federal minimum wage has had little or no impact on the share of the workforce experiencing low pay by the standard definition.

Starting in the late 1980s, as the real value of the federal minimum wage fell far below its historical levels, many states began to set state-specific wage floors above the federal minimum. In 2011, 17 states had state-level minimum wages above the federal minimum wage (**Figure 8**). The highest of these, however, were still about 20 percent below the low-wage threshold and therefore likely had only a limited impact on these states' low-wage share.⁶

Lesson 3B: The Earned Income Tax Credit (EITC) has a contradictory effects on the volume of low-wage work and the well-being of low-wage workers.

Since 1975, the United States has had an Earned Income Tax Credit (EITC) that effectively tops

3 The United States has a host of other policies, from education and training to Medicaid and food and housing subsidies, that have an impact on low-wage work. For a helpful, recent overview of social policy programs in the United States, see Scholz (2010).

4 See Figure 1 and Bosch, Mayhew, and Gautié (2010), Table 3.5.

5 See Mason and Salverda (2010), Figure 2.1 and Bosch, Mayhew, and Gautié (2010), Table 3.5.

6 See Department of Labor, "Changes in Basic Minimum Wages in Non-Farm Employment Under State Law: Selected Years 1968 to 2011, <http://www.dol.gov/whd/state/stateMinWageHis.htm>.

up the earnings of some low-wage workers in lower-income families. The program began modestly, but has grown to be the largest program providing financial assistance to low-wage workers and their families.⁷ In 2009, over 27 million families received \$60 billion in tax credits through the EITC (**Figure 9**).

The structure of the EITC is complex, but thanks largely to the relative generosity of benefits and the administration of the program through the income tax system, the take-up rate is high. The value of the EITC's refundable tax credit varies according to a worker's family income and size. In 2008, the maximum benefit per family was about \$4,800 per year for a family with two or more children and a maximum income of about \$39,000 per year.⁸ The benefit levels, however, vary substantially across family types. In the same year, the maximum EITC payment for a single person with no children, for example, was under \$500 on a maximum eligible income of just under \$13,000 per year (Athreya, Reilly, and Simpson, 2010, Table 2).

In practice, it is difficult to estimate the impact of the EITC on the wage structure. The EITC is not a direct subsidy to the wages of low-wage workers because its value depends on both the worker's family size and the income received by other adults in the family. For single workers with no children, the EITC has little effect on hourly earnings. For example, a single, childless, full-time, full-year worker earning the federal minimum wage in 2008 would have earned about \$10,880 before the EITC --an average of \$5.44 per hour.⁹ If eligible for the maximum EITC, this same worker would have seen his or her annual earnings rise to about \$11,320. This translates to about \$5.66 per hour, or an EITC top-up of about \$0.22 per hour, leaving this worker still only about half way to the low-wage threshold in 2008. To further complicate the calculations, if the same childless worker were in a family with another worker who earned more than about \$4,000 per year, neither worker would be eligible for any EITC payment because they would exceed the family income limits for a childless family.

The EITC has the greatest impact on the earnings of low-wage, single parents with children. Eissa and Hoynes (2005, Figure 3) estimate that in 2004, the EITC raised the hourly earnings of a single, full-time, full-year minimum-wage worker with two children by about \$1.90 per hour (relative to a minimum wage of \$5.15 per hour in that year), and the wages of a similar worker with only one child by about \$1.30 per hour. In either case, the combination of the minimum wage and the EITC would still leave this worker below the low-wage threshold in that year.

The EITC may also have a perverse impact on the wages of workers who do not qualify for the program (Leigh, 2010; Rothstein, 2010). Since the EITC significantly raises wages of many eligible low-wage workers, the EITC effectively raises the labor supply, which may act to lower the wages paid by employers. The EITC more than compensates recipients for any decline in the wage employers paid, but a large share of low-wage workers, especially those without children or in families with other adults in work, experience only the supply-induced reduction in the hourly wage. Rothstein (2010) estimates that the net result of these gains and losses for different types of workers is that an additional dollar spent on the EITC only raises after-tax wages by about 73 cents. Leigh (2010) concludes that "a ten percent increase in the generosity of the EITC is associated with a five percent fall in the wages of high school dropouts and a two percent fall in the wages of those with only a high school diploma."

Many states operate their own state-level EITC programs that supplement the benefits paid by the

7 For recent reviews of the EITC program, see Athreya, Reilly, and Simpson (2010), Eissa and Hoynes (2011), Holt (2006), and Wicks-Lim and Thompson (2010).

8 The American Recovery and Reinvestment Act of 2009 temporarily raised the generosity of the EITC. The maximum benefit rose to over \$5,500 and the maximum eligible family income increased to almost \$50,000. See Athreya, Reilly, and Simpson (2010) for details.

9 The federal minimum wage was \$5.15 for the first seven months of 2008 and \$5.85 per hour for the last five months. The calculations here assume that the worker earned the weighted average of these two rates for 2,000 hours in that year.

federal minimum wage. In 2010, 24 states had EITC programs (**Figure 10**), usually linked explicitly to the federal EITC. The generosity of these programs ranged from 3.5 percent (Louisiana) to 45 percent (Minnesota) of the federal EITC.

The state programs, which are modeled almost exactly on the federal EITC, reproduce the strengths and weaknesses of the federal EITC. The state EITCs raise the effective wage of eligible workers, sometimes considerably, but do so in a way that has a complicated impact on the after-tax (and transfer) wage structure. The EITC increases earnings of low-wage, low-income single parents substantially. But, the program has little direct impact on the wages of low-wage, even low-income, workers with no children, and likely a negative impact, through supply effects, on these same low-wage workers.

