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Growth strategies and poverty reduction:

the institutional complementarity hypothesis

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STRATÉGIES DE CROISSANCE ET POLITIQUES DE LUTTE CONTRE LA PAUVRETÉ : l'hypothèse de complémentarité institutionnelle

Robert Boyer

Résumé

Au cours des deux dernières décennies, les politiques qui supposaient une séparabilité des stratégies de lutte contre la pauvreté et de la logique du régime de croissance ont montré leurs limites. De plus, elles étaient basées essentiellement sur l'activation de mécanismes de marché. Par contraste les recherches en économie institutionnelle soulignent que la résilience et la performance des économies dérivent de la cohérence d'un ensemble de mécanismes de coordination, qui sont plus complémentaires que substituts au marché. L'hypothèse de complémentarité institutionnelle s'avère précieuse pour analyser simultanément les politiques anti-pauvreté et la dynamisation des régimes de croissance. Les différentes formes de capitalisme sont l'expression de complémentarités différentes entre le type de compétition, les institutions du marché du travail, la couverture sociale et le système d'innovation. Très généralement, les économies en voie de développement ne peuvent imiter ces configurations mais les études de cas nationales menées par l'UNRISD font ressortir des traits communs à la plupart des expériences réussies. Elles ont créé l'équivalent de cercles vertueux au sein desquels stimulation de la croissance et programme anti-pauvreté se confortent l'une l'autre. L'article propose deux méthodes pour détecter ces complémentarités : l'analyse qualitative comparative d'une part, les diagnostics des facteurs limitant la croissance de l'autre. Il importe aussi de prendre en compte la séquence des différentes mesures et le temps long du changement institutionnel.

GROWTH STRATEGIES AND POVERTY REDUCTION: the Institutional Complementarity Hypothesis

ABSTRACT

This article 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, labor 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 entitles antipoverty programs and conversely these programs 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.

JEL Classification : B52 – O11 – O17 – O57 – P52

Mots Clés : Théorie du développement – Politique de lutte contre la pauvreté – Consensus de Washington – Nouvelle économie institutionnelle – Complémentarité institutionnelle – Analyse qualitative comparative – Diagnostic de croissance

Keywords : Development theory – Antipoverty policy – Washington consensus – New institutional economics – Institutional Complementarity Hypothesis – Qualitative Comparative Analysis – Growth Diagnosis

Growth Strategies and Poverty Reduction: the Institutional Complementarity Hypothesis

CONTENTS

I. 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, labor 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 90s, many economists and international institutions stated that a *good macroeconomic policy* and environment was a necessary and sufficient condition for a stable and fast growth and consequently for a large 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 programs 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 marginal feature within prosperous economies are totally inadequate. It is much more relevant to 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 not any 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 implies frequently 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 article 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 (II). A second 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 (III). 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 (IV). 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 program are given as a first step in the full implementation of this methodology (V). 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 (VI). A conclusion sketches a research agenda, featuring close interactions between the basic concepts of ICH and the investigation of national case studies (VII).

II. 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 have 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 an evidence for the absence of a key single factor that has evolved continuously through time. Firstly, the scarcity of capital has been blamed and then the lack of entrepreneurship, thirdly 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?

Contents/ Explanatory goals factors	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)

II.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 90s, 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 the 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 into the opposite, i.e. and extension of poverty. Such an unintended outcome has actually been observed, but this does not mean that whatever 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 cases studies of UNRISD program suggest that some social transfers can simultaneously benefit to 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 70s, the Japanese model in the 80s, and then the Silicon Valley dynamism in the 90s. 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.

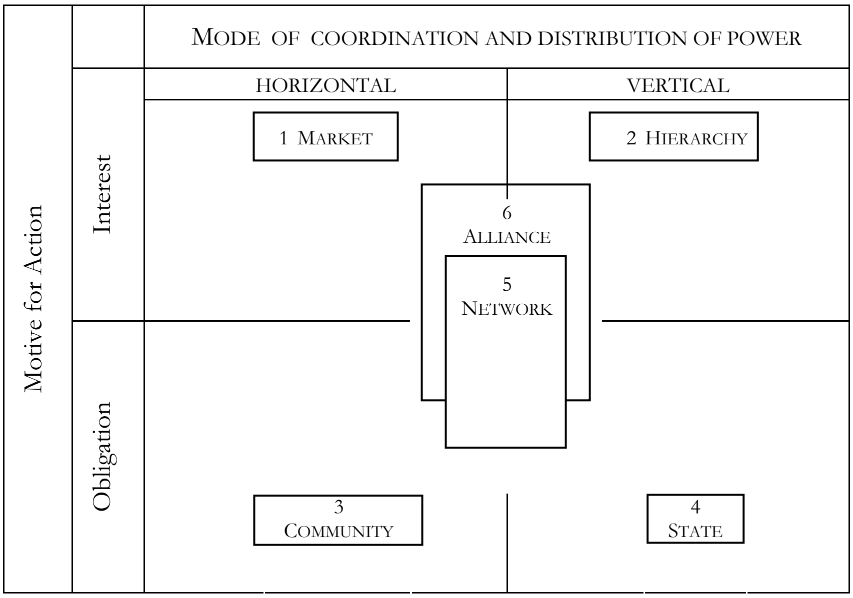
- Another pillar of the Washington consensus stated that a *sound macroeconomic policy* is the necessary and sufficient ingredient in order to promote full employment and rapid growth. Of course, unwise public policies extending debt and generating high and unstable inflation have proven to be quite detrimental to growth and poverty reduction: most Latin-American countries during the 70s and 80s followed such a trajectory. Nevertheless, the return to a more orthodox macroeconomic policy in the 90s has not been sufficient for a complete reversal of previous negative trends: slow and unstable growth, rising inequalities, large unemployment and surge of informal labor 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.

II.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.

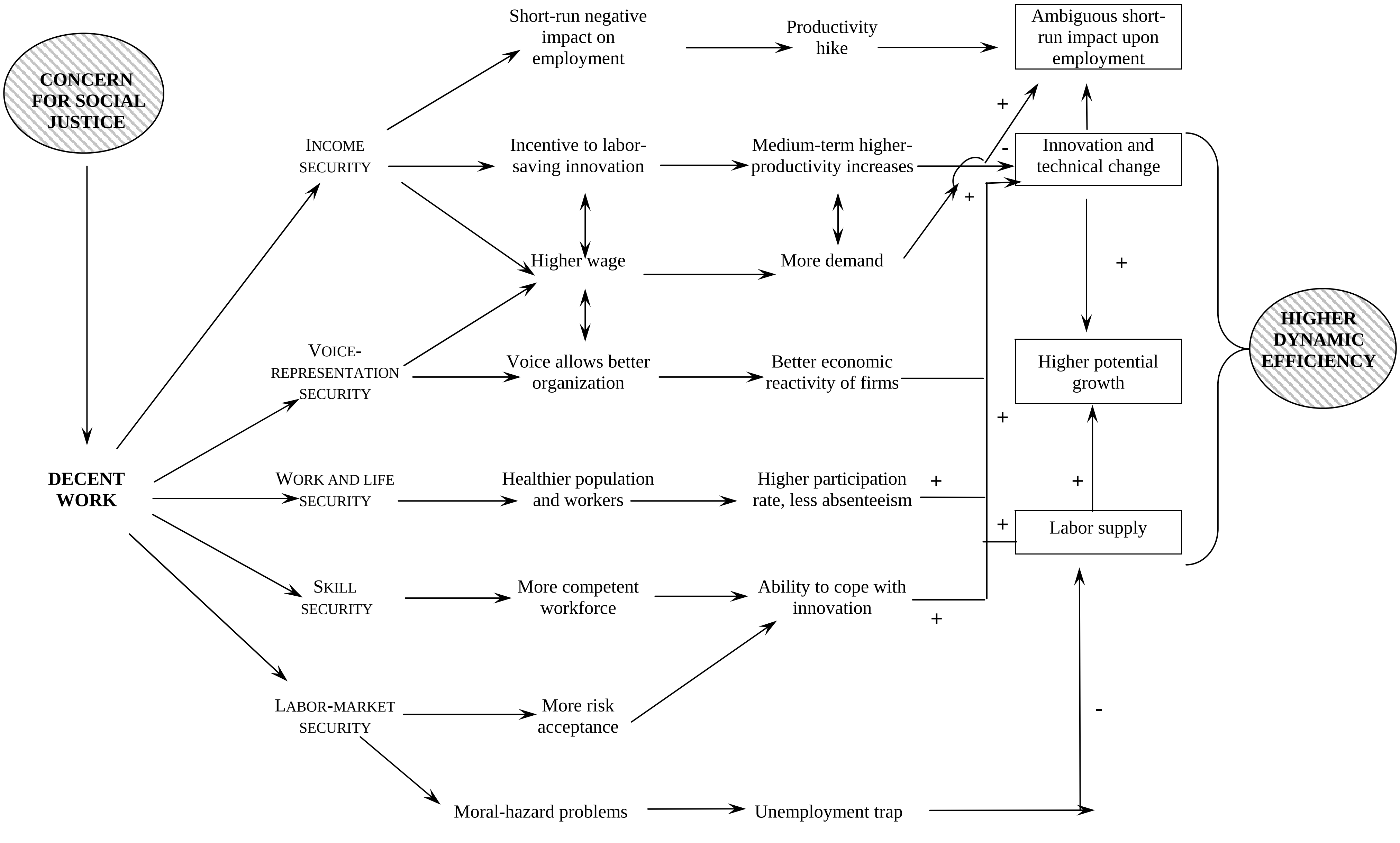
- Any really existing economy display a *significant variety of coordinating mechanisms,* much more diverse than the conventional opposition between Market and State. If the first mechanism relies upon interest and horizontal interactions among actors, at the opposite, the second is built upon obligation 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).

Figure 1 – A synopsis of different modes of coordination and institutional arrangements



- Recent research on development has stressed the possible role of *social capital* in the functioning of contemporary developed economies (Putnam 2000), but also in the process of economic development (Narayan 1999). Actually this term tries to capture the role of personal and collective networks concerning the flow of information, economic exchanges and the provision of a modicum of security to individuals. But there is another meaning that originates from the research on welfare States: by providing some basic collective goods related to health, education and security, the corresponding expenditures should be classified as investment, since they contribute to social capital formation. Its volume and composition are therefore factors of production and contributors to growth. This new framework was first proposed by Dutch scholars (Visser and Hemerijck 1997) and more recently by social scientists from Scandinavian countries (Esping-Andersen 1990; 2003). In a sense, the theory of capability by Amartya Sen (2000) is recognizing that some welfare enhancing supply of public goods may benefit simultaneously to poverty reduction and stimulation of growth. Within these new analytical frameworks, some *welfare policies* aiming at the development of workers and citizens securities may have favorable productive impact and positively affect the dynamic efficiency of the economic regime. For instance, income security may imply high wages but simultaneously higher productivity and easier acceptance of innovation and structural change: short run extra costs can be associated to a larger dynamic efficiency. Similarly, work life security may imply some constraints detrimental to short run performance of firms but it is an incentive to more innovations and higher growth. It is specially so for health, education and training expenditures. The same reasoning can be applied to skill security or voice and representation security. Therefore the search for social justice is not necessarily detrimental to growth performances, i.e. a strategy that makes compatible poverty reduction and growth (figure 2).

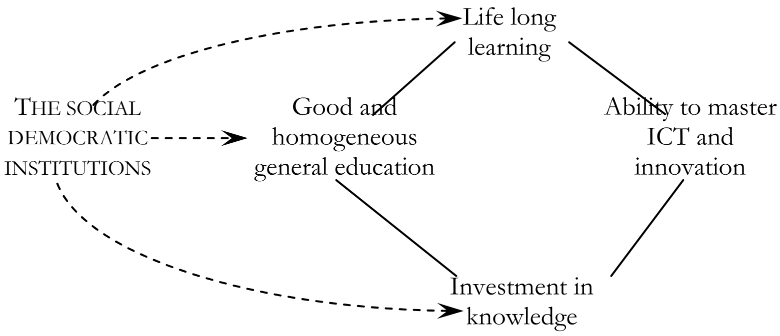
Figure 2 – How some social policies may enhance dynamic efficiency



- *Isolated best practices cannot be simply imported* at the level of national institutional building, since they have to be combined existing institutions and organize complementarities among new and old institutions. In some cases, a quite efficient institution in one country may prove to be detrimental to economic performance when transplanted to another country, with distinctive productive organization, social values and political intermediation. For instance, during the 90s, many analysts of the new economy thought that the scarcity of venture capitalist was the main constraint limiting European growth. In retrospect, it is quite clear that once that limitation has been removed, most European economies still have been lagging, by lack of the complementary institutions observed in the Silicon Valley, i.e. a new pattern for intellectual property rights, close relations between university and business, as well as a very active local labor market for highly qualified individuals (Boyer 2004b). Conversely, the absence of typical venture capital, American style, does not seem to have prevented some Scandinavian countries to be quite successful in implementing a knowledge based economy, i.e. the underlying paradigm to the late new economy.

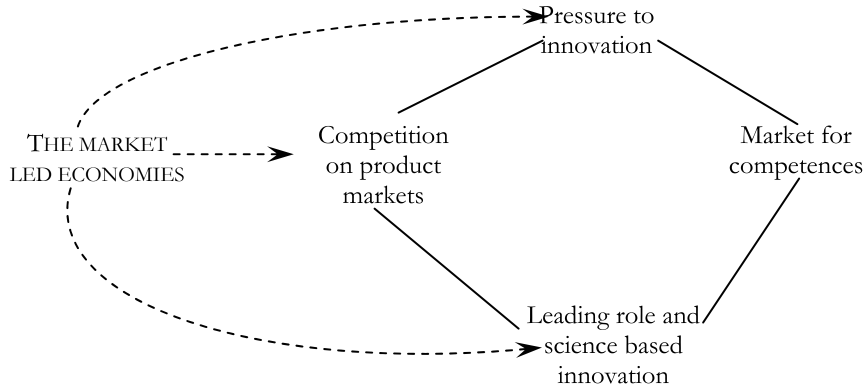
- This last remark points out a quite general teaching of contemporary institutional research: given the same productive paradigm and configuration for the world economy, there exist *several successful configurations* that display different complementarities among basic economic institutional forms. This result has been observed during the Golden Age when at least four brands of capitalisms coexisted and developed complementary specializations (Boyer 2004b, Amable et al. 1997). This plurality of institutional architectures persist in the present era of technological paradigm shift and globalization: the knowledge economy and the related growth regime are compatible with quite *contrasted complementarities*.
  In the *social democratic case*, a comparative institutional analysis shows that a good and quite diffuse general education, life long learning and a large investment by firms in knowledge are the precondition for the ability to master information and communication technologies and nurture innovations that provide the competitiveness of the national economy (figure 3).

