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## **Labor, Welfare and Coping with the Crisis**

*Comparing Domestic Adjustment in the Nordic and Korea*

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*Publication date:*  
2010

*Document Version*  
Accepted author manuscript, peer reviewed version

[Link to publication from Aalborg University](#)

*Citation for published version (APA):*

Schmidt, J. D. (2010). Labor, Welfare and Coping with the Crisis: Comparing Domestic Adjustment in the Nordic and Korea. Paper presented at The 1st Korea-Nordic Conference "Mapping the Two Corners of EurAsia in Comparative Ideas, Society and Politics", Venue: Yonhee Hall, Yonsei University, Seoul, Korea. December 16, 2010, .

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# Labor, Welfare and Coping with the Crisis

## Comparing Domestic Adjustment in the Nordic and Korea<sup>1</sup>

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The current crisis is not only a financial and economic crisis but also a crisis of neo-classical hegemony in economics – a crisis of the Anglo-Saxon or ‘Western’ mental imperative of “Homo economicus” - which has had an almost worldwide dominant position in its impact on thinking and discourses about globalization among policy elites. Some observers argue the crisis spells the end of the much heralded globalization model itself with its emphasis on export-orientation and unlimited growth (Schmidt 2009); others see it as a conjunctural phenomenon - a recession with solutions through state bail-outs and nationalizations of banks and industries; while still others regard it as a typical Schumpeterian phase of necessary ‘creative destruction’ more winners than losers.

Whatever the outcome may be at the global level it also raises many important questions for export-oriented economies such as the Nordic states (Iceland, Norway, Sweden, Finland and Denmark) and the Republic of Korea (ROK). Once the world economy experienced the downturn, the Nordic economies, with their high dependence on exports of capital goods and consumer durables were particularly hard hit<sup>3</sup> while in the ROK, capital outflows associated with global capital flight resulted in sharply lower asset prices and initial dislocations in the money markets. Moreover, exports collapsed, which quickly spilled over to domestic demand (IMF 2010).

The Nordic region and Korea’s dependence on export-orientation and trade was challenged by the unresolved status of the elements which originally created the crisis, namely the unregulated financial markets, income inequality and global trade imbalances. What these countries have in common is the general outcome of the crisis as external demand declined because of the erosion in their trading

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<sup>1</sup>First draft paper for the The 1<sup>st</sup> Korea-Nordic Conference “Mapping the Two Corners of EurAsia in Comparative Ideas, Society and Politics”, Venue: Yonhee Hall, Yonsei University, Seoul, Korea. December 16, 2010

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<sup>3</sup> Starting with the financial meltdown in Iceland which is a special case with its unusually high exposure to speculative capital and with the opposite exception of oil-rich Norway.

partners' growth. However, the crisis-induced collapses in asset prices and trade flows reduced domestic and external demand to varying degrees across different countries (IMF 2010) and as we shall see this was also the case in the Nordic region and in Korea.

The aim of this paper is to raise a number of questions on the impacts and responses of the crisis in a comparative perspective with focus on the Nordic experience and ROK. It asks the following questions: Where have the Nordic approach versus the Korean models delivered strong results, and what are the weaknesses? What are the human costs and collateral damage in the context of new types of regulation of labor markets and social welfare in the broadest sense and what are the differences and similarities between the models in general specifically with regard to crisis management? The approach guiding the analysis is based on a critical political economy perspective which utilizes a comparative and eclectic methodology (Rasiah and Schmidt 2010: 25-27).

The first part of the paper briefly describes the causes and impacts of the US induced financial crisis cum "Great Depression". The second part discusses the status of the various models of contemporary capitalism – the discredited Anglo-Saxon finance-driven model versus the export-driven production model of growth, with weak safety nets, adopted by East Asian countries in contrast to the export-oriented Nordic social welfare model. The third section documents the impact of the crisis on the economies, and discusses core examples of state intervention in the socio-economic sectors such as labor markets and social welfare in the Nordic as well as Korean contexts. The final section discusses some tentative conclusions about the resilience of the Nordic and ROK models and their potential for recovery.

## 1. The worst economic and financial crisis since the 1930s

The damaging results of the last few decades of free-wheeling Ponzi capitalism were predictable from the very beginning when the neo-classical counter-revolution replaced the Golden decades of Keynesian capitalism. In the beginning of the 1980s, the real economy began to crumble into an artificial and speculative "Casino economy" (Strange 1986); labor markets were increasingly deregulated, resulting in the emergence of a global work force constituting a non-regular, informalized and casualized reserve army (Schmidt 2006); simultaneously, there was a subsequent growth of an underground parallel economy estimated to be in the range of 15-20 percent of the real economy in the forms of global crime and the shadow activities (Schmidt 2009: 18).