Taken together, the minimum wage and the EITC could act as an effective tool to combat low-wage work in the United States (Wicks-Lim and Thompson, 2010; OECD, 2009). The EITC could substantially raise the after-tax hourly wage of eligible workers, without any negative impact on the employment prospects of low-wage workers. The minimum wage, meanwhile, could put a floor on the wages of workers ineligible for the EITC and limit the ability of employers to capture an important share of the total tax expenditure.¹⁰ In practice, however, the EITC and minimum wage have been set too low to limit the incidence of low pay, and the minimum wage has been set too low to prevent employers from reaping windfalls from the eligibility structure of the EITC.

Lesson 4: Low-wage work is not a clear-cut stepping-stone to higher wage work.

If low-wage work were a short-term state that helped connect labor-market entrants or re-entrants to longer-term, well-paid employment, high shares of low-wage work would be less of a social concern. Indeed, if low-wage work facilitated transitions from unemployment to well-paid jobs, countries might want to encourage the creation of a low-wage sector to improve workers' welfare in the long term.¹¹

Unfortunately, the preponderance of evidence suggests that low-wage work is a "sticky" state. Not only are low-wage workers likely to stay in low-wage jobs from one year to the next, they are also more likely than workers in higher-wage jobs to fall into unemployment or to leave the labor force altogether. From 1995 through 2001, for example, about half or more of low-wage workers in Denmark, France, Germany, the Netherlands, the United Kingdom, and the United States remained in low-wage work from one year to the next, and between 8 and 23 percent of low-wage workers left the workforce year-to-year. Over the same period, between 25 and 41 percent of low-wage workers in these countries crossed the threshold into higher-paying jobs (Mason and Salverda, 2010, Table 2.4). The years 1995 to 2001 were particularly good for low-wage workers in the United States, with sustained low unemployment and the most rapid wage growth over the last three decades for workers at the bottom of the wage distribution. More recent, internationally comparable, data are not available for any of these countries, but given the general deterioration in world labor markets, these transition probabilities are likely to be worse now than they were in the boom at the end of the 1990s.

Low-wage jobs may not help, and may even hurt the future labor-market prospects of the workers who hold them. Low-wage jobs, like spells of unemployment, may, for example, be associated with the erosion of a worker's accumulated human capital. If so, a worker's long-term earnings potential would be enhanced more by a period of education and training than by working in a low-wage job. Low-wage employment, like an unemployment spell, may also send a signal to potential employers that a worker

10 The OECD (2009) concurs: "minimum wages can increase the effectiveness of [in-work benefit] schemes: by providing a wage floor below which wages cannot fall, they help to achieve the intended redistribution to low-wage workers." (p. 168)

11 For a recent discussion of low-pay, including its role as a trap or a stepping-stone, see Lucifora and Salverda (2009).

has low productivity, reducing the probability that the low-wage worker will move up the pay scale. Based on a sophisticated analysis of data for the United Kingdom, Stewart (2007) finds that low-wage work has "almost as large an adverse effect as unemployment" on low-wage workers future employment prospects. He concludes: "not all jobs are 'good' jobs, in the sense of improving future prospects, and ... low-wage jobs typically do not lead on to better things."

None of this is to suggest that economic policy should not seek to create employment opportunities for less-skilled, less-educated, or less-experienced workers. The point is that low-wage work does not appear to be a self-correcting problem.

Lesson 5. In the United States, at least, low wages are among the least of the problems facing low-wage workers.

The intense policy focus on low-pay can obscure the reality that low pay is often among the least of the labor-market problems facing low-wage workers, especially in the United States.¹² US labor law offers workers remarkably few protections. US workers, for example, have the lowest level of employment security in the OECD (**Figure 11**) and no legal right to paid vacations (**Figure 12**) or paid sick days (**Figure 13**) or paid parental leave (**Figure 14**). The low level of union coverage in the United States means that contractual obligations generally don't make up for the lack of legal guarantees.

In the absence of legal or contractual rights, low-wage workers are the least likely to have access to core benefits. About 30 percent of private-sector workers who made less than \$15 per hour in 2006, for example, had no paid vacations or holidays.¹³ In 2008, more than three-fourths of private-sector workers in the bottom ten percent of the wage distribution in their occupation had no paid sick days, compared to only about one-fifth of workers in the top 10 percent of their occupational wage distribution.¹⁴ In the US context, however, probably the most critical problem facing low-wage workers is the lack of access to health care. Rho and Schmitt (2010, Table 5) estimate that in 2008 more than half (54 percent) of workers in the bottom wage quintile did not have employer-provided health insurance and more than one-third (37 percent) had no health insurance of any kind, private or public. The 37 percent non-coverage rate for the bottom quintile of wage earners in 2008 was up from 15 percent in 1979.

In countries with welfare state institutions and labor laws that provide significant rights and protections to all workers regardless of their wage level, a focus on the wage problems facing low-wage workers makes sense. In a country such as the United States, however, where welfare-state institutions and labor laws offer only weak protections, low-wage workers face a host of problems beyond low wages. In the U.S. context, raising wages at the bottom would certainly help. But, raising wages alone will do little to address these same workers' lack of access to health insurance or to alleviate the "time bind" caused by a lack of paid vacation, paid sick days, and paid family leave.¹⁵

Conclusions

The experience of the last few decades suggests that we have a pretty good idea of how to reduce the size of the low-wage workforce. "Inclusive" labor-market institutions that extend the pay, benefits, and working conditions negotiated by workers with significant bargaining power to workers with less bargaining power appear to be the most effective general remedy for low-wage work. The specifics can take many forms, from extending collective bargaining agreements to cover workers who are not

¹² See also Schmitt (2009), pp. 6-8.