Figure 3 – The social democratic configuration



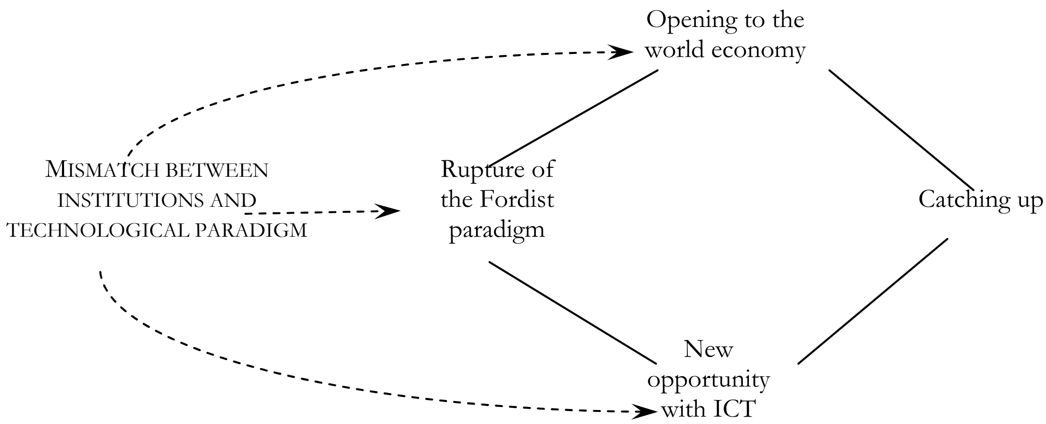
But this is not at all the unique configuration: a knowledge based economy can be the outcome of a large *deregulation* of quite all markets and the diffusion of science pushed innovations. In this context, the defense of intellectual property rights and incidentally sophisticated financial innovations and markets are crucial components of this configuration, typical of the American way to a knowledge based economy (figure 4).

Figure 4 – The deregulated, Science pushed configuration



The empirical analysis (Boyer 2004c) reveals a third configuration, probably the most interesting for contemporary developing economies. Actually, until the 70s, some *lagging countries* such as Ireland were constrained in their development by the existing international relations and their inability to forge the social and economic organizations relevant for their insertion into the Fordist productive paradigm. With the changing pattern in their relations with the world economy and the emergence of a productive paradigm based upon information and communication technologies, some of these countries have been successful in designing and implementing the institutional forms required by this new context. Consequently, the club of industrialized countries that was supposed to be definitely closed for outsiders, is now open for many South Asian countries, India, China, and not only Ireland (figure 5).

Figure 5 – Leap frogging for lagging countries



- A last rebuttal of the conventional vision about growth and poverty is derived from the advances in macroeconomic theory. Basically the core assumption that *long term growth* is the mere outcome of a series of shift in the *short run macroeconomic equilibrium* of an economy has been falsified by the analysis of the two last decades. Clearly, growth is a matter of surplus creation and its productive reallocation, in conformity with the old classical vision. When the degree of sophistication of the economy increases, it is not sufficient to invest a large volume of saving, since it becomes necessary to innovate in order to permanently renew the competitive advantage. Beneath this general approach, the factors constraining this process appear to be quite specific to each group of countries. Therefore, traditional comparative analysis and cross section econometric studies have to be replaced by a precise investigation of the characteristics of *a national trajectory* in order to detect the hierarchy of the factors that are limiting growth and possibly poverty reduction (Hausmann et al. 2005).

III. THE INSTITUTIONAL COMPLEMENTARITY HYPOTHESIS IN A NUTSHELL

This approach belongs to the theoretical aggiornamento just described by the previous section. One of its merits is to overcome the conventional opposition between Markets and States as exclusive and antagonistic coordination mechanisms and it gives the basis for a better understanding of the complexity of the link between national institutional architectures and performances in terms of economic efficiency and social justice.

Within the quite dynamic field of the economics of the institutions, the Institutional Complementarity Hypothesis (ICH) has proposed a new research agenda in order to understand simultaneously the issue of the diversity of capitalism and how to design viable strategies for reforming the institutions inherited from the Second World War (Hall and Soskice 2003; Aoki 2001; Amable 2003). This framework has successfully been tested for developed and industrialized countries but one finds few references in the domain of development theory. The purpose of this short paper is to initiate such a research program.

III.1. No single coordinating mechanism can warrant the viability and efficiency of a national economy

This is at the core of institutional analysis.

On one side, any single institutional arrangement (IR) – a market is one of them – requires a precise organization, rules and norms, means of individual and collective compliance and these requirements have to be manufactured by the mobilization of resources outside this institutional arrangement. Under this respect the pure market competition is among the most demanding institutional arrangements and not at all a state of nature that would result from a spontaneous evolution. This is the converging conclusion of the microeconomic theory of asymmetric information, the findings of economic history about the emergence of markets and the evaluation of the fate of deregulation in OECD countries. The quite difficult and painful transformation of former socialist economies is quite illustrative of the fact that a market economy is a complex social and political construction (table 2).

Table 2 – Coordinating mechanisms: their governance and prerequisite

GOVERNANCE MECHANISMS	ORGANIZATIONAL STRUCTURE	RULES OF EXCHANGE	INDIVIDUAL MEANS OF COMPLIANCE	COLLECTIVE MEANS OF COMPLIANCE
MARKETS	Free entry and exit	Voluntary spot exchange	Legal enforcement of control	Norm of private property
	Bilateral exchange or market place (Wall Street)		Regulations to maintain a public market	Legitimacy of free market
COMMUNITIES	Informal membership evolves over long period of time	Voluntary exchange based on social solidarity and high degree of trust	Social norms and moral principles impose obligations	Highly institutionalized norms and rules require members to accept "corporate" obligations
			Knowledge of others and reciprocity over time	
NETWORKS	Semiformal membership	Voluntary exchange over a time period	Contractual bonds	Personal relations
	Bilateral or multilateral exchange		Resource dependence	Trust built outside the economic arena
ASSOCIATIONS	Formal membership	Restricted to members	Self-interest	Some degree of compulsion
	Multilateral exchange	Opposition insider/ outsider	Reputation effect	Partially private administration
PRIVATE HIERARCHIES	Complex organizations which tend to become bureaucratic	Restricted to members, exchange based on asymmetric power, bureaucratic rules	Rewards to individuals	Highly institutionalized rules
			Asymmetric power, threat of sanctions	Members socialized into corporate culture, use of sanctions
STATE	Public hierarchy	Unilateral action	Exit (tax evasion, migration)	Coercion
	De jure and imposed membership	Indirect and global political and economic exchange	Voice (vote, lobbying)	Social rules or norms

On the other side, each institutional arrangement has a limited domain of applicability and cannot be extended to the entire economy. Some IR are adapted to allocate efficiently typical goods, some others are building the trust necessary to the coordination of complex productive chains, still others are devoted to the supply of public goods. Furthermore, equity concerns are not taken into account by the same IR that aim at the efficiency of allocation of resources. For instance, the market cannot deal with the determination of the supply of public goods, with externalities and with social justice concern. States have no clear superiority to allocate conventional goods but they are quite adapted to the coordination of strategic externalities and the delivery of public goods (table 3).

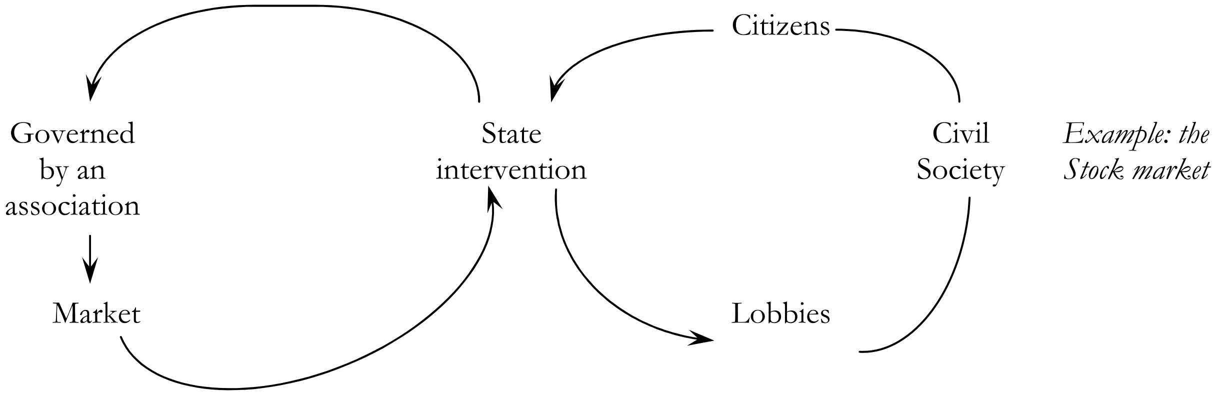
Table 3 – Each coordinating mechanisms has is own specific strengths and failures

TYPE OF FAILURE	COORDINATING MECHANIMS					
	MARKET	COMMUNITIES	NETWORKS	ASSOCIATIONS	PRIVATE HIERARCHIES	STATE
ENFORCEMENT	Needs an internal enforcement authority	Needs trust and loyalty, often coming from outside (family, religion, ethnicity)	Need an external enforcement authority	Usually relies on the state as an enforcer	Might enhance opportunistic behavior	Needs controls external to state bureaucracy (judges, parliament, market) to correct state abuses
	Facilitates collusion and imperfect competition	Compatible with various types of competition	May facilitate cartelization and monopoly	Resembles enforcement mechanism of carrels	The ideal of internal markets might hurt incumbent workers	Lobbies can capture public interest goals
PUBLIC GOOD AND EXTERNALITY	Cannot provide collective goods or deal with externalities	Can internalize some collective goods (quality, training) but not others (welfare, general public goods)	Useful for enhancing quality and training but not very good in providing for societal general welfare	Useful for establishing standards and quality, for setting rules of competition in the industry	Governance costs might exceed the benefits of internal division of labor	Can provide public goods but has difficulties in providing them in precise amounts
	Inadequate monitoring of technical change and innovation	Members tightly integrated into community, have limited capacity for innovations	Weak in the provision of collective goods	Useful for providing many goods collectively that individual members cannot provide for themselves	Slow to react to changes in the environment	Might fail in inducing technical change
EFFICIENCY	Some basic social relations cannot be provided by pure market mechanisms	Some goods cannot be delivered at sufficiently low costs	Slow to enhance efficiency and speed of adaptation, except in industries where technology is complex and rapidly changing	Facilitates cooperation and X-efficiency but not allocation efficiency	Deficient in cooperation and X-efficiency	Can be highly bureaucratic and cannot easily deliver goods at low cost
EQUITY	Facilitates inequality in income and wealth	Might lead to retarded development	When widely developed into industrial districts, networks may facilitate greater equality and income distribution. When weakly developed, networks tend to increase societal inequality	Narrow encompassing associational structures lead to income inequality	Excessive multiplication of controllers (frustration and inequality)	Might enhance inequality (power and privilege)

III.2. The various coordinating mechanisms are more complementary than substitute

The previous results have an important implication: the imperfections of one mechanism are to be corrected by another one, that itself calls for a third and different coordinating mechanism. The example of financial markets is enlightening: what is generally conceived as a pure market do suppose an organization of the transactions under the aegis of an association or a firm, themselves under the supervision of a public agency in charge of preserving the transparency and fairness of transactions. This agency can be captured by lobbies and this may call for direct State intervention. This complex mix displays different configuration across countries and is under permanent threat to be eroded by the generalization of opportunistic behavior. Consequently, the hegemony of a single IR is quite unlikely and generally successful configurations organize a de facto complementary between a whole spectrum of IR (figure 6).

Figure 6 – Combining various and complementary institutional arrangements in order to get a viable configuration



III.3. A definition of complementarity and related concepts

Actually, there is a risk of confusion of complementarity with seemingly similar but distinct concepts. The emergence of this term has been associated with some implicit hypotheses that have to be spelled out.

III.3.1 Supermodularity

Two elements E and E' are said to be supermodular if the performance R of the conjunction of E and E' is superior to any other mix of elements i.e.

$$R(E,E') > R(E,A)\ \forall\ A \neq E' \text{ and } R(E,E') > R(B,E')\ \forall\ B \neq E$$

This precise definition put strong limits to the use of the notion of supermodularity. First the analyst has to explicit a criteria of performance that is not so evident (profit maximization for the firm, but what for capitalist economies as a whole: average profit rate , rate of growth, total factor productivity, level of employment and activity, equalitarian distribution of incomes, wealth,…). Second, the concept is clearly associated with the idea of optimum and maximization, a core trend of economic analysis but it is not necessarily so for sociology, law, history and so on. Basically, only sophisticated models (see for instance Amable et al. 2001) are able to prove such a supermodularity. But how can we diagnose supermodularity? It cannot be done by direct observation, since it requires the construction of a formal model engendering a series of fictitious worlds.

A good *example* of possible supermodularity relates to productive models. It has been argued that just in time, total quality control and high skill workers define a genuine productive model at odds with the previous Fordist model whereby mass-production of standardized good required less competence from the workers and less demanding consumers in terms of quality. The very concept of supermodularity has precisely been used in order to show that a continuous and piece mal adjustment of managerial tools was not able to promote the transition from the old to the new productive model (Milgrom and Roberts 1990).

III.3.2 Complementarity

Two elements E and E' are said to be complementary if the performance R of the conjunction of E and E' is superior to the performance of each element considered separately, i.e.

$R(E,E') > R(E)$ and $R(E,E') > R(E')$

The concept of complementarity is less demanding that supermodularity, since it only requires that the conjunction of two elements is Pareto improving with respect to the existence of only one of the two entities. Nevertheless, both complementarity and supermodularity require the choice of a performance criteria R and the ability to compare various systems in order to check the basic property. Either by using formal models or by observing a hierarchy in the ranking of systems composed respectively of only E, only E' or both E and E'.

Some examples of possible complementarity might be useful to grasp the nature of this concept. According to many authors, a financial regime governed by direct finance is complementary with weak unions and the domination of short-term strategies and conversely, a patient financial regime built upon banks credit is complementary to a strong union, both involved into long-term strategies. Another example associates as complementary an accommodating monetary policy and flexible labor markets, a typical American configuration, whereas the monetary regime associated to a conservative central banker is seen as complementary to rigid labor markets that are supposed to explain European unemployment.

III.3.3 Compatibility

This third notion is frequently confused with the second one…but it should not! Actually E and E' are compatible if they can be jointly observed in existing economies and societies, i.e.

There exists an economy such that: $E \cap E' \neq \emptyset$

An interesting *example* is provided by Martin Höpner (2003) when he investigates the links between the dual management board system and employees' codetermination. The tenants of a strong variant of VOC would call these institutions as *complementary* – having observed the good "performance" of the German economy until the early 90s – whereas the observation only says that they are *compatible*. The proof of complementarity would call for a theoretical model adding up and/or subtracting a complete series of institutions and assessing the related impact upon an agreed measure of performance.

IV. DEVELOPED ECONOMIES: A SUGGESTIVE INTERPRETATION OF MAIN STYLIZED FACTS

Frequently, institutions are conceived as pure constraints that are detrimental to economic efficiency because they block the free adjustments of preferences and production constraints via price formation. For Douglass North (1990) they are also enablers for the strategy of individuals, in dealing with uncertainty, coordination and interpretation of information. Thus, contrary to Chicago school's conceptions, some mix of institutions may deliver better economic and/or social outcomes that a pure market economy. This conception considers that some constraints restricting economic opportunism, short-termism or allow the supply of some public goods, are quite essential to the competitiveness of firms and thus they may have beneficial impact on economic and social outcomes (Streeck 1997).