When the worst financial crisis since the Great Depression broke out in full fury in 2008 it was the result of the crash of asset markets and extreme volatility in speculation in the leading capitalist economy, the USA; IMF estimates show the loss of asset values at \$55 trillion, equivalent to almost one year's global output of goods and services (Harvey 2009). World trade collapsed by more than 13 per cent in volume and by as much as 23 per cent in value in the first half of 2009 (UNCTAD 2010: 19); volatile capital flows made things much worse for the developing countries that had been fiscally

and externally “disciplined” and “punished” by the International Financial Institutions as they were affected by a crisis that was not of their making (Ghosh 2010: 209).

Bailing out the private banking and other financial institutions is estimated to have cost the United States and the European Union a total of US\$11.4 trillion – an unbelievable one-sixth of world GDP (Torres 2010: 231). However, the collateral damage has been even more detrimental. With 210 million people currently out of work worldwide, official unemployment has reached its highest level in history (IMF 2010).

## 2. Model convergence or divergence

It can be argued that the three prototypes of industrial capitalist societies characterized by different labor market institutions and social welfare levels and modes of functioning can be analyzed on their own merits. Such an approach is justified in spite of the hegemonic position neoliberalism had achieved in policy-making institutions until the financial crisis revealed it to be more of an ideological construction more than as a scientific economic theory!

The first model, the neoliberal or Anglo-Saxon model is characterized by the leadership position of the United States leading the race to the bottom in wages, benefits, working conditions and social protections. The discourse associated with the implementation of neoliberalism in the United States, during the era of Ronald Reagan and in Britain at the time of Margaret Thatcher, was that market liberalization would become a universal paradigm and spread to the entire world. In the words of the British Prime Minister “There is no alternative”.

The basic characteristic of the Anglo-Saxon model, as related to the accumulation of capital and societal arrangements, is that economic decisions are overwhelmingly left to the discretion of private actors who are given the space and opportunities of maximizing short-term profitability of the enterprise and to raise needed capital in available financial markets. As far as the sociopolitical dimension is concerned, labor enjoys limited legal industrial and social rights, with workers’ livelihood depending on the wage they can negotiate with employers in unregulated labor market. With regard to state involvement in the economic sphere, it is primarily centered on creating and protecting a favorable environment for industrial and especially financial capital markets. “In these societal arrangements, politics, morality and ideology lean towards promoting individualism and liberalism. In the laissez-faire model of US capitalism, the role of the state with regard to social protection is one of minimal allocations to low-income groups. Private insurance schemes are worked out at the place of employment” (Schmidt and Hersh 2006: 74).

The second prototype of capitalist economy, the Nordic model (Denmark, Finland, Iceland, Norway and Sweden) relies on production based on trade and exports. Socially and politically, the Nordic socio-economic model can be interpreted as aiming at collective risk sharing with a view of fostering acceptance of open markets, new technologies and the need for change. In a broad sense the model

includes a set of labor market organizations allowing for an important degree of negotiations, a comprehensive social safety net and a high rate of state-supported investment in human capital. Embracing globalization and sharing risks are mutually reinforcing planks of the Nordic model (Andersen et al. (2007: 32-33). The Nordic countries are characterized by a mixed economy, predominated by the private sector, but with an extensive role of government and the public sector. The government is involved in financing and organizing the welfare benefits to a greater extent than in most other countries. The system is universal, covering every citizen and financed by taxes. The development of the tripartite cooperation between unions, employers and the state has had a great influence on the political life in all the Nordic countries. To a great extent this has historical reasons.

The Nordic model builds on a developed capitalist economy with a regulatory state managing the socio-economic and political contradictions. Its origin is to be found in the post-World War II period when US hegemony was trying to rebuild the capitalist world system to serve its economic and geopolitical interests. This was done by giving the European political systems a certain degree of autonomy and freedom to control the economic reconstruction. The welfare state that took shape arose around the "historical compromise" between labor and capital with the state as the intermediary, and the "passive revolution" of the bourgeoisie as discussed by Gramsci. Economically though the capitalist system encompassed in what has been called "Sozialmarktwirtschaft" after the reconstruction period following the war became export-oriented.