¹³ See Ray and Schmitt (2007), Table 2.

¹⁴ Heymann, Rho, Schmitt, and Earle (2010).

¹⁵ Moreover, as my colleague Dean Baker notes, giving low-wage workers the right to paid time off (vacations, holidays, sick days, and family leave, for example) would lower the total annual number of hours worked per employee and therefore would expand employment opportunities for workers at the low end of the wage distribution.

themselves members of unions, to setting a minimum wage at or near the threshold for low-wage work. Greater public social spending may be another way to increase the "inclusiveness" of national industrial relations systems since a generous social safety net improves the bargaining position of low-wage workers relative to their employers. The national details aside, the available cross-country data show a strong association between higher levels of inclusiveness and lower levels of low-wage work.

The United States, as one of the least "inclusive" OECD countries, primarily offers cautionary lessons when it comes to low-wage work. Union coverage rates in the United States are the lowest among comparable OECD economies, providing little in the way of protections for the large majority of low-wage workers. In principle, federal and state minimum wage laws and federal and state EITC programs could significantly lower the incidence of low-wage work. But, in practice, wage floors and EITC payments have been set too low to prevent a long-term increase in low-wage work, let alone reduce the ranks of the already sizable sector.

For some workers, low-wage work is a stepping-stone to better things. For an important share of low-wage workers, however, a low-paid job is not much better than unemployment and can even harm their long-term wage and employment prospects. Policy discussions often rightly emphasize the importance of a job, any job, in the fight against poverty (particularly in contexts where national benefit systems are not generous enough to raise jobless families out of poverty). But, the relatively low levels of mobility out of low-wage work argue against seeing an expansion of low-wage employment as a straightforward solution to the problems of poverty or wage inequality.

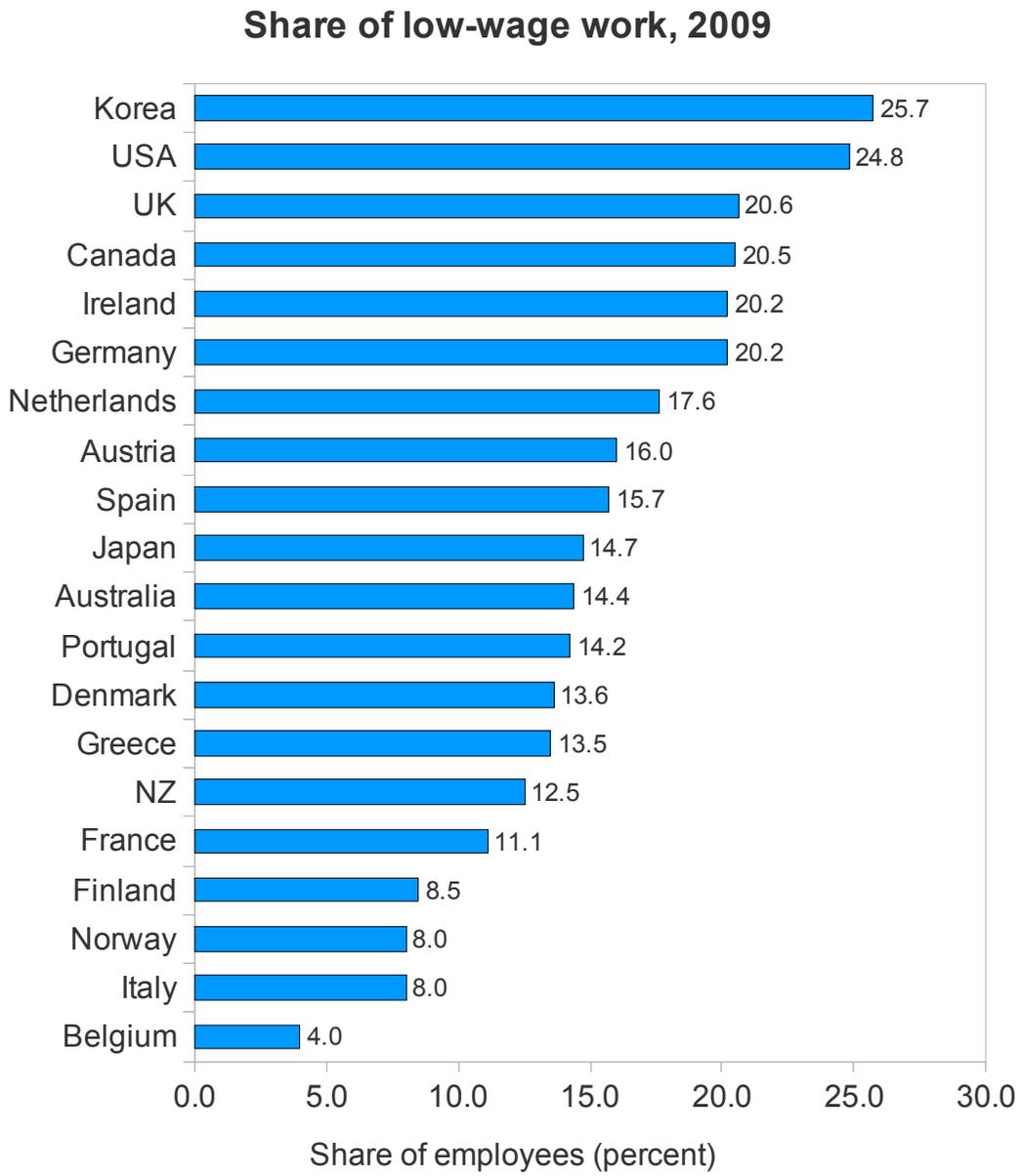
In the United States, in particular, low wages are only the most obvious problem facing low-wage workers. In the absence of legal or contractual guarantees, low-wage workers in the United States are far less likely to have health insurance (private or public), paid sick days, paid family leave, paid vacation and holidays, and other benefits that are more routinely provided to higher-wage workers. Raising wages at the bottom --without other measures to address the terms and conditions of low-wage employment-- will do little or nothing to address these other pressing concerns facing low-wage workers.