IV.1. The origin of a paradox

In the Walrasian tradition, the equilibrium prices make compatible preferences and technological constraints. This feature can be captured by the following equation that expresses that excess demand for each product and factor market is equal to zero.

$$\underset{\text{Net excess demand}}{Z} = f\,(\underset{\text{Price}}{p},\ \underset{\text{Preferences}}{\mathcal{P}},\ \underset{\text{Technology}}{\mathcal{T}}) \Longrightarrow \underset{\text{Equilibrium price}}{0} \quad \underset{\text{Walrasian equilibrium}}{[\,\underset{\text{}}{p^w}\ \ \underset{\text{Consumption}}{C^w},\ \ \underset{\text{Employment}}{N^w}\,]}$$

Unfortunately, the Walrasian auctioneer i.e. the global market maker, does not exist and has to be replaced by a series of institutions: a monetary regime (I_1), a competition law, labor market institutions (I_2). Therefore, individuals now not only react to the price signals but also according to the existing institutions that shape the formation of prices. *A priori* this institution rich economy displays a different equilibrium

$$\underset{\text{Net excess demand}}{Z} = g\ (\underset{\text{price}}{p},\ \underset{\text{Institutions}}{I_1,\ \ I_2}) \Longrightarrow \underset{\text{Equilibrium price}}{0} \quad \underset{\text{Institutional equilibrium}}{[\,p^i\ \ \underset{\text{Consumption}}{C^i},\ \ \underset{\text{Employment}}{N^i}\,]}$$

For most economists, the name of the game is to compare the outcome of a totally abstract economy, the Walrasian one, for which any market equilibrium is Pareto optimum, with a more realistic economy with various institutions but still an auctioneer. It is easy to understand then that any institution can only deteriorate the fit between preferences and technological possibilities. But if really existing decentralized imperfect markets are introduced, the various institutions might help in reaching a satisfactory equilibrium. Ideally, the various institutional settings should be compared according to their economic and social outcomes. But this requires the equivalent of a social welfare function in order to derive a single index out of the distribution of economic outcomes among individuals. Concerning the issue of complementarity, this very simple formalization might help in understanding the difference between compatibility and complementarity.

Compatibility among institutions is observed when there exists a set of equilibrium prices, consumption and employment. Such a property is not necessarily fulfilled and thus this is a discriminating criteria in the assessment of the viability of alternative institutional architectures.

$$I_1 \text{ and } I_2 \quad \text{are compatible if there exists an equilibrium} \quad E(I_1, I_2) \neq \varnothing$$

Complementarity is a much more demanding criteria. First, the analyst has to compute an equilibrium with only the first institution I_1 i.e. $E(I_1)$ and repeat the same operation for institution I_2. Second, one adds the second institution and has to compute the new equilibrium $E\ (I_1, I_2)$. Third and it is still more difficult, the economist has to adopt a welfare function in order to compare the two equilibria. Finally, the institutions I_1 and I_2 will be said complementary if their joint presence delivers a better outcome than each of the separate institutions. It can be captured by the two following conditions:

$$I_1 \text{ and } I_2 \quad \text{are complementary if} \quad E(I_1, I_2) \succ E(I_1) \qquad \text{and} \qquad E(I_1, I_2) \succ E(I_2)$$

IV.2. Four examples

If one stick to *general equilibrium theory*, one could introduce two discrepancies with respect to the conditions that deliver an equilibrium. First increasing returns to scale (H_1), second imperfect competition or more precisely oligopolistic pricing (H_2) have positive influence upon the existence of an equilibrium. Whereas a pure competitive (H_0) equilibrium does not exist with (H_1), the existence of imperfect competition entitles the existence of an equilibrium i.e.

$$E(H_1 , H_2) \succ E(H_1, H_0)$$

Recent research about *institutional complementarity* (Amable et al. 2002) shows by formal modeling that strong unions (SU) and patient capital (PC) provided by bank credit may deliver better macroeconomic outcomes than competitive labor (CL) markets and short-termism (ST) capital markets, i.e.

$$E(SU, PC) \succ E(CL, PC) \quad \text{and} \quad E(SU, PC) \succ E(SU, ST)$$

Similarly, theoretical and empirical investigations exhibit a rather surprising complementarity (Amable 2003; 2004). Traditionally, economists consider that product market deregulation (PMD) and labor market flexibility (LMF) strategies are to be undertaken simultaneously, because they complement one with another. But empirical analysis shows that a second configuration is built upon the complementarity between product market regulation (PMR) and a significant institutionalization of labor mobility (ILM). By contrast, the intermediate configurations (deregulation of one market, but strong regulation of the other one) display less satisfactory outcomes in terms of growth and employment.

$$E(PMD, LMF) \approx E(PMR, ILM) \text{ and } E(PMD, ILM) \prec E(PMD, LMF) \text{ ; } E(PMR, LMF) \prec E(PMR, ILM)$$

The viability of *a banking system* is threatened by periodic bank runs especially when free banking (FB) and fierce competition (FC) prevail. This has triggered the efforts of economists in order to find out regulations that could prevent such dramatic episodes. After nearly two centuries of recurring banking crises, practitioners and analysts finally find out the complementarity of two corrective devices. On one side a deposit insurance (DI) reduces the probability of bank runs but it simultaneously might induce banks to take more risk for their credit activities. Thus, on the other side, prudential ratios (PR) have been imposed in proportion to the risk taken for each category of credit (Borio 2003). We find again that this institutional equilibrium is better that the constraint- free equilibrium:

$$E(DI, PR) \succ E(DI, FB) \quad \text{and} \quad E(DI, PR) \succ E(FC, PR)$$

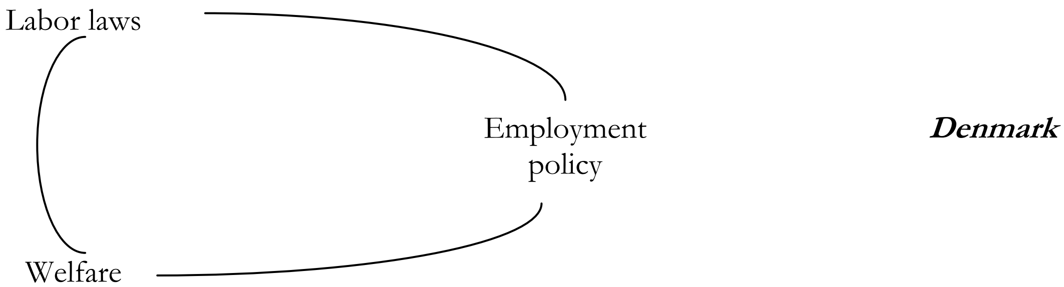
This leads to two general proposals expressing the same idea. First, *two imperfections might be better than a single one*, since they correct each other potential unbalances. Second, *two constraints might be beneficial* to the quality of economic equilibrium and social outcomes, provided they adequately interact each with another.

IV.3. From dyadic to triadic complementarity: towards an understanding of complex institutional architectures

The analysis can be pushed one step forward since the ICH extended to more than two institutions. Actually, when social scientists diagnose the existence of socio-economic models, they mobilize a complex web of institutions, organizations and markets.

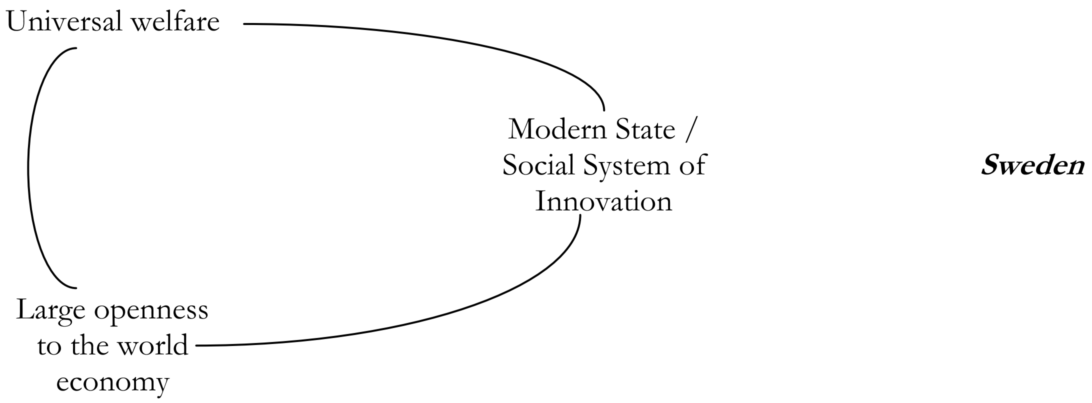
- The now well known *flexicurity model* is based upon the synergy of three components (Boyer 2006a). Quite permissive labor laws concerning the hiring and firing of workers generate intense flows on the labor market. Such a permanent flux is accepted by workers under the condition of quite generous unemployment benefits. In order to counteract the possible adverse effects of this generosity upon the duration of unemployment, the system had to be completed by an active employment policy, based on a sophisticated mix of control of the unemployed and upgrading of their competencies (figure 7).

Figure 7 – The flexicurity configuration



- The Danish flexicurity is itself embedded into a *social democratic model*, typical of Scandinavian economies. They tend to show that a large openness to world competition can be associated to an extended universal welfare provided that the Social System of Innovation (SSI) is sufficiently dynamic and the State is responsive to the demands of citizens. It is the conjunction of at least four institutions (the welfare system, the form of competition, the style of innovation and finally the conception of the state) that is successful in terms of economic performance and limitation of inequalities. In isolation none of any single component could produce such a result, but each plays a determinant role in conjunction with others (figure 8).

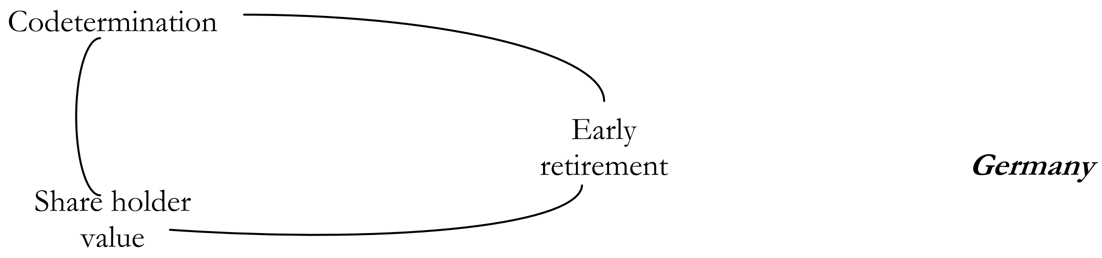
Figure 8 – The small open social democratic economy



- The contemporary *German configuration* is a good example of a triadic complementarity. A careful study of the transformation of the structure of governance of German firms (Hopner

2001) has exhibited a surprising compatibility between the adoption of shareholder value and the persistence of a significant power of wage earners via codetermination laws. How is such apparent oxymorum possible? One answer is precisely that a third institution, the welfare state allows the restructuring and employment reduction required by shareholder value by its financing of early retirement and unemployment (Boyer 2006b). The initial mismatch between two managerial styles has been overcome by a socialization by public budget of the externalities thus generated (figure 9).

Figure 9 – an atypical complementarity



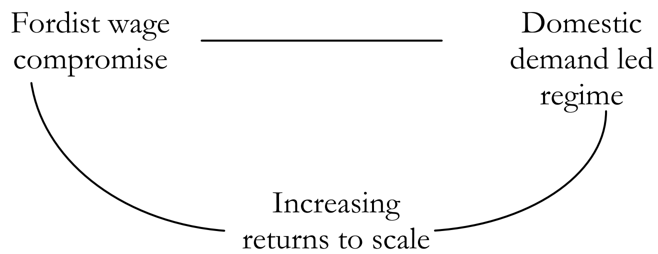
These examples point out a specificity of the present analytical framework. Instead of analyzing separately the efficiency (and legitimacy) of any single institution, ICH deals with the coherence and viability of a whole institutional architecture. Therefore, the association of so-called "imperfect institutions" may sustain a rather efficient configuration. Given the diversity of formal and informal organizations in developing countries, this methodology is quite useful in order to detect and explicit actual institutional configurations, faraway from typical text book representation of a pure market economy.

IV.4. The institutional complementarity at the level of growth regimes

One may analyze the institutional configurations from the point of view of the viability of a growth regime and take the rate of growth as one of the criteria for deciding about the complementarity of a given set of institutions. This has proven to be useful in order to understand the difference among growth regimes within OECD economies.

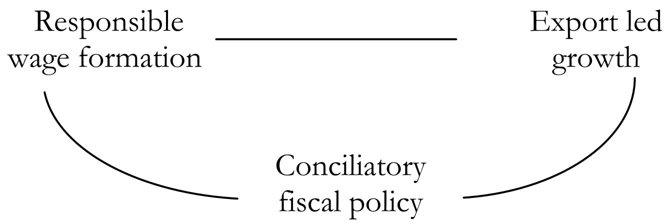
- For medium or large size economies during the Golden Age, the so called Fordist growth was based upon three core institutional arrangements: collective agreements that codified the synchronization of productivity and wage increases, a mass production system of standardized goods capturing increasing returns to scale and finally a large degree of autonomy with respect to foreign competition (figure 10).

Figure 10 – The golden age Fordist growth regimes



- For small open economies, the precise mix of institutions that shape the growth regime is quite different from the previous one. The wages are set in the exporting sector in accordance with the preservation of the competitiveness of domestic firms in order to be compatible with the requirement of an export led growth. The productive organization is based upon the differentiation of products by quality and innovation. These complementarities do shape a growth regime that is a priori quite adapted to the new trends of the international economy (figure 11).

Figure 11 — The Scandinavian social pacts



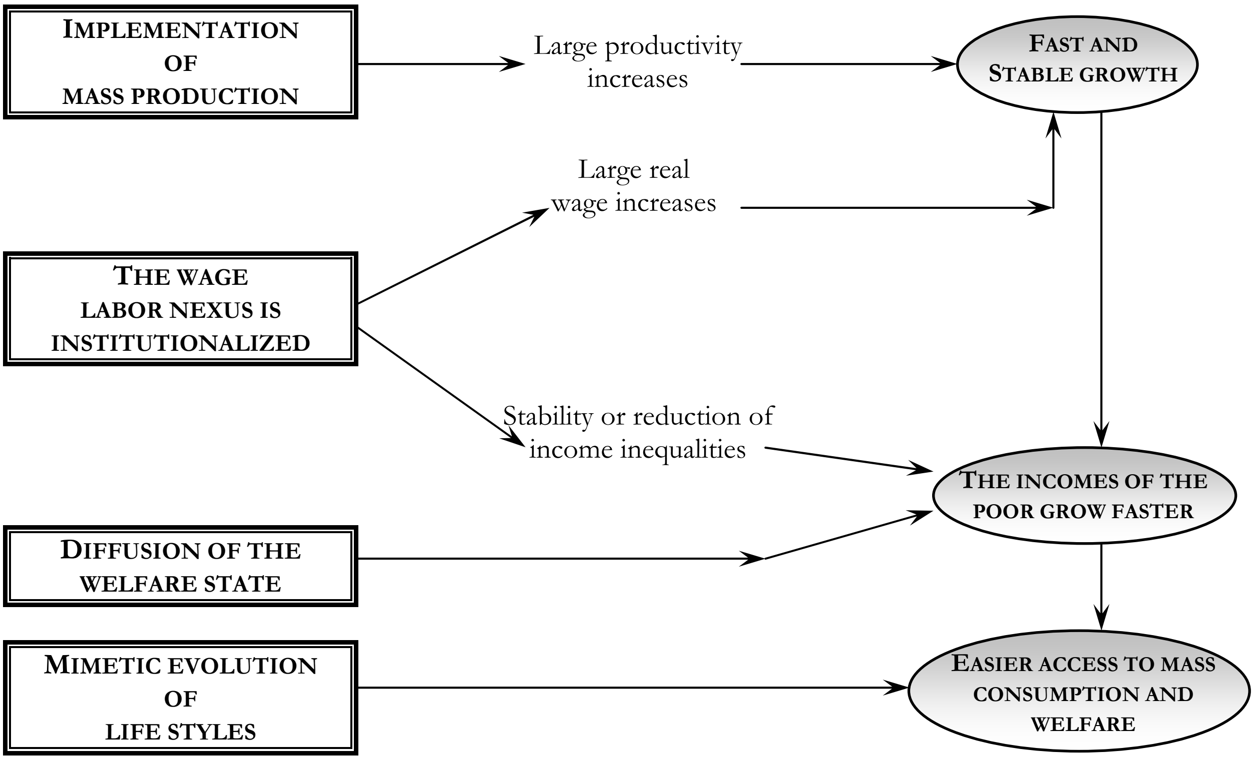
Therefore, the concept of institutional complementarity is quite useful in order to understand simultaneously the coherence and the diversity of growth regimes. It is of special interest when this methodology is extended to developing countries: given quite different mixes of formal and informal institutional arrangements, the related growth regimes may differ from those already detected for mature economies.

