UNRISD
UNITED NATIONS RESEARCH INSTITUTE FOR SOCIAL DEVELOPMENT

DRAFT

# Growth Strategies and Poverty Reduction

*The Institutional Complementarity Hypothesis*

Robert Boyer
Pse - Paris-Jourdan Sciences Economiques

prepared for the UNRISD project on

**UNRISD Flagship Report:
Combating Poverty and Inequality**

April 2008 ▪ Geneva

UNRISD was established in 1963 as an autonomous space within the UN system for the conduct of policy-relevant, cutting-edge research on social development that is pertinent to the work of the United Nations Secretariat; regional commissions and specialized agencies; and national institutions.

Our mission is to generate knowledge and articulate policy alternatives on contemporary development issues, thereby contributing to the broader goals of the UN system of reducing poverty and inequality, advancing well-being and rights, and creating more democratic and just societies.

UNRISD, Palais des Nations
1211 Geneva 10, Switzerland

Tel: +41 (0)22 9173020
Fax: +41 (0)22 9170650
info@unrisd.org
www.unrisd.org

## Abstract

This chapter starts from the limits of the policies that assume a significant de-connection between antipoverty strategies and the logic of the growth regime and that mainly rely upon market mechanisms. By contrast, a branch of the new institutional economics argues that a complete set of coordinating mechanisms is constitutive of really existing economies and that they are more complementary than substitute. The Institutional Complementarity Hypothesis (ICH) may be useful for analyzing simultaneously the antipoverty policies and the viability of growth regimes. The different brands of capitalism are the outcome of complementary institutions concerning competition, labour market institutions, welfare and innovation systems. Generally, such configurations cannot be emulated by poor developing countries, but reviewing the preliminary findings of the UNRISD country case studies suggests some common features to all successful experiments. Basically, antipoverty policies are efficient when they create the equivalent of virtuous circles within which growth enables antipoverty programmes, and conversely these programmes sustain the speed and stability of growth. Two methods are proposed in order to detect possible complementarities and design accordingly economic policies: the Qualitative Comparative Analysis (QCA) on one side, national growth diagnosis on the other side. A special attention is devoted to the timing of policies and the role of policy regimes. A brief conclusion wraps up the major findings and proposes a research agenda.

## 1. Introduction

For many governments and most international organizations, the reduction of poverty is now a crucial objective for the current decade and even the millennium. But the major issue is then to design and implement the related policies. A brief retrospective analysis suggests that the previous policies have had mitigated outcomes and therefore they cannot be generalized to lagging countries.

More precisely, the impact of internal and external liberalization has been reassessed. In some cases, the strengthening of *market forces* and price mechanisms has been quite helpful in reducing poverty, if not inequalities: it seems to be the case for China and other Asian countries. In other instances, the *full liberalization* of product, labour and financial markets has been quite detrimental to macroeconomic stability since the bursting out of major financial crises has exacerbated poverty creation in the very same countries that represented themselves as dominated by a large middle class: one recognizes the dramatic transformation of the Argentinean economy.

Similarly, during the 1990s, many economists and international institutions stated that a *good macroeconomic policy* and environment was a necessary and sufficient condition for stable and fast growth, and consequently for large-scale poverty reduction. This hypothesis has been falsified by the trajectory of most Latin American countries, where the implementation of the so-called Washington consensus has significantly pauperized a fraction of middle classes. Even for some Asian countries, the implementation of stabilization programmes after the 1997 financial crises has aggravated poverty, far from reducing it. The Indonesian trajectory is quite illustrative of this unexpected outcome.

Therefore since the early 2000s, experts and governments are searching for new strategies in order to promote what is called in most Latin American countries “growth with equity”. This aggiornamento has been associated with a clear perception that the motto “the same size for all” has failed therefore the challenge is to take more explicitly into account the specificities of each national economy. In order to address these two core issues, the present chapter is built upon a threefold hypothesis:

- For any country with massive poverty, policies that target poverty as if it were a marginal feature within prosperous economies are totally inadequate. It is much more relevant to make explicit the interrelations between the contemporary structural transformations, emerging growth regimes, and their impact upon poverty and inequality.

- A recent development in institutional analysis provides a tool in order to cope with this challenge. The Institutional Complementarity Hypothesis (ICH) explains why no single policy tool is able to reduce poverty: basically, several instruments have to be combined in order to generate a viable economic regime that reduces poverty.

- Whereas the implicit reference to a pure market economy frequently implies the reference to a one best way and canonical institutional configuration, ICH points out that several configurations may trigger the emergence of a virtuous circle, within which growth and poverty reduction are closely associated.