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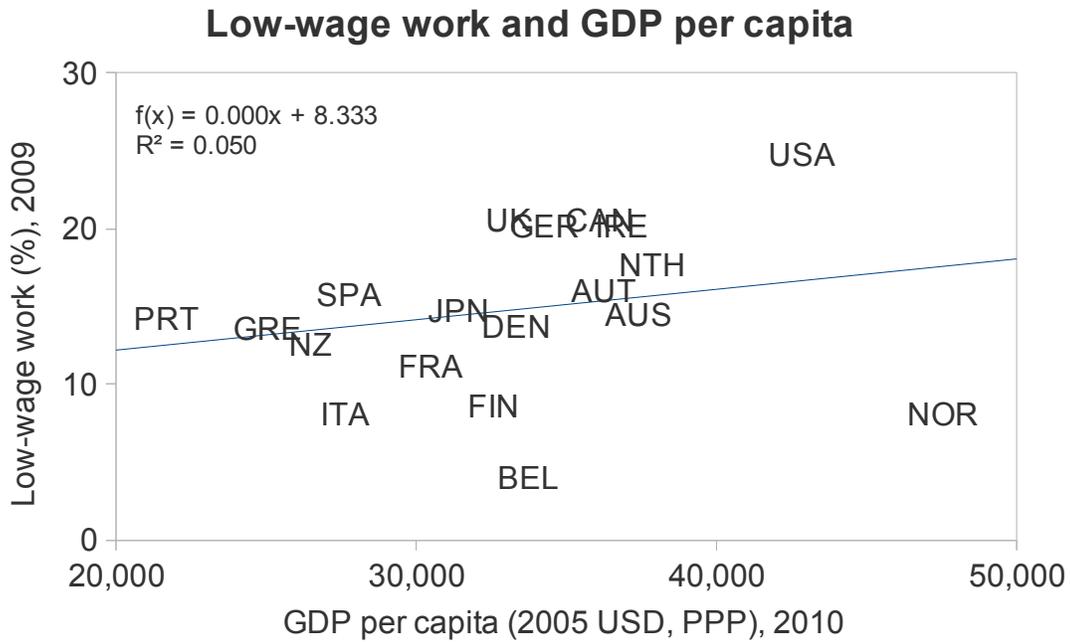
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Figure 1



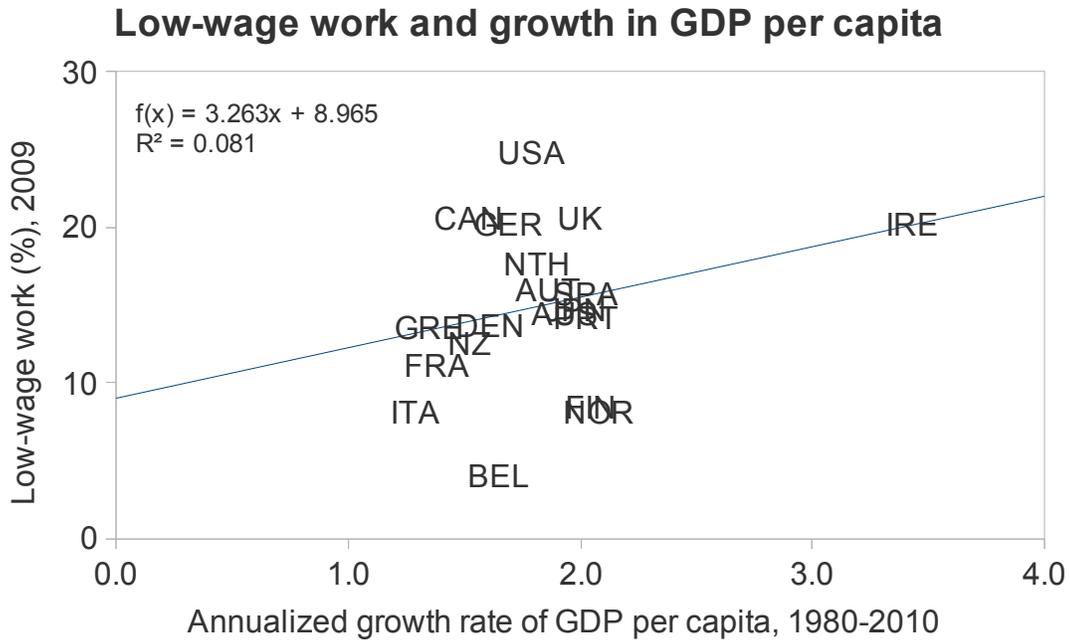
Source: OECD (2011) and Mason and Salverda (2010); France, Netherlands refer to 2005.