IV.5.Some welfare systems may generate virtuous circles…but do not last for ever

It is now possible to deal the issue of welfare: can redistributive measures sustain a dynamic growth regime? Retrospective and comparative analyses suggest the possible compatibility or even more complementarity between a large welfare State and a dynamic growth regime.

- Within the *Fordist growth regime*, the intensity and predictability of productivity increases was sustaining a very specific capital labor accord that was codifying an institutionalized increase of real wage in line with productivity. This was the key component of an original growth regime that was satisfying the objective of each collective actor: high and stable profit for entrepreneurs, near full-employment and better standards of living for wage-earners, buoyant tax base for State and social welfare financing. Thus, contrary to the teaching of a pure short run macroeconomic analysis, an extended system of income redistribution and supply of public goods (education, health, security in response to unemployment,…) was exerting a positive role upon the stability and the legitimacy of this new institutional architecture (figure 12).

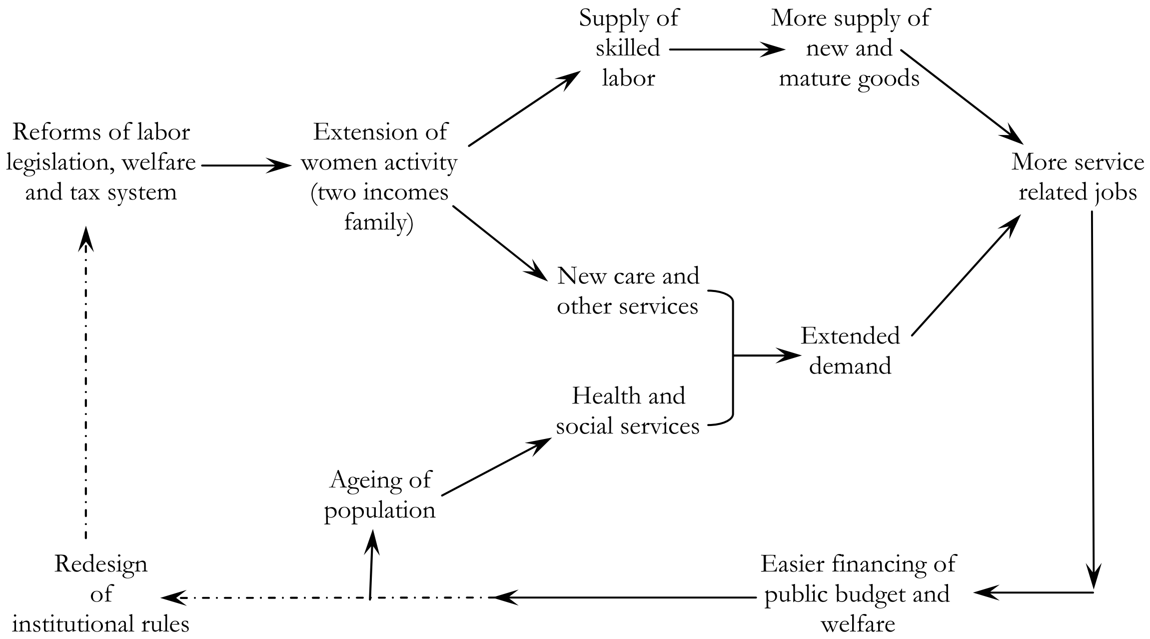
Figure 12 – An extended welfare: a key component of the Fordist growth regime



- The demise of this quite interesting regime brings at the forefront a key finding by *régulation* theory: the *very success* of this institutional configuration has brought *adverse trends* that have been cumulating and have transformed a virtuous circle into a vicious one. Firstly, the productive potential of Fordist methods has been exhausting through time. Secondly, the search for increasing returns to scale has triggered an unprecedented internationalization first of exchanges and then of production. Thirdly, financial liberalization, both internal and external, has eroded the previous institutionalized compromises, especially in terms of tax competition among national State. Hence a central conclusion: no institutional configuration, however efficient and satisfactory for social actors in the early beginning, can last forever. This is an important difference with respect to a branch of the economics of institutions based upon an intensive use of the hypothesis of rational expectation and the search for steady state growth regime.

- Should one conclude from the previous statement that the epoch of the complementarity between an extended welfare and an efficient growth regime is over? Clearly, many OECD countries experience recurring financial deficits affecting the various components of their Welfare systems, especially concerning healthcare and pensions. But again, the small open *Scandinavian economies* exhibit an interesting counterexample. Of course, the various subsystems (unemployment benefit, pensions, health,…) have been rationalized, but the creation of new collective rights in response to emerging social needs has generated a *new virtuous circle* between a rejuvenated welfare State and an innovation led growth regime. Basically, the effective implementation of full *gender equality* has triggered an extension of labor supply for women, whereas this move has generated new jobs in the service sector in the direction of child care, *elderly care* and health. Coupled with a knowledge based economy, this domestic internal economics circuit has proven to be quite satisfactory in terms of response to social demand from citizens (figure 13).

Figure 13 – Gender equality and responses to ageing as the source of a new service led growth



This is an invitation to investigate how the various institutional arrangements put forward by figure 1 can be combined in order to take into account the large diversity of contemporary Welfare States.

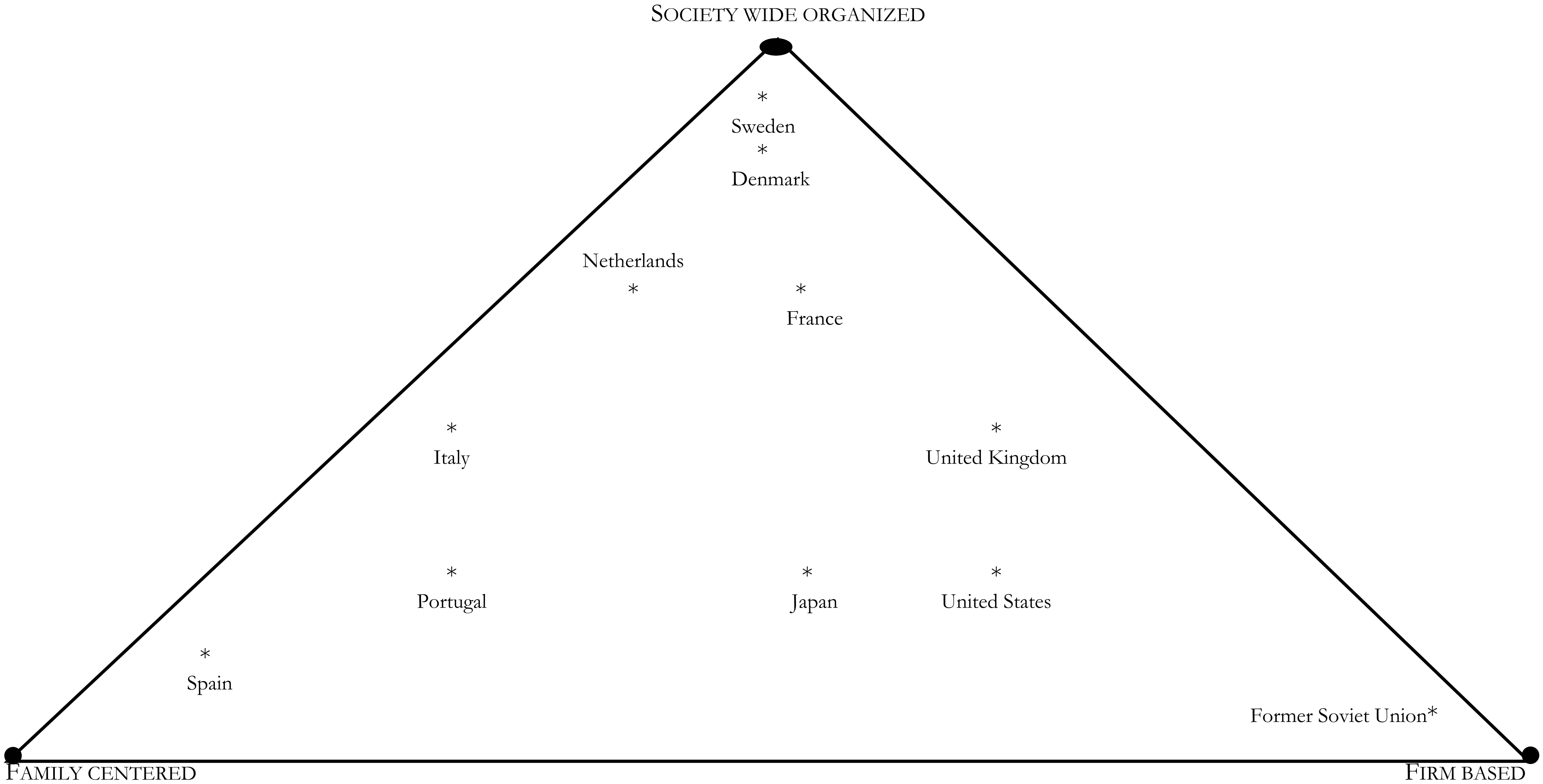
IV.6.The diversity of welfare configurations

The central idea is to map the previous "molecules" into the structure of the costs and benefits associated with each of the three spheres. Each national system is defined by the share of welfare fulfilled within families (domestic order), within large firms (corporatist or paternalistic strategy) or across the whole society via State interventions (citizenship as a basis for collective solidarity). One gets the following description of social security systems (figure 14).

- Some countries exhibit a clear domination of a leading sphere. Former Soviet Union was a good example of a *firm based welfare*, since a majority of the benefits used to be provided by the firm, be they under a monetary payment or by direct provision of health, education leisure. By contrast, Sweden and Denmark are emblematic for *society wide organized welfare*, with universalistic values and a financing by general taxation. Southern Europe is a good example of the lasting role of *family centered solidarity*. The idea put forward by New Labor in UK would suggest that this is not necessarily an archaism (Giddens 1998) when the solidarity is extended from the family to the community and civil society supposed to manufacture trust and security (Fukuyama 1996).

- But generally speaking, most systems *combine the three sources of solidarity*. In Japan for instance, a firm based social welfare goes along with an important role of the family, as well as a residual role of a minimalist society wide welfare. In France, the ideal of social security, i.e. society wide welfare is mitigated by the fact that the financing and in some case the supply of many components are provided by the firms. In the US, the provision of welfare is largely attached to the labor contract negotiated between the workers and the firms, with some limited examples of society wide welfare for specific categories of population. Under this respect, *most Welfare States are hydrid.*

Figure 14 – At the origin of Welfare State diversity: three logics and organizing principles



IV.7."Commodification" is not the only future of welfare systems.

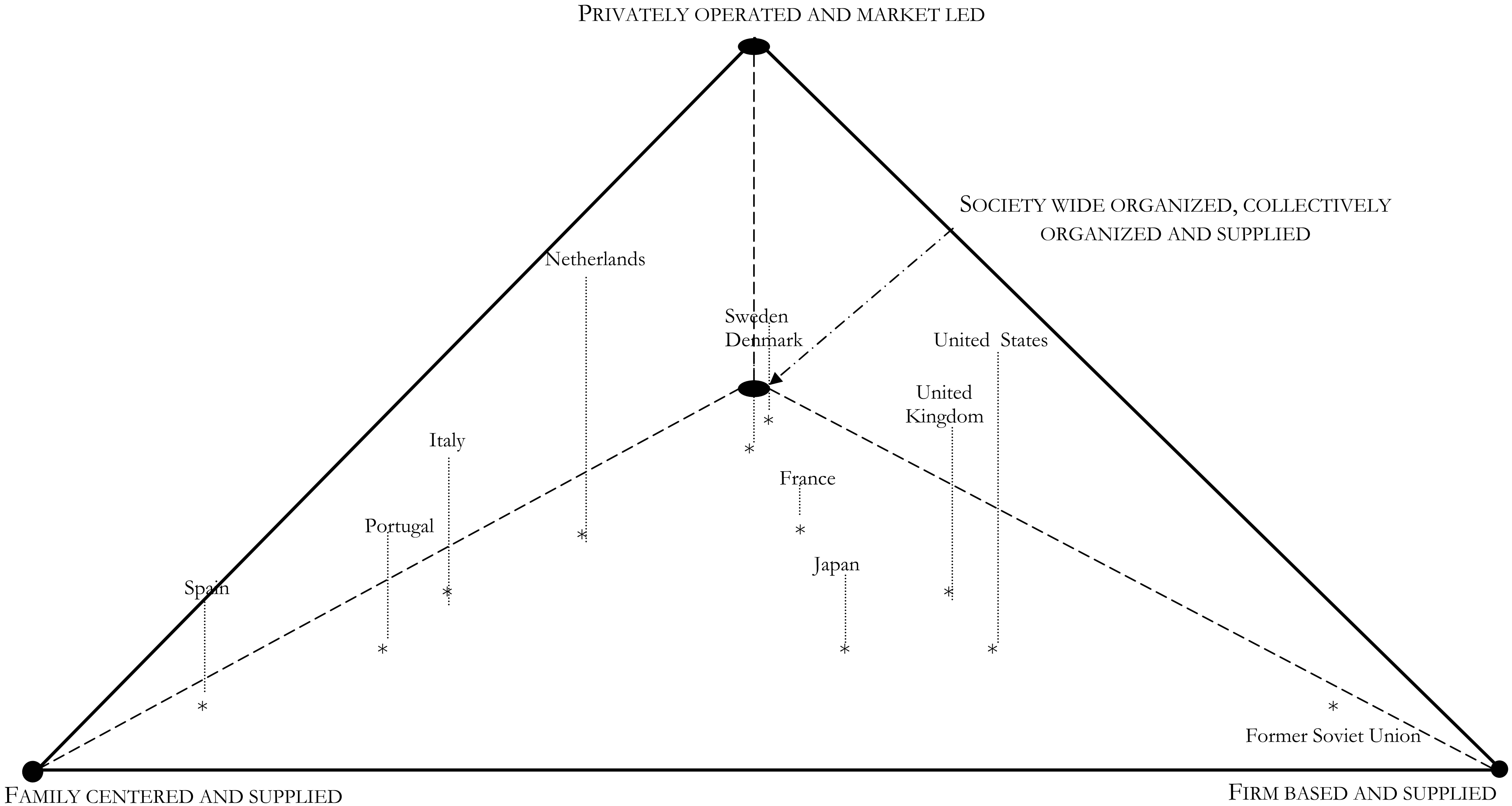
The contemporary issue, widely discussed, about the role that should be attributed to privatization and market competition (Le Grand and Bartlett 1993; Esping-Andersen 1996; Myles and Pierson 2000) is thus largely redefined (figure 15). Basically, each society manifests a strong path dependency that is not due to pure historical accidents or circumstances but the very nature of social protection (Bonoli and Palier 1999; Palier and Bonoli 2000). The major issue, and the French case is quite enlightening under this respect, is the evolution within the triangle (State, family, firm). For instance, catching-up countries might need to replace domestic solidarity by society wide organization and this is the case for Spain and Portugal. Other societies, such as the German and the French ones, might call for a progressive shift from a typical Bismarckian system, i.e. largely firm based, toward more Beveridgian, Scandinavian type configuration.