The emergence of the Scandinavian prototype showed variations of policy implementation with, however, a certain degree of similarity. Under such a regime of capital accumulation the mutual interests of the enterprise and those of employed personnel are combined for the benefit of a more harmonious relationship between the different actors including the political supervision and moderate intervention of the state. Labor market institutions and policies provide both relatively low employment protection (advantage for employers) and high unemployment protection (advantage for the wage-earners), coupled with high income-support benefits, strict activation policies and a high degree of centralized wage coordination; - comprehensive social benefits and public provided social services, as well as large state investment in education and research and development financed through fiscal policies; and - openness to trade and competitive product markets. - High taxes. These features together offer a collective mechanism for risk sharing and play a key role securing the political acceptability of structural reforms (Gurria 2008). On the down side is that this socio-economic arrangement is dependent on the fiscal policies of the state and translates in a rather high degree of taxation. At times of economic difficulties the fiscal revenue of the state becomes strained pitting political forces behind a continuation of this arrangement against populist parties favoring a reduction of taxes. In addition, because of the tax question and the increasing costs of production, many labor intensive enterprises and industries outsource thus creating a problem for the model.

The third prototype of contemporary capitalism has emerged in Northeast Asia. The model combines late economic development with the establishment of capitalism. Historically speaking, it can be

associated to the experience of economic nationalism that was implemented by former countries of the periphery to catch up to the level of the core nations. The South Korean societal and economic model is related to the Capitalist Developing State (CDS) as conceptualized by Chalmers Johnson (1982) in the analysis of the New Industrializing Countries.

Seen in the context of the world capitalist system, late development has historically taken place in opposition to the advance countries' control of the world economy. However in the post-World War II era an under the challenge of Asian socialism, the CDS phenomenon was accepted and supported by the leading capitalist nation. In Korea's case it encompassed the willingness of the United States to accept the Korean chaebol model (zaibatsu in Japan - or often family-based conglomerates with interlinked shareholdings – closely monitored, directed and collaborated with the state and bureaucracy). The economic strategy implemented was based on a certain mix of import substitution and export-orientation, protectionism and internal reforms of agriculture. The political structure was that of military dictatorship which with economic development evolved towards a kind of soft democracy characterized by a high degree of labor exploitation. This model of 'corporatism without labor' (Schmidt 2000) has emphasized government protection and a "command capitalist" industrial strategy in the formation of an industrial capitalist society.

The joker in this evolution of late development and catching up is related to the ability of the capitalist world system to absorb the overproduction and overcapacity which are the results of the accumulation of capital on a world scale. The real problem is associated with the fact that according to a recent UNCTAD "Trade and Development Report 2010", entitled "Employment, Globalisation and Development": We have reached "the End of the Export-Led Growth Model". "The global economic and financial crisis has marked the end of the model of export-led growth for everybody, since "there must be somebody who imports and somebody who exports", Dr. Supachai Panitchpakdi, UNCTAD secretary general, stated at the presentation of the report in Geneva. He further explained, "Export-led growth prescriptions are associated with the neoliberal capitalist Washington Consensus" (UNCTAD 2010; Agazzi 2010).

Another problem is related to the fact that while the crisis originated in the financial system, a more fundamental factor in the build-up to its outbreak was the inefficient distribution of the gains from growth during the pre-crisis period. In most countries, wages grew less than would have been justified on the basis of productivity gains during the two decades preceding the crisis. This explain the fact that wages as a percentage of GDP declined in the majority of countries, while the GDP share of gross profits increased accordingly. In many countries, "wage moderation" has meant stagnant real incomes for low-paid workers and their families (Torres 2010: 229). In Korea, however, real wages almost doubled from 1995 through. Korean firms were able to afford these wage hikes because of soaring productivity which not only financed higher real wages, but also bought about more leisure time. Back in the early 1980s, the average Korean worker labored a stunning 2,900 hours per year, compared to 2,100 in Japan and 1,900 in the average OECD country. Today, Koreans work 25 percent fewer hours

per year, a still-high 2,240 number of hours compared to 1,700 in Japan. Yet, despite working 25 percent fewer hours per year, each worker has increased his output from \$11,500 in 1980 to \$40,300 in 2008 (in 1990 dollars). On the other hand the Nordic countries have managed to maintain high employment rates and fairly egalitarian wage and income structures and the Nordic trade unions have managed to retain strong influence on overall wage developments and, in spite of growing differentiation, have kept alive a legacy of egalitarianism and solidarity in working life policies (Dølvik 2008: 9, 35). Although the Nordic model is characterized by high wages it is also clear that wage restraint is part of the corporatist framework.