Figure 2



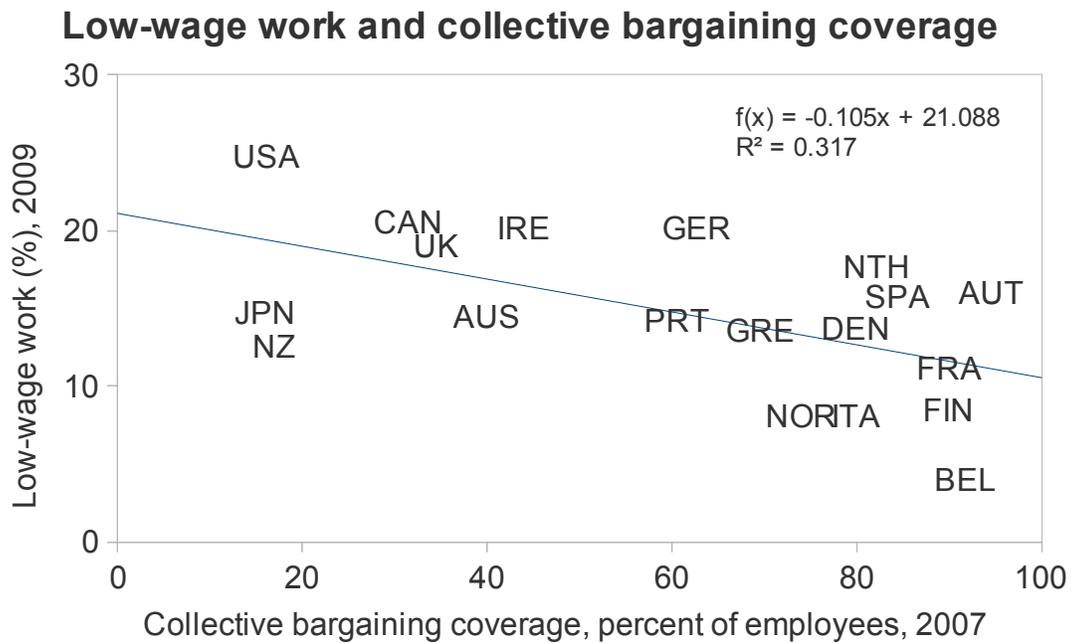
Source: Analysis of OECD (2011) and Mason and Salverda (2010).

Figure 3



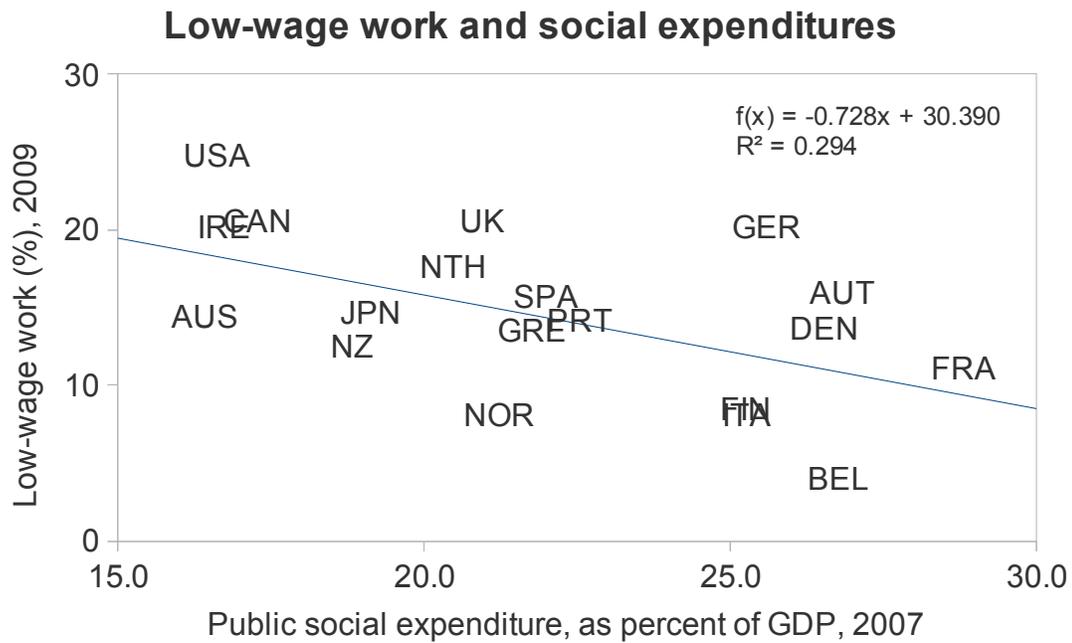
Source: Analysis of OECD (2011) and Mason and Salverda (2010).

Figure 4



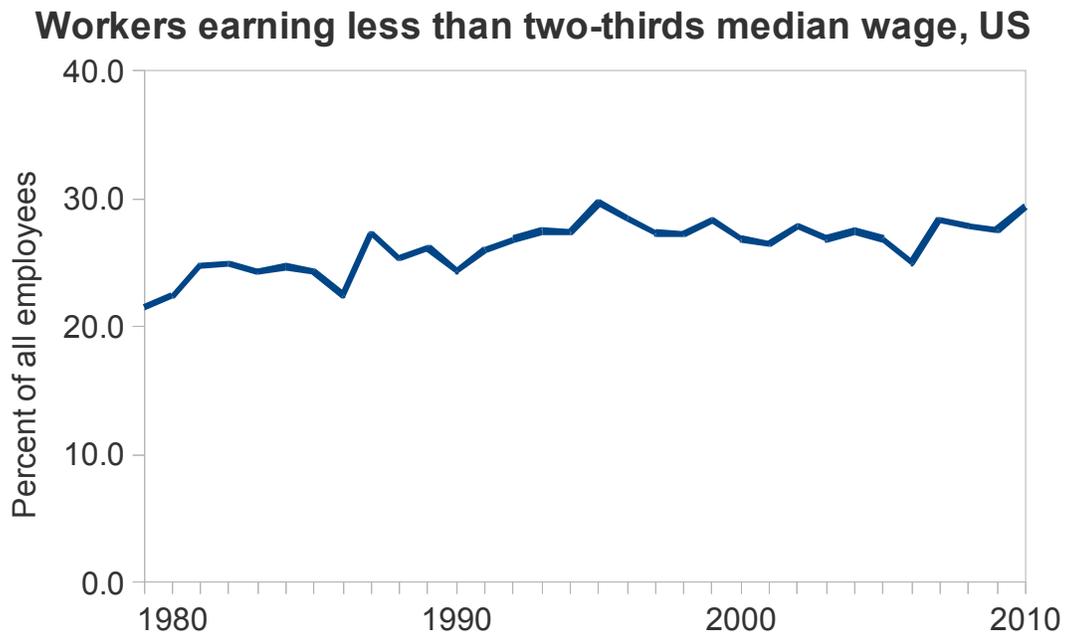
Source: Analysis of OECD (2011), Mason and Salverda (2010), and Visser (2011).