Only few national social security systems display a clear move towards privatization and quasi market competition in the supply of welfare. A key reference under with respect is the Chilean strong move toward a leading role of private insurance, with a mixed evidence about the gain in terms of efficiency and the clear non egalitarian consequences for instance for health care provision (WHO, 2000:109). The second example is of course the American privatization of pensions, in a sense largely idiosyncratic to the North American Society (Montagne 2000; O'Sullivan 2000). But the most intriguing trajectory relates to the Dutch case: the extension of universal social rights concerning for example a fully equal treatment of part time and full time jobs has been associated with a significant reliance to market mechanisms for the provision of welfare (De Beer and Luttikhuizen 1998; Barbier and Theret 2000; Esping-Andersen 2000).

Therefore the choice is not between a *purely public* welfare and a *totally privatized* one, but governments and social partners are facing the tricky problem of *reforming* rather idiosyncratic configurations, that manifest strong path dependence and combine various logic and regimes for welfare provision (figure 16). At least four forces shape the contemporary transformations.

- The *privatization strategy* is strengthened by the emergence of a finance led regime (Boyer 2000b) that develop so quickly stock markets that the old pay-as-you-go systems are presented as inefficient and even unfair, since workers do not get their share of the increased financial wealth (Orléan 2000). But many obstacles prevent the implementation of market mechanisms in the other welfare regimes, such as family, unemployment or sickness. Even the constitution of *quasi markets* between independent, generally non profit, institutions competing from the supply of welfare benefit is not so easy given the inertia and localization of the supply, the difficult of entry, the poor assessment of quality, the large transaction costs associated to the management of this competition by regional public bodies. Furthermore, if strict rules are not set by public authorities such as block contracts, private firms could cream skim the market and let the most severe risks to the public welfare (Le Grand and Bartlett 1993). Not to forget that the Chilean and American cases show a clear increase in inequality in the access to welfare, as a consequence of privatization.

Figure 15 – Introducing market mechanisms in Welfare States: A fourth dimension.

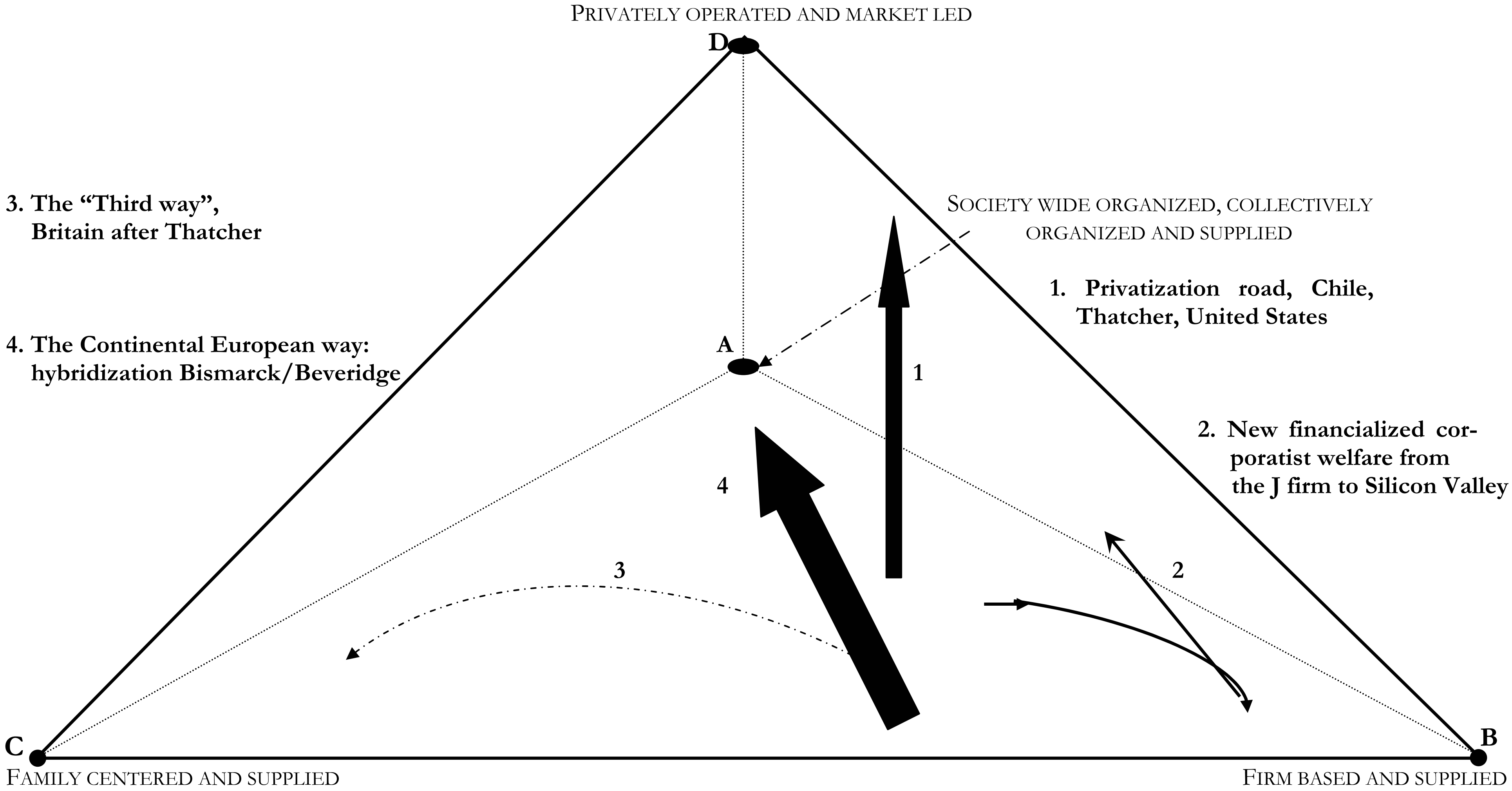


- A *new financialized corporatist welfare* is also emerging in the most dynamic industries or regions. In a sense it is an updating of the so-called Japanese model. Actually, until the early 90s, the Japanese employment system had been perceived as quite efficient and the industrial welfare provided by the large firm was conceived as complementing the internal labor market (Hanada and Hirano, 2000). This system is now under strain due to the poor macroeconomic performance of the Japanese economy and the difficulty for firms to provide the expected amount of welfare, especially pensions, given the low profit and the tiny real return of financial assets. But the management of some ICT American firms, for instance in the Silicon Valley, is in fact updating this model. First, the Japanese profit sharing is replaced by the diffusion of stock options and some components of welfare are idiosyncratically adjusted to the needs of each employees, in order to prevent him(her) to move to another company or even launch his(her) own start-up. Such an implicit welfare model cannot pretend to be universal, since it concerns mainly high level professionals, holders of scarce competence in high demand on the international market.

- A *community based welfare* is too an updating of the family centered welfare typical of some contemporary economies, such as the Asian NICs. Actually, even in Europe, the mass unemployment hitting specially the young workers and the early retired employees has put forward the solidarity organized within the family and this still is a typical pattern for Southern Europe. Statistical surveys do show an increase in intergenerational transfers, largely a compensating mechanism for deficient society wide welfare. In a sense, the New Labor is theorizing this process and trying to extend the solidarity from the domestic circle to the community wider scale. It remains to be seen that will be the actual consequences of these theoretical conceptions upon the management of the British welfare. In any case, such a model cannot pretend to be the dominant one for many reasons. First, the family structure is transforming itself toward a two sources of income and gender neutral configuration that calls for a redesign of universal welfare as a precondition for its viability (Majnoni d'Intignano 1999; Esping-Andersen 2000; Théret 2000). Second, the same family or community pattern cannot generally prevail in Europe given the diversity of the national trajectories since one century. Third, from a theoretical point of view, the internationalization and financialization of modern economy propagate new risks that can only be insured at a wider level than the family or the community.

- A *modernization of universal welfare* is far from defining an obsolete model. From a conceptual point of view, this is one of the best responses to globalization and it is not an accident if small open economies are at the forefront in the redesign of such a welfare model. By the way, it has to be remember that Sweden, Finland, Denmark experience a very good record in terms of technological advances and the insertion into the ICT revolution, while preserving the society wide character of their Welfare State (see figures 3, 8 and 13 supra). If institutionally the losers are sure to be compensated by the winners, then the speed of technical change can be enhanced, national competitiveness preserved, thus reconciling dynamic efficiency with social justice (see figure 2, supra). Contrary to a widely held belief, the negotiation by social partners of social pacts that set new rules for wage formation and welfare reforms is as efficient or even more than a typical market led strategy (Fitoussi and Passet 2000). Under this respect, in the 90s the Dutch model was widely recognized as one way quite different from the "*Third way*" but no less attractive (Visser and Hemerijck 1997). In 2007, the Danish flexicurity model is the implicit or explicit reference of most experts and policy makers in the domain of welfare (Boyer 2006a).

Figure 16 – Four strategies for reforming the Welfare States: Contrasted national trajectories.



This reminds that welfare systems do *co-evolve* along with national conceptions about *social justice, political institutions* that convert them into specific tax systems and social security regimes, and *economic specialization*. Given the present comparative evidence, it would be an *overstatement to conclude that there is a single best way for organizing welfare*, be it market-led, firm based, community centered or Society wide and collectively organized. For developing countries, this widens the scope of possible antipoverty policies that have to be tailored to their specific features and objectives.

V. DEVELOPMENT AND POVERTY REDUCTION STRATEGIES: SOME PRELIMINARY RESULTS

Are institutional complementarity approaches restricted to industrialized democratic countries? This section argues that developing countries should not necessarily *mimic* the best practices of rich economies detected by ICH, but that they may try to detect *genuine policies* by a creative use of the same methodology. Clearly, specific economic specializations dominated by primary resources, poor State capabilities, overwhelming role of the informal sector in employment relations are among the main *distinctive features* that call for idiosyncratic approaches, tailored for each local or national case.

V.1. Do not extrapolate successful policies designed for already developed countries

Under this respect, many social sciences might be victim of their ambition and search for generality, inspired by the methodological principles of natural sciences. *Macroeconomists* are working hard in order to find out the general structure of a model that would explain quite all contemporary issues in economic policy making. *Development economists* build frequently general equilibrium applied models and are tempted to consider that nearly the same key parameters do characterize most ,if not all, national economies. *Business schools* use intensively the detection of best practices in order to find out general principles for management, whatever the sector or the locality. This aspiration to universal laws, however in conformity with scientific methodology, may hide the specificity of social sciences: they have to deal with *a large variety of social political and economic organizations*, far more complex than the configurations studied by physics or chemistry.

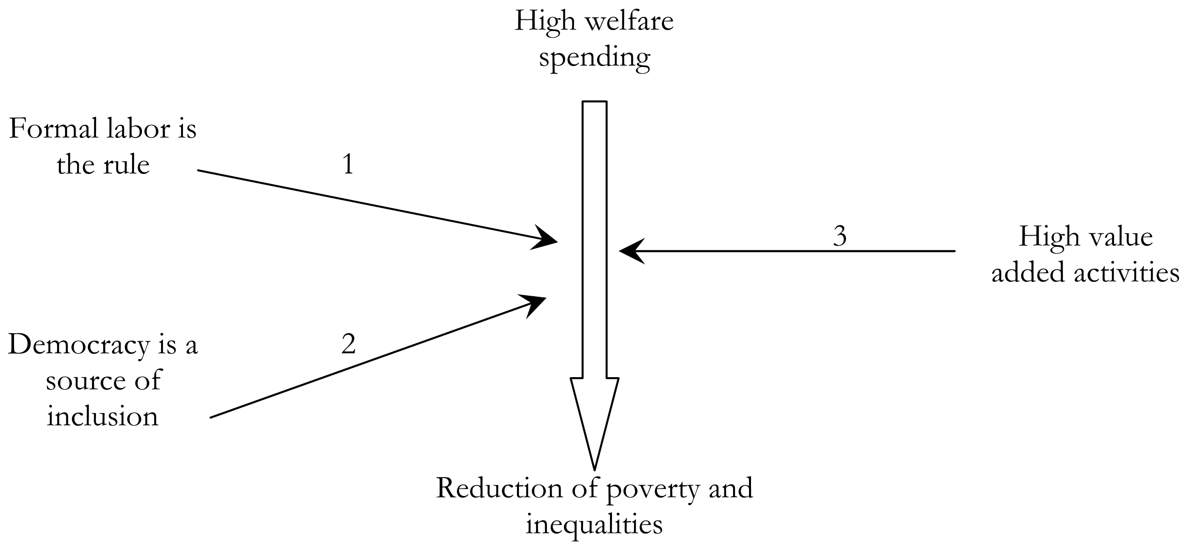
Let us take for example the Scandinavian social democratic countries as the reference and consider that the main if not exclusive determinant of low poverty rates is the large volume of spending for welfare. The policy recommendation in the direction of developing countries would be to extend welfare expenditures and eventually try to import the same organization. Some countries have followed such a path but they are far from reaping the same benefits in terms of poverty reduction and growth performance. The ICH helps in understanding why: a highly developed welfare goes along with three related and somehow complementary features (figure 17).

- By definition, welfare and employment legislations only apply to *formal labor*. Since it is highly developed in mature economies, the policy has a real impact upon the evolution of total employment and wage income.

- Clearly, the *general inclusion* of population into the *democratic process* gives everyone a say in the determination of economic and social policy, at least indirectly. One should not underestimate the impact of the access to the electoral process upon the incentives of governments to adopt welfare policies directed towards the mass – or the majority – of the population. Contemporary Brazil is a good example of the positive impact of democratization upon poverty reduction programs adoption (Draibe 2007).

- *High value added activities* can easily finance not only good wages but also a quite extended social insurance coverage. In a sense, the social democratic economies exhibit a complementarity between innovation-led growth regime and generous universal welfare State.