In the context of the global economy, no country can stand outside the structural and conjunctural changes that are taking place. All societal models of welfare and employment are being tested by the current global financial crisis and the growing stress caused by what seems to be a strategy of compliance to the phenomena of increasing globalization and pressure on exports. The Nordics and ROK are directly exposed to the current crisis but in different ways.

### 3. Labor market and social policy responses

The comparison between the present global crisis and the Asian financial crisis which struck Thailand, Indonesia and ROK in 1997 is revealing. At that time, the IMF and the United States insisted on the implementation of a raise in interest rates in the bailed-out countries. In Korea's case, Seoul undertook "Washington-Consensus style" reforms to receive the financial assistance it needed to deal with the capital flight bringing down its currency. Unemployment rose to around 8 per cent, real wages declined, and labor unions' battled management and government in a futile effort to preserve job security for workers in large firms. Growth and employment recovered quickly, but the new jobs were primarily in "non-regular" and temporary positions with limited benefits and low wages. Inequality in the ROK went from very moderate levels to the second highest among advanced OECD countries, just behind that of the United States (Freeman 2010: 173; Schmidt 2000; Schmidt 2007; Schmidt 2008). In 2009, trade declined 5.2 percent and manufacturing contracted 6.2 percent.

In 2009, the Korean CDS appears to be paying off its debt in terms of a relative soft landing process. The rapid turnaround from the recent financial crisis was in part due to the size of its stimulus package, starting with US\$11 billion last November, and the rapidity it was passed and implemented by the government. A further reason was the degree of social and political cohesion that allowed the stimulus package to be targeted more precisely. "In times of crisis, Koreans come together," said one analyst, contrasting it with Washington, where a crisis is an opportunity to eviscerate one's political enemy (Williams 2009).

This time the government seems to have been more prepared to think "out of the box. It introduced two types of active labor market policies consisting of measures to sustain labor demand and measures to improve employment prospects. In concrete terms this meant carrying out the following steps: "(i) temporary expansion of public sector job creation schemes; (ii) youth internship program for small and

medium-size enterprises with wage subsidies for hiring interns at the end of the internship; (iii) easing of the eligibility for STW (short-time-work) schemes by reducing the proportion of workers to be reassigned and the minimum training hours to be eligible for STW subsidy; and (iv) increased employer subsidy for STW. Furthermore, policies to improve employment prospects for existing workers and those out of work were implemented: (i) increase in PES (public employment services) staffing and expanded use of private employment agencies; and (ii) increased funding for expansion of training places for the unemployed. In 2009 the government established a program of short-term employment in the public sector for older and long-term unemployed (“Hope Work Program”) and this coupled with exceptional downward wage flexibility (IMF 2010: 10-14). It seems that ROK has transformed its contract-based employment system into a more flexible one. The process took ten years and was brought about through intense tripartite bargaining, pressure from the IMF and the Asian financial crisis (Vandenberg 2010: 34).

Helped by increases in exports to China, South Korea surprised the world by achieving a 3.9 percent annual economic growth, the highest rate in OECD. Korea's jobless rate rose in September at the slowest pace among the world's major economies - up by 0.4%, to 3.4%, compared with a year earlier, indicating that its employment conditions remain relatively better than others in the face of the economic slowdown (Williams 2009). To counterbalance the move towards more flexible employment protection, an unemployment insurance scheme covers 36 per cent (in 2006) of the workforce, which excludes public servants and most private-school teachers. Benefits are provided for between three months and two years; depending on age and contribution record (Vandenberg 2010: 43-44).

In the Nordic region in contrast, the global crisis has seen a GDP decline of between 4.5 percent and 7 percent. The region has had the world's highest tax rates for decades, and as Reuters mentions: “now they're seeing the pay-off.” Despite the government stimuli in 2009, Denmark's GDP was expected to contract by 4.5 percent, Sweden's 5 percent and Finland's nearly 6 percent. Norway, buoyed by a huge offshore oil sector, saw a more modest 1 percent decline. The four economies grew by a weighted average of 2.8 percent in 2007. “The Nordics' social safety net provides high unemployment benefits - in Norway, two-thirds of an employee's last salary for two years - plus hands-on help in job training and counseling, including crash courses on job interviews” (Wojciech 2009).

Overall, Denmark is relatively more exposed to the housing market crisis, while Sweden and Finland are more reliant on their export industries, which have been hit by the drop in demand in the global market. Finland is expected to do better given that its financial sector is relatively well shielded from the direct impacts of the global crisis.