Figure 5



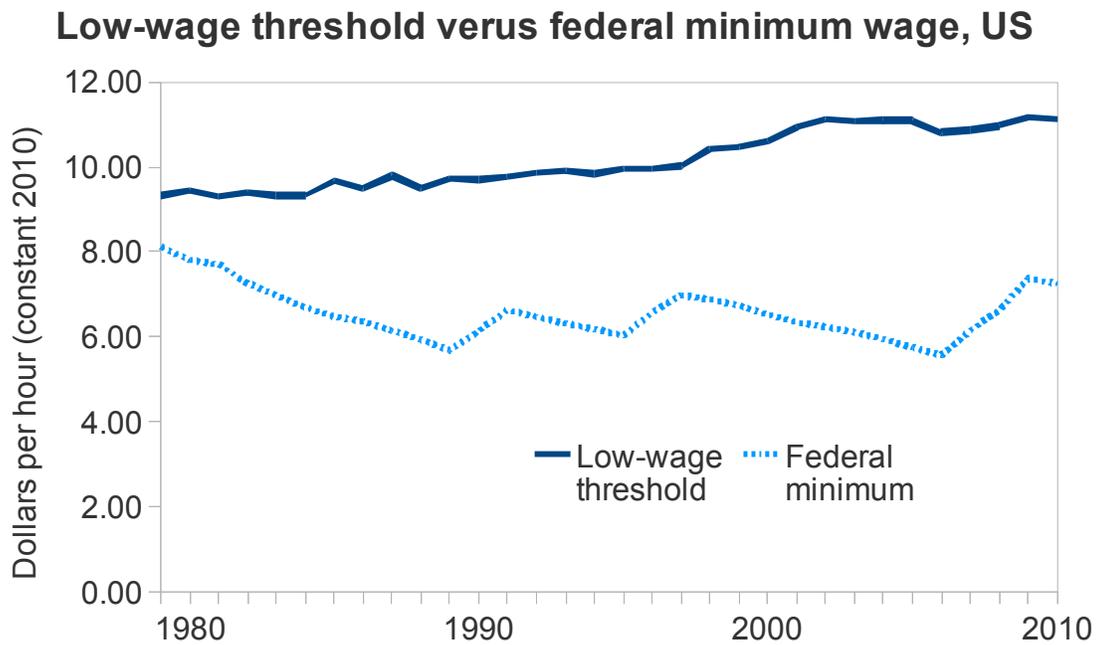
Source: Analysis of OECD (2011) and Mason and Salverda (2010).

Figure 6



Source: Author's analysis of CEPR CPS ORG extract.

Figure 7



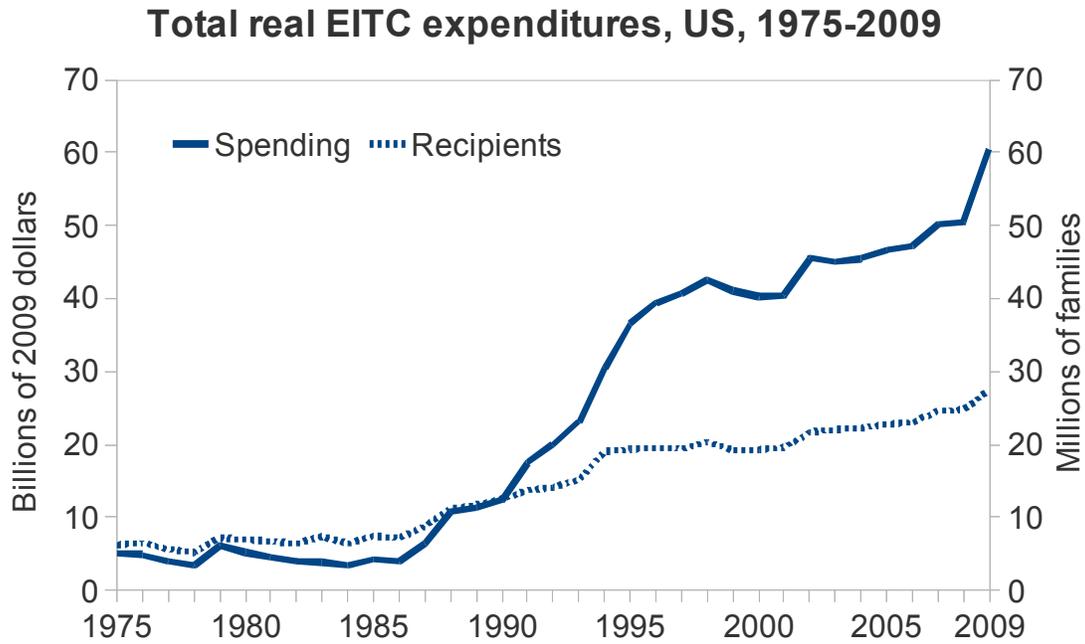
Source: Author's analysis of CEPR CPS ORG extract.