Figure 17 –Developed economies: poverty reduction by large welfare transfers, but the context matters



Examples: Social democratic economies (Finland, Denmark, Sweden)

These are the hidden or at least frequently neglected components of the general institutional architecture that sustains a universal welfare State. Therefore if they are not fulfilled, an isolated program of welfare extension will not deliver the same expected outcomes.

……But take into account the specific context of developing countries

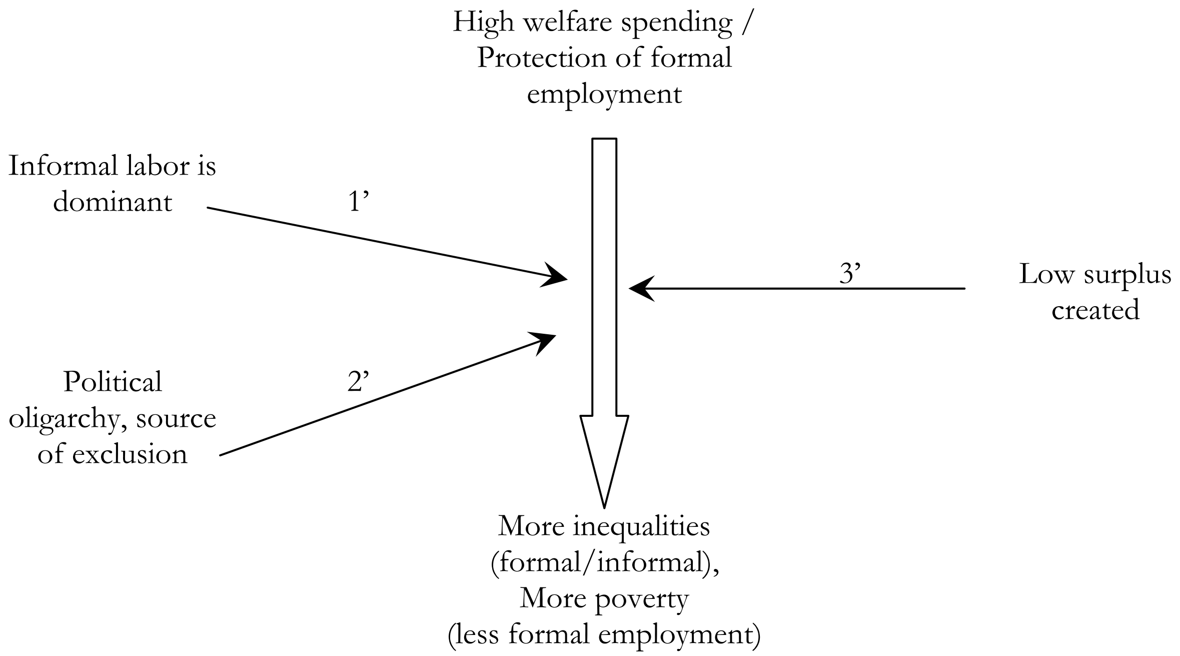
The Bostwana (Selolwane et al. 2007) and the South Africa (Leftwich 2007) cases incidentally deal with this issue. Given the local conditions, the antipoverty programs have had mitigated results, largely unintended. The present analytical ICH framework gives an interpretation of this process: the programs were not fitted to the local economic social and political configurations (figure 18).

- In a society where *informal labor* is the rule, the strengthening of labor protection and welfare of formal employment may exacerbate inequalities between formal and informal workers and even induce employers to move away from formal employment contract. The more so, the weakest State capacity to enforce regulations. A quite paradoxical and unintended outcome indeed…at least for policy makers if not trained economists.

- If the weakest groups of the population are somehow *excluded from the political process*, governments face no incentives to design and implement pro-poor policy, and this might be an explanation of the perverse mechanism pointed out by the previous paragraph. Only formal workers are able to influence the formation of political coalitions, whereas informal ones don't. The low mobilization of the poorest is directly related to the scarcity / modesty of antipoverty programs. Therefore, changes in the political sphere might be a precondition for an effective pro-poor policy. Brazil under President Lula exhibits such a correlation (Draibe 2007)

- Some localities, regions or countries are so poor that they cannot provide the minimum subsistence level to all the members of the society. In other cases, some surplus exists but it is appropriated by a small elite. In both cases, the *low productivity* of the economy *a priori* precludes the possibility of any redistribution towards the poorest, unless quite drastic and coherent structural changes take place in response to a major political, social or financial crisis.

Figure 18 – The poor countries context affects the outcome of the same policy



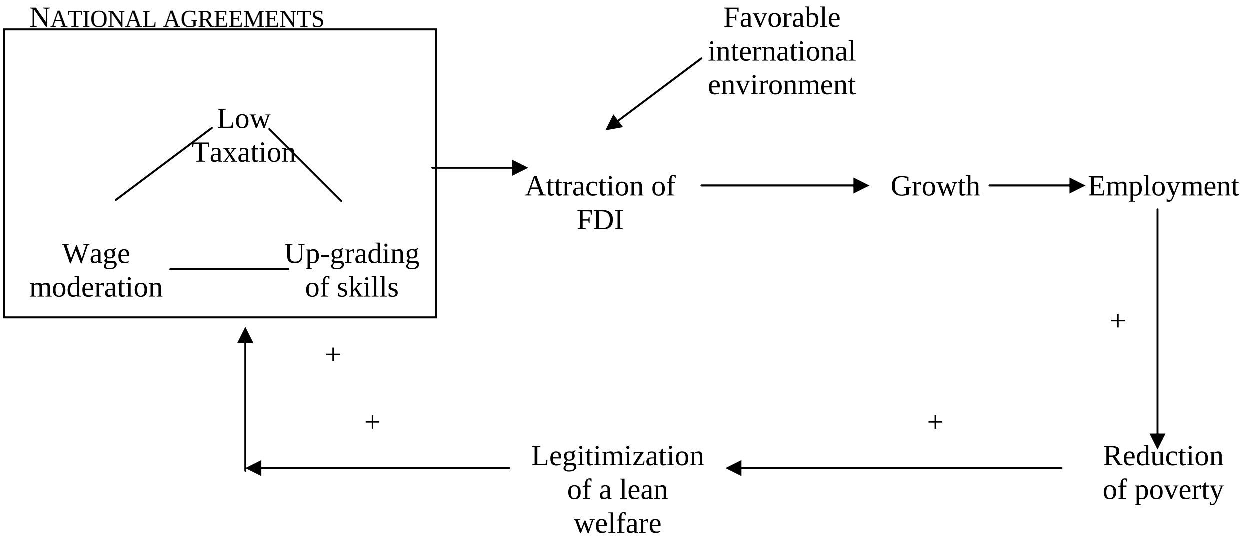
Examples: Botswana, South Africa

Consequently, the same policy does not have the same impact in any region of the world. This makes quite necessary an adequate diagnosis of the factors limiting productivity, growth, employment (see section VI.2, infra).

V.2. The art of creating virtuous circles by coordinated policies….

Contrary to the vision popularized by an extreme interpretation of path dependence (Crouch 1999; Streeck and Thelen 2005), such vicious circles, whereby underdevelopment and mass poverty reinforce each other, can be broken down in special circumstances when for instance a acute social, economic and political crisis make impossible the reproduction of the past, especially if the international relations change and a new productive paradigm emerges (see figure 5 supra). Actually, the Irish case (Kirby 2007) is a good example of such a change in a long term trajectory along which poverty was perceived as a fatality. Virtuous circles, if not miracles, can be created by collective action (figure 19).

Figure 19 – The creating virtuous circles: searching for complementarity institutional reforms and policies (Ireland)



The success, observed ex post, seems to proceed from the synchronization of *complementary policies*. All of them aim at shifting economic specialization towards high added value activities:

- In order to attract high tech multinationals, the *taxation* of profit should be kept low by comparison of alternative location in Europe. The subsidies generated by the adhesion of Ireland to Europe have also played a role in the building of modern infrastructures, as a source of competitiveness.

- National agreements between entrepreneurs association, unions and State look for the competitiveness of the Irish territory via a complex mix of *wage moderation*, *skill formation* various incentives in the direction of an *industrial policy and innovation*.

- A rather *lean Welfare State* built upon minimal levels of universal entitlements to income along with market supplied services.

One does not observe a big push in welfare but the dynamism of growth, employment creation and productivity increases finally trickle down and eradicate a large fraction of poverty, without any clear redistribution of income from the rich to the poor. Even if the disadvantaged are treated as a residual category (Hardman 1998, quoted by Kirby 2007), a virtuous circle has taken place in Ireland, largely based upon complementary policies, without a leading role for welfare policy.

….but they do not last for ever!

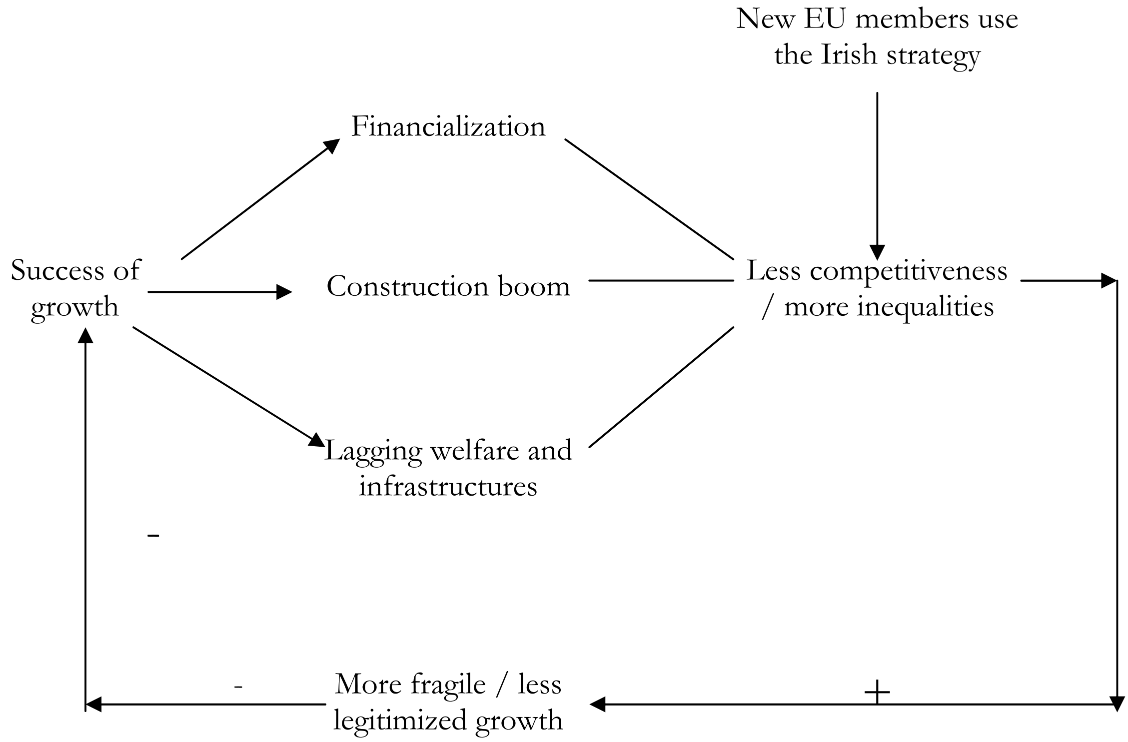
This is of course a limit of the "Celtic tiger" model: poverty reduction does not mean a stabilization of inequalities. But it is not the only one, since the maturation of this new growth regime generates a series of structural transformations and emerging disequilibria (figure 20).

- The shift of employment creation from the manufacturing sector to the financial sector and the construction may *destabilize* the previous source of *competitiveness* and the very engine of Irish *growth*.

- These structural changes also bring a widening of income and wealth distribution and in such a context, the minimalist welfare State could be perceived as *insufficient* and this could trigger a *de-legitimization* of current policies.

- Finally, the *international context* may turn less favorable, the net transfers from the European budget level off and new EU members may outperform Ireland by using the same strategy but more efficiently. This is a major risk to the Irish strategy of reduction of poverty, essentially economic led.

Figure 20 – The tensions in the Irish configuration

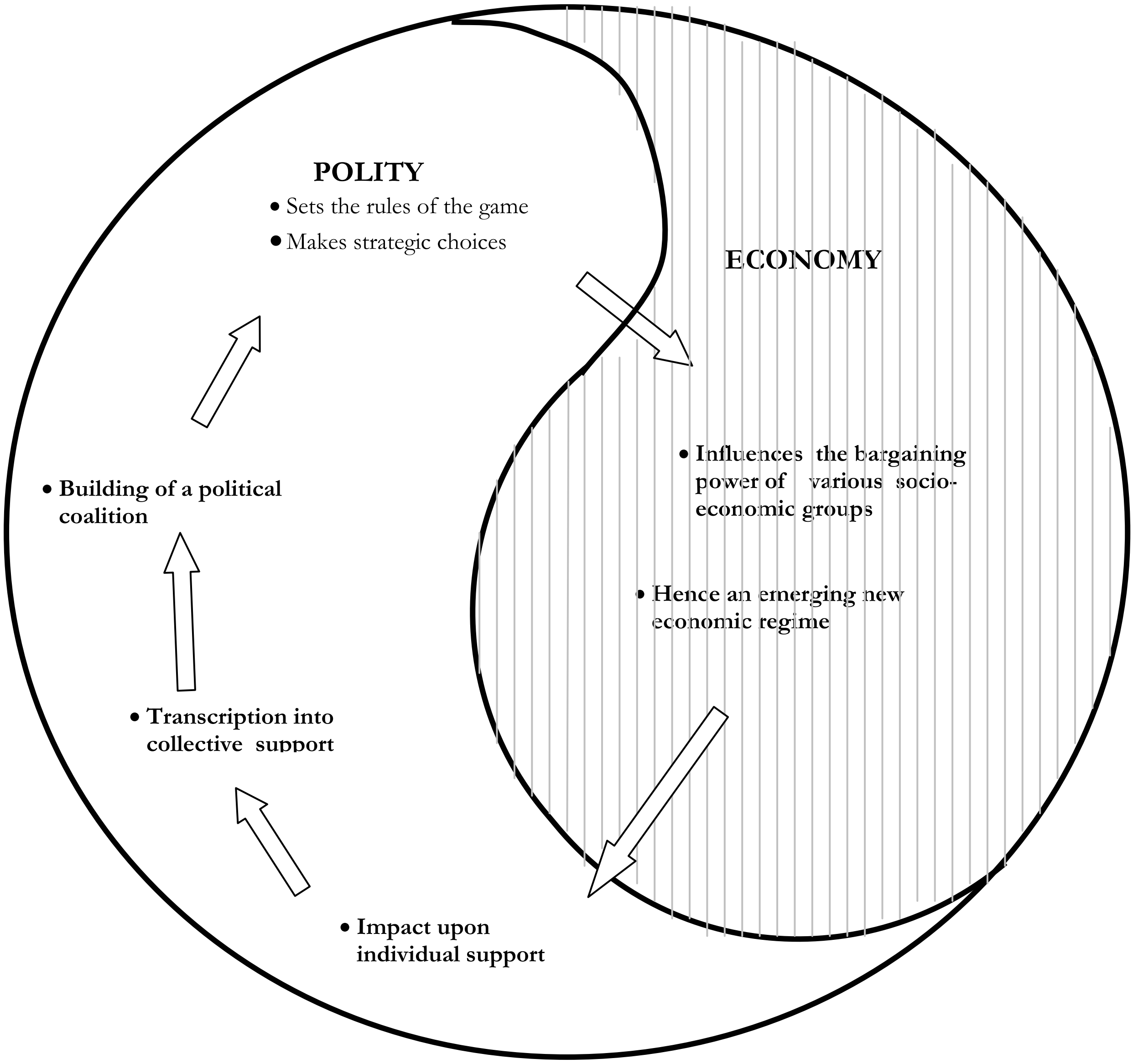


V.3. The crucial role of political alliances…

The previous analyses might suggest that the selection and implementation of a "good policy"- i.e. Pareto improving- is essentially an exercise in applied economy. If politicians do not buy their pet program, the economists generally blame the irrationality of the groups that have blocked it or the lack economic expertise of decision makers. This feeling originates from a drastic underestimation of politics, defined as "all the activities of cooperation, conflict and negotiation involved in decisions about the use, distribution and distribution of resources" (Leftwich 2007:3). Therefore, the inner intricacies of the political process are crucial since any institutional reform of requires the formation and durability of a socio-political coalition in democratic regimes (figure 21). Of course, such a coalition is easier if the reform sets into motion a positive and increasing sum game, at odds with policies that would organize a mere redistribution from the rich to the poor at the cost of a possible negative impact upon economic activity.