Building upon this analytical framework, this chapter is organized as follows. It is first important to survey briefly the nature of conventional antipoverty strategies and explicit the reasons for rather unsatisfactory outcomes. A core argument of the present chapter is precisely that there is no single panacea for promoting a high growth with equity, since market mechanisms are far from being the only existing and efficient coordinating mechanisms (section 2). The next step of the analysis is devoted to the general presentation of the ICH that precisely builds upon the complementarity of various coordinating mechanisms as key factors in the viability and stability of a growth regime and simultaneously poverty reduction. The purpose of any institutional design should be to organize such a complementarity in order to propitiate the emergence of a virtuous circle: antipoverty policies enhance growth and conversely the dividends derived from growth allow their financing (section 3). Since the concept of ICH might be unfamiliar to the reader, it might be enlightening to show how this framework helps in understanding some major stylized facts for developed economies. Basically, combining two or more institutional forms, somehow imperfect with respect to a pure market arrangement, may nevertheless deliver quite satisfactory outcomes in terms of economic efficiency and social justice. Various examples of such configurations are provided concerning the social democratic institutional configuration or the variety of the institutional arrangements fitted for a knowledge-based economy (section 4). Nevertheless, it is important to show that ICH can be applied to developing countries, delivering original results concerning the variety of configurations able to promote growth with equity. The purpose is not to mimic or extrapolate the developed world arrangements but to use the related methodology in order to diagnose what are the relevant complementarities in each national case study. Some examples extracted from the national studies of the UNRISD programme are given as a first step in the full implementation of this methodology (section 5). Finally, any progress in the direction of a better understanding of contemporary issues calls for the implementation of some original methods that stick to the specificities of each case study, in space and historical time (section 6). A conclusion sketches a research agenda, featuring close interactions between the basic concepts of ICH and the investigation of national case studies (section 7).

## 2. Under-development and poverty: The failure of mono-causal explanations

The emergence of the sub-discipline of development economics took place when economists had to recognize that the theories they had been elaborating for mature industrialized countries do not fit with the main features of the rest of the world. Thus, the analyses of development have explored the impact upon growth of alternative hypotheses by contrast with those adopted by conventional growth theory. Basically, economic instability, poor growth performance and the persistence of poverty were interpreted as evidence for the absence of a key single factor that has evolved continuously through time. Firstly, the scarcity of capital was blamed and then the lack of entrepreneurship, the absence of competition, and finally a poor human capital formation have been attributed a key role in the absence of development. More recently the lack of transparency, economic freedom, and ultimately good macroeconomic governance have been perceived as key factors inhibiting growth and poverty reduction (table 1). Since the 90s, the so-called 'Washington Consensus' has diffused all over the world a basic vision: full liberalization, both internal and external, was the key strategy for promoting growth and eradicating poverty. In retrospect, the relevance of this strategy has to be reassessed.

Table 1: Under-Development theories: a succession of mono causal interpretations?

| Explanatory factors \ Contents/ goals | Self-perpetuating growth | Higher standards of living | Technological and institutional modernization | Human development (health education,…) | Less poverty | Empo-werment | Development as a form of freedom | Ecological sustainability |
|---|---|---|---|---|---|---|---|---|
| Development of capital | Neo-classical theory of growth SOLOW (1956; 1957) | | | | | | | |
| Entrepreneurship | | Schumpeterian theory HAGEN (1962) | | | | | | |
| An appropriate pricing system | | Theory of equilibrium SCHULTZ (1964) | | | | | | |
| The opening up of an economy | Open economy model KRUEGER (1979) | | | | | | | |
| Human capital | | Theory of endogenous growth LUCAS (1988; 1993) | | | | | | |
| The basic institutions of capitalism | | The new institutionalism NORTH (1981; 1990) | | | | | | |
| Good governance | | | | World Bank (1993-2001) | | | | |
| Absence of corruption | | | State and corruption MAURO (1995) | | | | | |
| Democracy | | | | | | Democracy and Growth BARRO (1996) | | |
| Promotion of rights and freedom | | | | | Development as a form of freedom SEN (2000) | | | |
| Environment | | | | | | | | Ecological model MEADOWS (1972); CHAKRAVORTY (1997) |

## 2.1 The conventional orthodoxy and its limits

Basically, the so-called Washington consensus was built upon five main pillars. This framework was perceived as rather coherent and relevant, but the last decade has largely mitigated this statement.