To maintain long-term competitiveness in the face of globalization – which puts pressure on their high-tax policies – and a reduction in the labor supply due to ageing population, the Nordic countries are refining their welfare state policies by mixing tax cuts or freezes with reductions in government

expenditures. They are attempting to improve competition in certain sectors and to adjust their labor markets to meet the challenges identified in the EU's Lisbon Strategy for growth and jobs.

The Korean government's labor market response to the crisis has been multi-faceted but especially harsh as workers have experienced declines in real wages, hours worked and temporary employment cuts. The reduction in working hours took place through both government programs and direct negotiations between employers and employees, depending on the sector. "A program to reduce long-term unemployment through short-term government job opportunities also proved effective during the downturn. Employment initially fell in most sectors, with the exception of nonmanufacturing industry and public sector employment, but has fully recovered more recently. In addition to macroeconomic policies and financial sector support measures, exchange rate flexibility may also have supported the economy at the onset of the crisis" (IMF 2010: 20).

In contrast Sweden was affected primarily through both the financial and real sectors. "Concentrated exposures of domestic commercial banks to troubled emerging economies forced credit tightening, reducing private consumption and investment demand, while the collapse in world demand for manufactured goods caused a contraction in export demand and a substantial drop in manufacturing employment. Increased labor market flexibility following reforms in the last decade and labor market policies in response to the crisis muted the impact of these shocks. Labor hoarding by firms also played a role, as they expected the shocks to be temporary. Exchange rate flexibility may have also helped absorb the external shocks" (IMF 2010: 20).

In 2005, gross public social expenditure was 20.6% of GDP on average across OECD countries, with spending on cash benefits as on services. Cross-country differences in public social spending are wide, ranging from 7% of GDP in Mexico and Korea to just over 29% in France and Sweden (Adema and Ladaique 2009).

On average public expenditure on health services amounted to just over 6% of GDP in 2005 while spending on other social services was just over 2% of GDP. The latter exceeds 5% of GDP only in Denmark and Sweden, where the public role in providing services to the elderly, the disabled and families is extensive, whereas it fluctuates around 1% of GDP in the US, where there is a greater reliance on private and informal care (Adema and Ladaique 2009).

In the World Bank's index for the rigidity of regulations covering hiring, firing and hours of work, the United States scores a zero on a scale of 0 to 100, with 100 indicating the greatest degree of regulation. The score for most European nations falls between 40 and 65. Korea and the Nordic region score approximately 40 indicating a middle position not far from the OECD average (World Bank 2010).

Concluding remarks

The two socio-economic models, the Nordic and the Korean, share a number of interesting characteristics. First the initial and long emphasis on egalitarianism which plays a paramount symbolic and real meaning in terms of social cohesion and ethnic homogeneity; but in the Nordic case this also contains the tendency of triggering xenophobia, anti-foreign discourse and nationalism as a cultural matrix against “the other”. Historically speaking both models have experienced radical land reforms which originally acted as motors for the economic take-off and created the conditions for equality and even development. Both regions also share experiences from the Cold War as frontline states neighboring communist countries and as such received special treatment from the United States through the Marshall Aid and the US military presence in ROK.

It is interesting to note that the UNDPs Human Development Report ranks ROK and the Nordic countries in the top 20 league among the 169 countries surveyed. Between 1980 and 2010 Korea's HDI rose dramatically by 1.2% annually from 0.616 to 0.877 today, which gives the country the rank of 12th out of 169 countries with comparable data (UNDP 2010).

The official discourse in both entities concerning free trade comes at a time when the world market has become ever more competitive. Seen from position of the political and economic elites, this requires disciplining of labor through productivity increases and decreases in living standards. Korea, just like the US, Germany and the Nordic countries before them, grew their industries to maturity in the greenhouse of protectionism before exposing them to competition (Williams 2009). The signing of bilateral free trade agreements with the EU and recently with the US shows a readiness on the part of the Korean corporatist elite to compete with the big players on the global scene.

It seems to be safe to say that the crisis response in both settings share a number of important similarities as well. In terms of the response towards labor markets and employment both entities have taken a pro-active and progressive Keynesian inspired attempt to shield of labor from the caveats and pitfalls of the crisis. However and although this has not been fully covered by this paper it is safe to say that there are huge differences in terms of taxation, social entitlements and publicly covered health and education – the traditional signifiers of the Nordic welfare state.

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