The task of the social scientist is then to "identify, support and encourage the political forces and coalitions which alone will create and sustain the institutional arrangements of development states dedicated to both growth and poverty reduction" (Leftwich 2007 :1).

Figure 21 – The interplay of political and economic determinants of institutional reforms

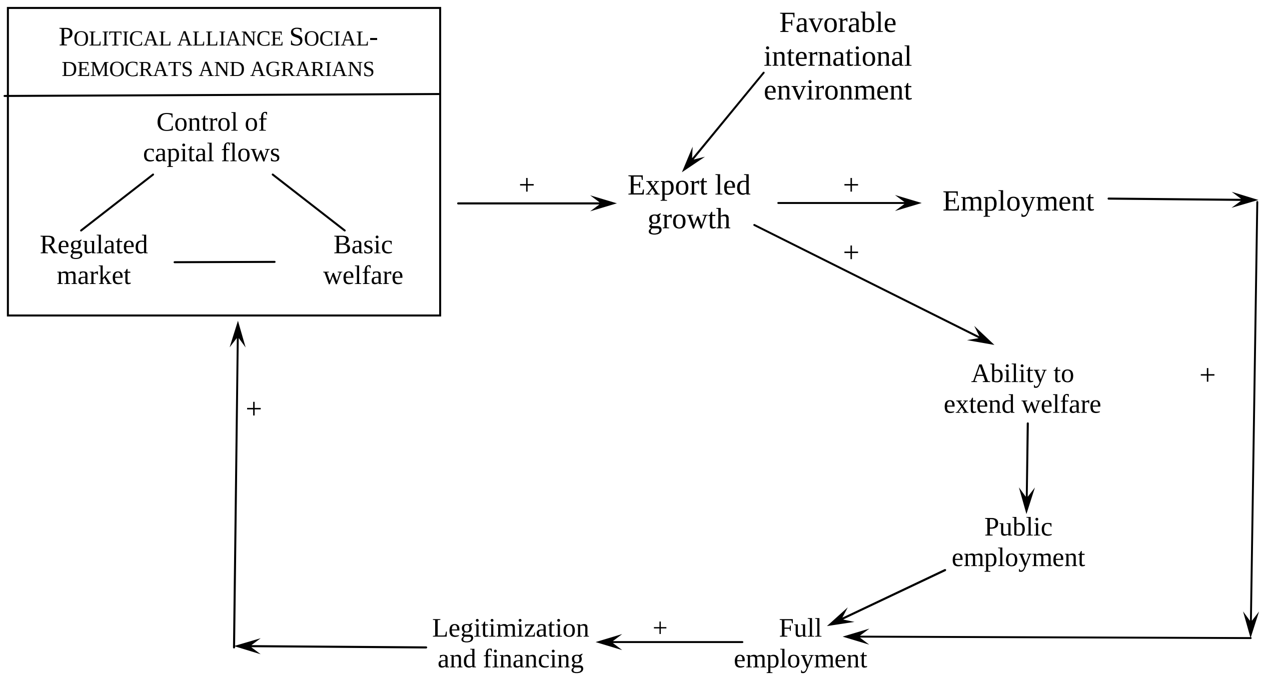


….that differ from one country to another

The fact that both some democratic and some authoritarian regimes have succeeded in poverty reduction shows the absence of a canonical model. The complexity of the interactions between polity and economy probably explains the diversity of national trajectories in terms of growth regimes and anti poverty policies.

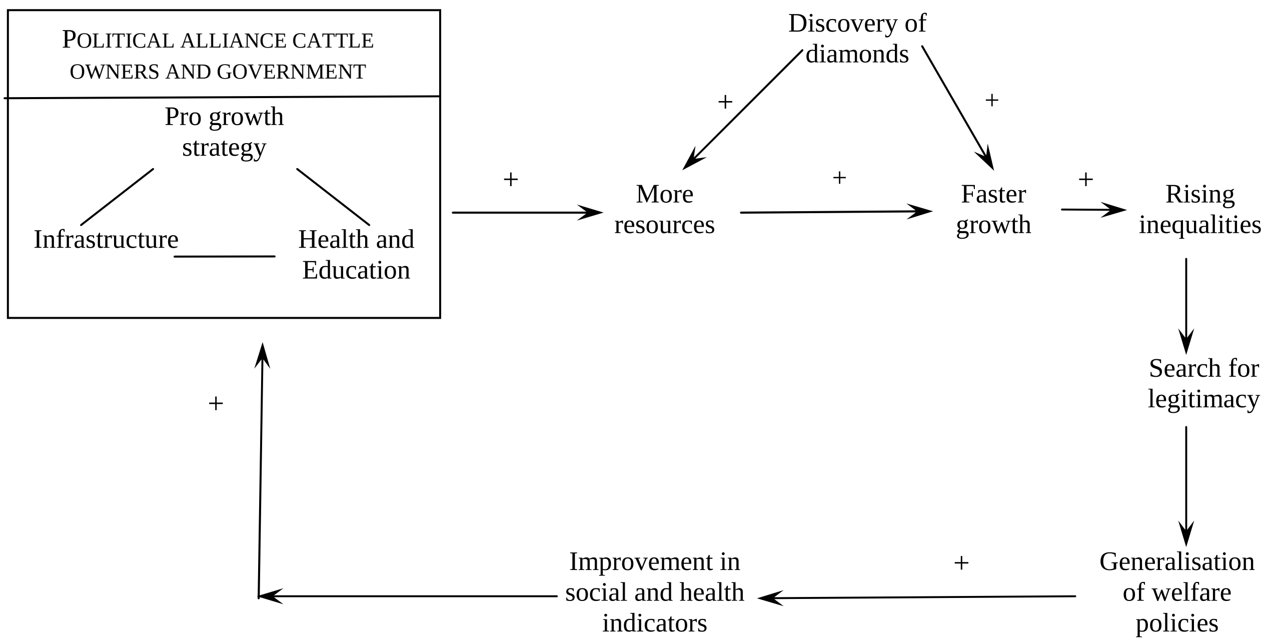
- In the case of *Finland* the rupture with respect to the era of slow growth and mass poverty has taken place after the emergence of a quite genuine political coalition between *social democrats and an agrarian party* (Kiander 2007: 2-3). A rather stable and permissive international system has allowed the maturation of a export led growth regime that generated employment and the financial resources to extend the welfare coverage. The configuration has proven to be simultaneously rather efficient and legitimate. But when the external permissive conditions changed, a major structural crisis burst out after the collapse of Soviet-Union, and put an end to a quite successful growth regime (figure 22).

Figure 22– The creating virtuous circles: searching for complementarity institutional reforms and policies (Finland 1960-1980…)



- An equivalent feedback from political compromises to economic growth took place in *Botswana* but the political alliances were quite different indeed between *cattle owners and government* (Selolwane et al. 2007). The emerging complementarity between accelerated growth and an improvement in social indicators originated from a positive shock, i.e. the discovery of new and highly valuable natural resources. But similarly to the Finnish case, a prudent initial move concerning welfare was progressively extended, thus generating a cumulative transformation of the society and the economy (figure 23).

Figure 23– Botswana exhibits a totally different virtuous circle



Clearly, *various configurations* may exhibit a complementarity or at least a *compatibility*, between different institutional arrangements that themselves derive from quite specific *political compromises.*

V.4. An aggiornamento in development strategies

Finally, the present use of ICH to renew some development theory brings an interesting perspective. Development economics has become *systemic and institutionalist*, given that they have benefited from the lessons learnt from history and from theoretical advances; and also because they are now imbued with their own conceptual foundations.

Comparative development analysis and modern economic theory actually constitute useful antidotes against those dogmatic visions and ideologies that attempt to pit interventionist conceptions against the neo-liberal vision. The end result is that *no pure and unadulterated strategy,* i.e. one which is based either on "100% State" or on "100% market", has been successful – and theory has confirmed the innate limitations of any economic regime that is based on only one of these two mechanisms of co-ordination. A first solution thus consists of *offsetting market failures* by the appropriate State interventions and, vice versa, *transcending the State's limitations* thanks to processes that mimic market competition wherever possible.

The crises that were observed throughout the 1990s reinforce this diagnostic. Whereas in the 1980s certain instances of under-development could be attributed to *excessive interventionism,* the financial crisis of 1997-1998 showed that the *extension of the market to the financial sphere* (and to derivative financial products) could also lead to a de-stabilization of even the most dynamic modes of development (e.g. South-East Asia). *Too much market* can be harmful to development. The 1998 disintegration of the "Washington consensus", which had previously dominated international organization's conceptions of development, attests to this awareness. Political leaders and experts have been looking for a new doctrine (in the noblest sense of the term). Most have recognized the need for a new institutional architecture or at least for new rules for running the international financial system.

This is the second path that we would like to open up in our attempt to *solve the State/market dilemma* (figure 24). On one hand, we now know that successful development depends on the complementarity between these two logics, and not on the affirmation of one or the other. Remember that the market is a social construction whose emergence and viability are predicated on a rich set of legal rules, codes and supervisory bodies. In addition, modern institutionalist research has stressed that the institutional arrangements serving as *intermediaries between the State and the market* (i.e. associations, communities, partnerships, etc.) can play a crucial role in reconciling the imperatives of dynamic efficiency (such as higher productivity or living standards) and social justice, construed here as an overly un egalitarian distribution of the fruits of growth.

It is therefore illusory to blame one single factor for the hindrance of development. An approach that is based on interdependency, externality and complementarity is far superior. The *systemic and changing nature of development* has to be acknowledged.

Figure 24 – From the Washington consensus to an institutionalist and systemic approach to development

THE CRISIS OF THE WASHINGTON CONSENSUS	STATE AND MARKET : COMPLEMENTARITY WITHIN DIVERSE INSTITUTIONAL ARRANGEMENTS
1. Instability or political crises	1. Re-legitimization of the State as a promoter of growth and justice
2. Unemployment/growing inequality as a consequence of market adjustments	2. The market co-ordinates decisions on a day-to-day basis, the State makes strategic decisions
3. Fragility of financial and social institutions and weakness of certain actors	3. Encourages a density of institutional arrangements as well as actors' organizational capabilities
4. Under--investment in collective infra-structure	4. The public sector is responsible for social cohesion and collective infrastructures
5. Major dependency on the international environment	5. Preservation of a balance between domestic needs and external competitiveness
6. De-stabilization of growth regimes as a result of capital flows	6. Differentiated opening up to the international economy, depending on national goals or the domains concerned
In the late 1990s	*In the early XXIth century*

On this theoretical background, what are the methods and analytical tools in order to implement pro-growth and antipoverty strategies?

VI. SOME METHODS IN ORDER TO APPLY THE INSTITUTIONAL COMPLEMENTARITY HYPOTHESIS

This section proposes some perspectives concerning the extension of the previous framework to the issue of poverty reduction outside the industrialized world

VI.1. A first method for detecting successful configurations

In order to counterbalance the tyranny of the deductive method that looks for a first best solution or a one best way, it might be interesting to approach inductively the issue of poverty reduction. Firstly, what are the countries that in the contemporary period or back to some previous episodes have been successful in significantly reducing poverty? Secondly, what are the factors possibly explaining these successes: the intensity, stability and nature of the growth regime (inward or outward looking, natural resources or innovation led); the volume and composition of welfare expenditures (education, health, income security, quality of public services); the degree and nature of regulation of labor markets (minimum wage, type of labor contracts, coverage of collective bargaining); the style of policy regimes (degree of centralization, nature of democracy, process of intermediation of conflicting interests). The first step is then to use Qualitative Comparative Analysis in order to detect the various configurations of the previous variables that are empirically associated to poverty reduction. This is the method that allowed the detection of the three configurations of the new economy exhibited by figures 3, 4, and 5. An alternative method would be to mix all the variables and use a cluster analysis to look for what is the grouping of successful countries that emerges.

This method could be useful to test the relevance and generality of the taxonomy of policy regimes of poverty eradication proposed by the project proposal elaborated by UNRISD (2005) in its Appendix 1 (legacy of the socialist model, Asian authoritarian development State, the democratic development State of Nordic countries, structural adjustment, good governance and pro-poor policy). Finally, a panel data analysis could mix cross section and time series in order to test more precisely the quantitative contribution of the variables typical of each regime.

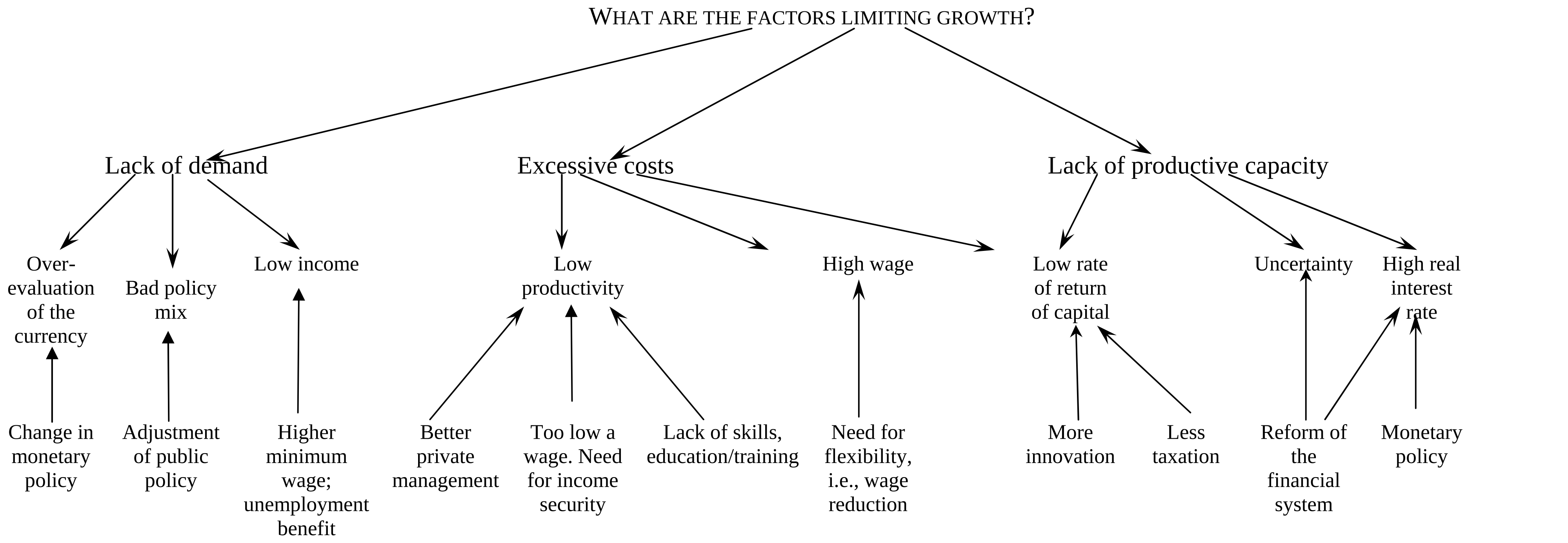
VI.2. A second method: combining two diagnoses about the origin of poverty and the inhibiting factors of growth

By contrast, this second approach aims at capturing the features that are specific to a given country at a precise period in time. The issue is to detect what should be the most convenient policy mix compatible with a dual objective of growth promotion as source of productive employment and poverty eradication. The answer cannot be derived from pure theory since the precise structural conditions have to be analyzed in each national, regional or local context. In a sense, this is a drastic reversal with respect to the legacy of the so-called Washington consensus, according which the same general menu was supposed to fit all the domestic contexts.