- The first pillar assumed that *pure market mechanisms* imply the convergence towards full employment, and that it is the best strategy in order to alleviate the sources of poverty linked to underemployment and unemployment. *De facto*, no careful analytical studies substantiates this belief about the positive role of liberalization on poverty reduction (Reddy 2007). One can find striking counter examples. On one side, back to the 1990s, the Argentinean government was among the very best followers of the strategy of full liberalization both internal and external: this has not prevented the pauperization of a large fraction of the population and finally the financial collapse of the country. On the other side, continental China has liberalized most product markets, but not removed strong public interventions in the economy: the poverty rate has drastically declined but inequalities have been widening.

- Another basic assumption was that any *welfare policy or institutionalization of workers/citizens rights* was bounded to push the economy out of its "natural equilibrium". Consequently, any measure explicitly devoted to the reduction of poverty, may end up doing the opposite, i.e. an extension of poverty. Such an unintended outcome has actually been observed, but this does not mean that any adequate pro-poor policy is bound to fail. Remember that the celebrated social democratic model of Sweden came out of a very turbulent period characterized by rural poverty and large emigration out of the country. Various case studies from the UNRISD *Poverty Reduction and Policy Regimes* project suggest that some social transfers can simultaneously benefit poor people and stimulate growth as experienced in South Africa (Seekings 2007) and in Botswana (Selolwane *et al.* 2007).

- Conventional approaches rely heavily upon a rather specific method, *benchmarking*. It assumes that it is easy to attribute the success of a strategy to a single device. Consequently governments should try to implement it into their economy in order to improve past poor performance. This approach suffers from a basic weakness: the quite impressionistic diagnosis of the unique factor at the origin of a successful strategy. Most of these diagnoses have proven to be false concerning the secrets of the German social market economy in the 1970s, the Japanese model in the 1980s, and then the Silicon Valley dynamism in the 1990s. Basically, a series of economic institutions contribute to the viability and success of a growth regime, and it is not so easy to try to directly import such a complex nexus of social compromises and coordinating mechanisms. It is crucial to understand a specific configuration and its internal dynamics, as a precondition for designing a pro-growth and pro-poor policy.

- A derived conclusion was precisely that lagging countries should try to import the complete institutional setting of the most successful country during the present period. Actually this assumes that there is a *single one best configuration*, with possibly strong complementarities, for example between market-competition and democratic principles. The recent literature on the diversity of capitalisms (Hall and Soskice 2001) and the previous comparative analysis inspired by *régulation* theory (Boyer 1996; Amable 2003) challenge this uniqueness and explain that various complementarities and political alliances justify a significant variety of institutional configurations. This opens some opportunities for developing countries that are not bound to emulate the best strategy observed in the developed world.

- Another pillar of the Washington Consensus stated that a *sound macroeconomic policy* is the necessary and sufficient ingredient in order to promote full employment and rapid growth. Of course, unwise public policies extending debt and generating high and unstable inflation have proven to be quite detrimental to growth and poverty reduction: most Latin-American countries during the 1970s and 1980s followed such a trajectory. Nevertheless, the return to a more orthodox macroeconomic policy in the 1990s has not been sufficient for a complete reversal of previous negative trends: slow and unstable growth, rising inequalities, large unemployment and a surge of informal labour have persisted (IADB 1995, 1996). Therefore, experts and governments have to design *other policies* directed towards innovation, institutional reform and growth and this might be especially important for poverty reduction.

### 2.2 The institutional analyses and their responses

At the opposite of the ideal of a pure market economy, recent advances in institutional economics enlarge the scope of analysis and provide a more balanced view about the coherence and viability of market economies. For development theories, this means the adoption of a *systemic and institutionalist approach* that could be summarized by the following motto: getting the institutions right according to the legacy of past economic specialization, social traditions and present political choices (Boyer 2006d). This helps in correcting the limits of previous conceptions of development.

- Any really existing economy displays a *significant variety of coordinating mechanisms,* much more diverse than the conventional opposition between market and state. If the first mechanism relies upon interest and horizontal interactions among actors, at the opposite, the second is built upon obligation and an asymmetric exercise of power. Therefore, if one takes into account both the motive of action (either interest or obligation) and the distribution of power among actors (either symmetric or typically hierarchical) four other coordinating mechanisms emerge: the private hierarchy of organizations and firms, the community, the association, and finally network. Hence societies and economies exhibit a multiplicity of institutional arrangements, more or less imperfect, that have to be compared one with another and not with a mythical pure market economy (figure 1).