Figure 8



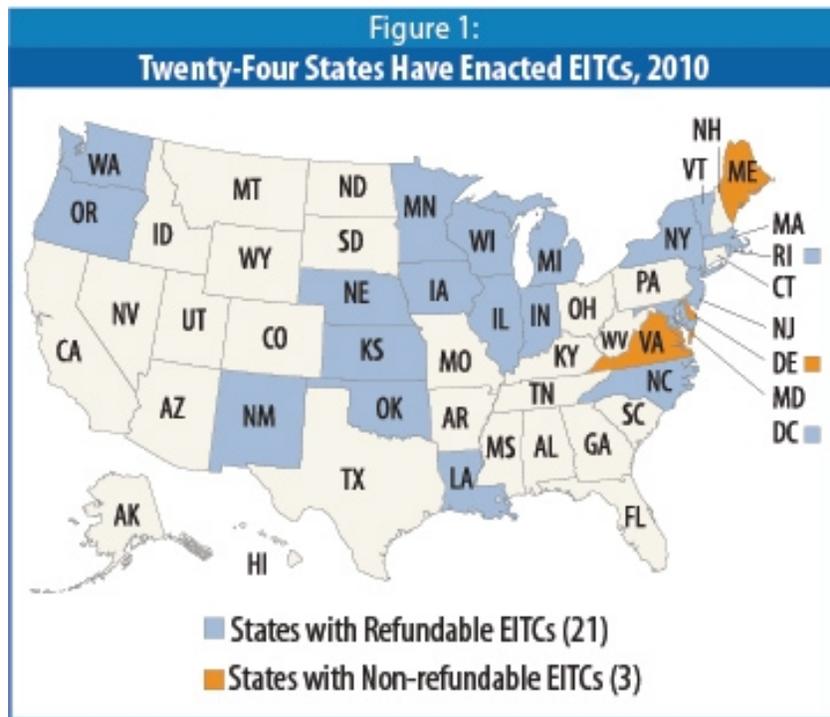
Source: US Department of Labor, <http://www.dol.gov/whd/minwage/america.htm>, accessed November 12, 2011.

Figure 9



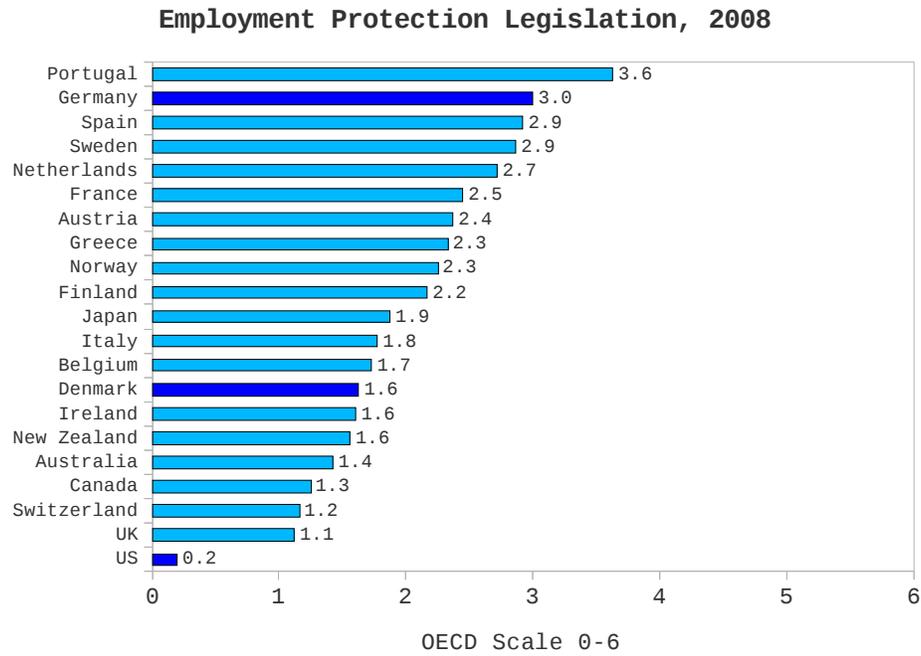
Source: Tax Policy Center.

Figure 10



Source: Center on Budget and Policy Priorities, <http://www.cbpp.org/cms/index.cfm?fa=view&id=2987>, accessed November 12, 2011.

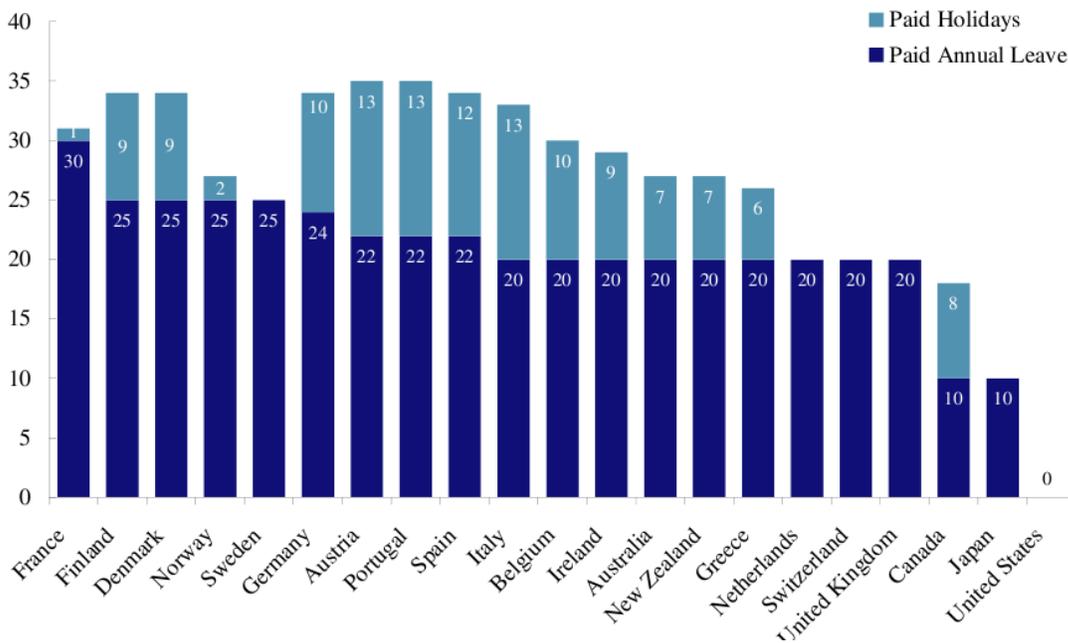
Figure 11



Source: OECD.

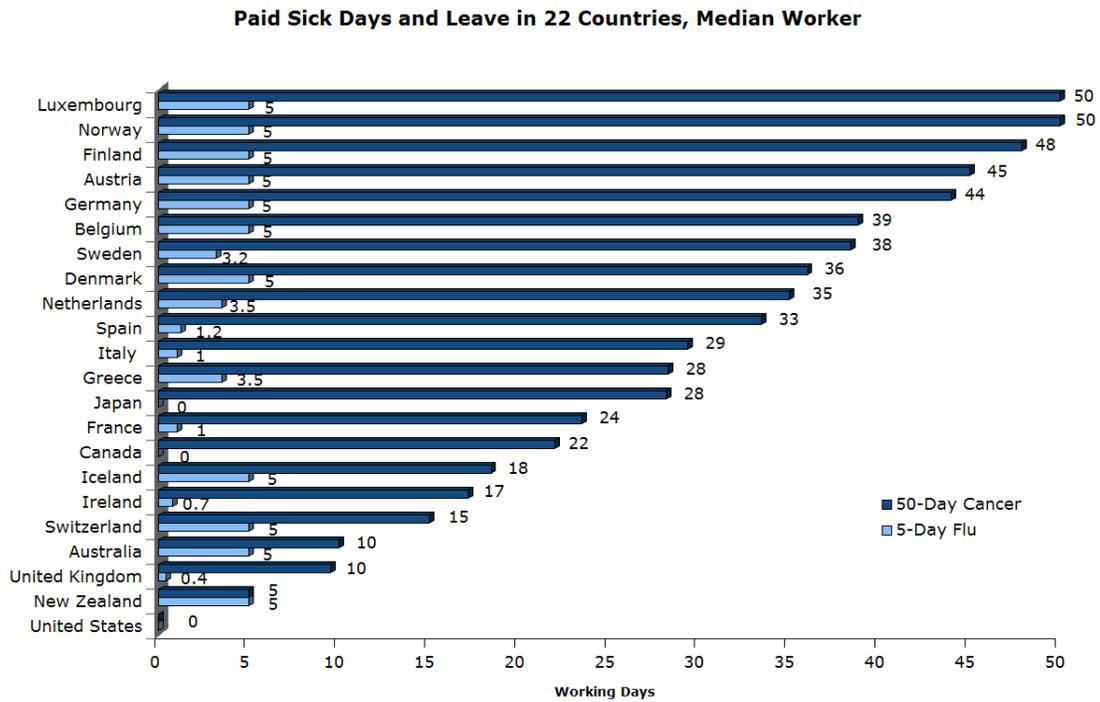
Figure 12

Paid Vacation and Paid Holidays, OECD Nations, in Working Days



Source: Ray and Schmitt (2007), Figure 1.

Figure 13



Source: Heyman, Rho, Schmitt, and Earle (2009), Figure 1.

Figure 14

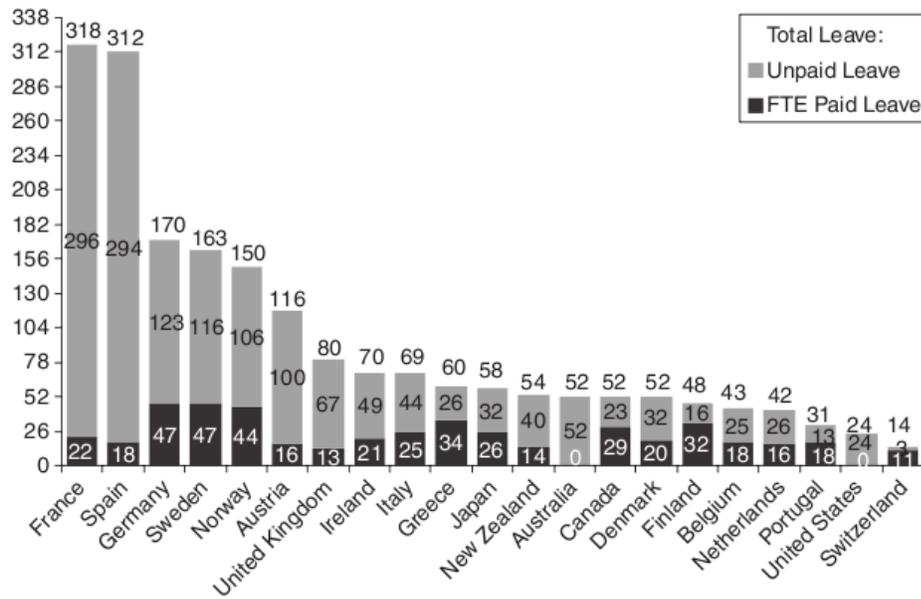


Figure 1 Total and FTE paid parental leave for two-parent families, in weeks
 Source: Authors' analysis, Ray (2008), and Ray et al. (2008).

Source: Ray, Gornick, and Schmitt (2010), Figure 1.