Have we the relevant tools in order to make such an analysis? The long experience of development economics has recently delivered a quite interesting and stimulating method in order to cope with the diversity of developing as well as developed countries. The *growth diagnostics* (Hausmann et al. 2005) proposes to systematically review what are the multipliers associated to the relaxation of the various constraints inhibiting economic activity and to design accordingly economic policy and reform economic institutions. In some instance, a policy that delivers quite impressive result in one country may be inefficient, or worse detrimental, to growth in another and conversely. Actually, static efficiency – frequently associated to price flexibility – has to be distinguished from dynamic efficiency, i.e. the ability to improve cumulatively productivity and standards of living of an entire population. This dilemma has already been addressed to in section II.3 and figure 2).

It might be useful to rejuvenate a macroeconomic theory that has been quite enlightening in the 80s in order to propose an analytical framework that would transcend the opposition between Keynesian and neoclassical conception of the determinants of employment (Benassy 1982). Actually the so-called disequilibrium theory exhibits a series of determinants of employment. The unemployment is Keynesian if the limiting factor is effective demand, classical if the low profitability limits hiring, Marxian if the scarcity of productive capacity is at the origin of low employment. When applied to developing countries and to the analysis of growth and employment, this framework delivers three major teaching (figure 25).

Figure 25 – A diagnostics approach to growth stimulation



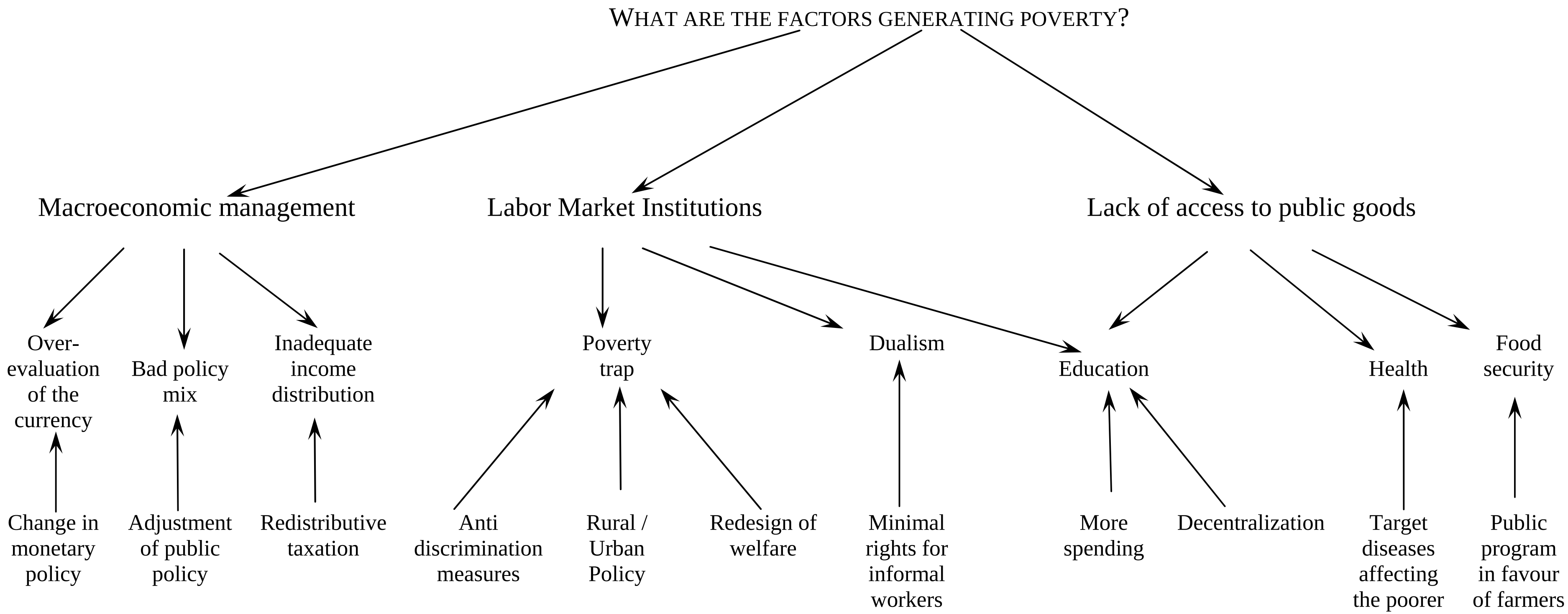
- In many cases, the issue of *labor market institutions and welfare reforms* might be *irrelevant*, since the disequilibrium originates from totally different factors: an overvaluation of the domestic currency, an excessively high interest rate due to the lack of credibility of economic policy or a bad management of firms…In such a context, the search for wage flexibility for example may deliver second order results, since this is not the relevant constraints of growth. Too often, in the 90s, financial disequilibria have triggered excessive down grading of workers security in terms of wage, work intensity, welfare…

- In some instances, growth and employment can increase by *strengthening* a precise form of *workers rights*. For instance, if unemployment is Keynesian, more income security for workers has a positive impact both on employment and profit rate. Similarly, when firms are limited by skill scarcity, a policy developing workers competences simultaneously improves macroeconomic performance and promotes welfare as well as a possible reduction of income inequality. In this case, there is a complementarity between employment level and a form of antipoverty policies. Nevertheless, this is not necessarily the case, and the precise social policy mix has to be tuned to the precise *local situation* at a given *historical period.*

- Within a *third configuration*, *labor flexibility* might be required in order to increase productive employment if for instance classical unemployment is the main source of macroeconomic disequilibria. Alternatively, some collective agreements can codify automatic indexation to inflation and productivity, and this configuration that might appear unable to react effectively to new macroeconomic shocks. This case was quite frequent in the 70s and 80s (see figure 12) but that nowadays the majority of developing countries are suffering from the opposite disequilibrium: productivity increases mainly feed profit increase and relative prices decline but only marginally wage increase. The likelihood of this third configuration is now quite small in most developing countries.

The compatibility between pro-growth policies and antipoverty strategies can be addressed applying the *same method* of growth diagnosis to the analysis of the factors that explain *poverty* (figure 26). After a second diagnosis of the most efficient instruments against poverty, one can look for measures that simultaneously belong to the two diagnoses. The originality is to look for the policies that *simultaneously* reduce poverty and enhance growth. The previous general discussion and various examples suggest that such a policy set is not empty, but probably depends a lot from the local context. Actually, a pro-growth and antipoverty policy takes place within totally different institutional settings, since productive structures, social values and political choices significantly differ from one country to another. Furthermore, even within the same national economy, one could observe the coexistence of defensive flexibility – i.e. via wage reduction and work intensity increase – in some clusters along with offensive flexibility in others where the building of individual and collective competence is the main answer to technical change and evolution of world competition (Vijayabaskar 2005).

Figure 26 – A diagnostics approach to poverty reduction

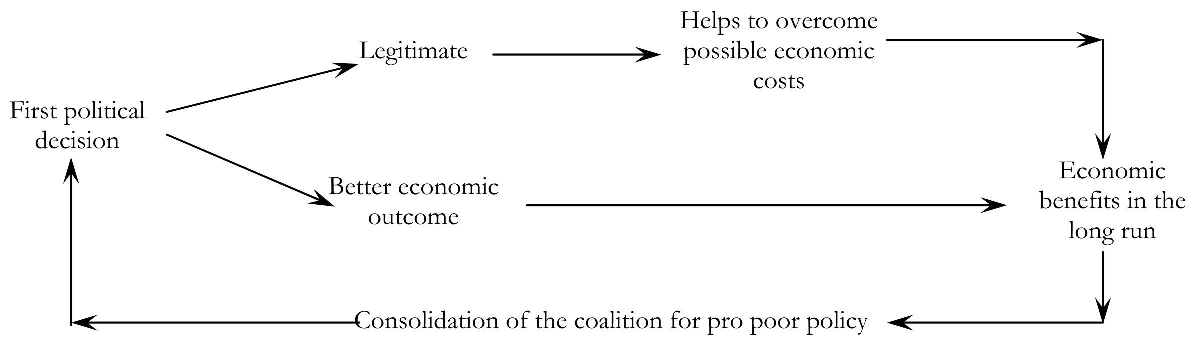


But the task of the expert does not end with the detection of possible and more satisfactory growth regimes.

VI.3.How to go from here to there?

A rigorous economic analysis may well detect the key factors at the origin of poverty and propose relevant policies. Will national governments adopt these policies and international organizations co-finance some of the programs derived from these policies? A *political economic* approach is then required. Efficient policies might be rejected by lack of legitimacy and conversely political legitimacy and social acceptability do not imply any economic rationality (figure 27).

Figure 27 – The duality between political legitimacy and economic efficiency



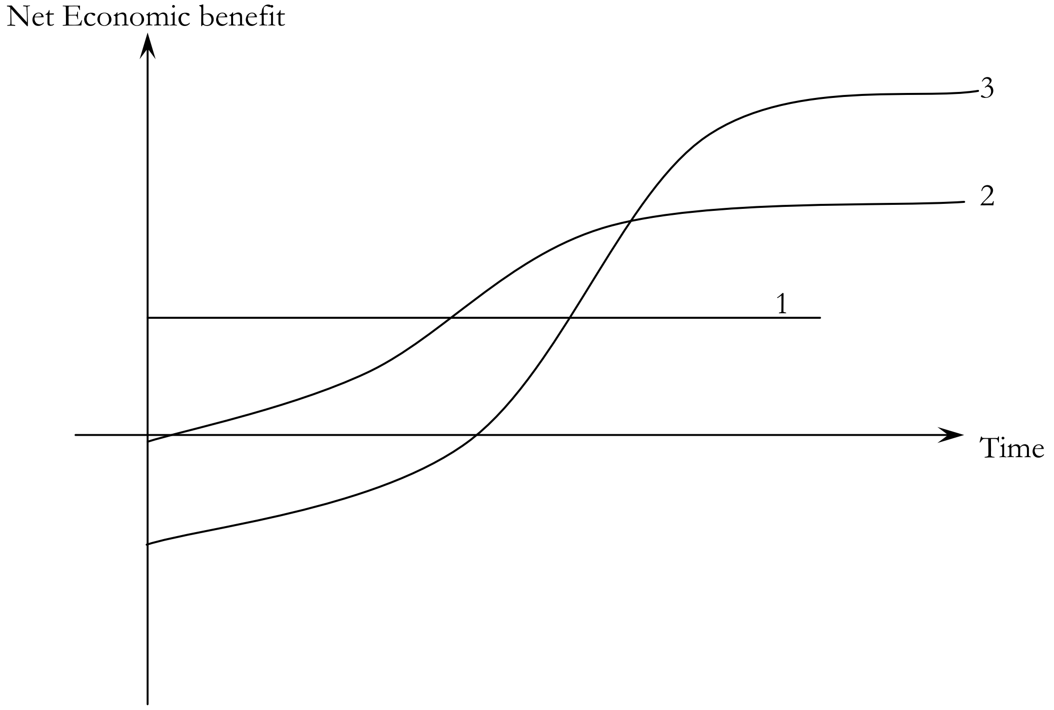
The timing of the costs and benefits of any economic reform plays a major role in its acceptability and legitimacy (figure 28).

- If this is *a win/win strategy* for all the actors and for any subsequent period and it should be easy for the government to convince them to support the program. But this case is rather rare indeed (trajectory 1)

- Initially, some individuals and groups may win but others may loose in the context of a *positive gain* of welfare at the economy wide level. Only in the long run do all the groups and individuals gain from the reform. Finally, the faster the growth, the larger the dividends of growth that can be redistributed, including to poor people, but explicit redistributive arrangements have to be built (trajectory 2). But in the transition period, the nature of the political process become crucial, the better dynamic efficiency can be blocked by the *short termism* implicit to electoral cycles or by the *absence of legitimacy* of a pro-poor policy.

- The political leadership is still more needed when the reform initially *reduces national income* if for instance a higher taxation of high incomes or profit initially triggers a flight of capital out of the country before the recovery of domestic investment (trajectory 3).

Figure 28 – The time profile of costs and benefits of an institutional reform



Thus *policy regimes are crucial* in the implementation of any pro-poor policies and this confirms one of the basic hypotheses of the UNRISD program.

VII. CONCLUSION: ORGANIZING THE SPILL-OVERS BETWEEN CASE STUDIES AND INSTITUTIONAL COMPLEMENTARITY THEORIZING

The guiding principle of the present chapter is quite simple. How could Institutional Complementarity Theory enlighten one of the crucial contemporary issues in development, i.e. the design and implementation pro-growth and anti-poverty strategies? The present analyses converge towards the following provisional teachings.

1. The failure of *mono-causal explanations* of under-development and the limited efficacy of the *benchmarking* of anti poverty programs and the adoption by other countries of best practices call for a *systemic and institutional* approach to development. The motto could be "Getting the institutions right" not in the abstract, but taking fully into account the *national legacy* in terms of productive organization, basic social values and style of the political regime.

2. The *Institutional Complementarity Hypothesis* is part of this research agenda since it helps in assessing the viability and performance of a complete set of economic institutions. When poverty is a mass phenomenon, informal labor is the rule and economic performance poor, any *anti-poverty* has to be part of mix of policies that affect the very nature of the *growth regime*. Thus economic and social policies have to be at least compatible and ideally complementary.

3. Whatever the variety of national institutional embeddedness of these policies, they all share a common general principle: they aim at creating not miracles but virtuous circles via the promotion and coupling of higher value added products and processes with a legitimized distribution and redistribution of income towards the less privileged groups of the society. No ambitious social policy can be successful in a society with no productive surplus.

4. This theorizing inspired by ICH opens the possibility of *various virtuous configurations* for pro-growth and anti-poverty strategies and preliminary comparative international analyses confirm their *diversity* in response to *local conditions and circumstances*, such as the nature of the insertion into the world economy, past economic specialization, emerging new opportunities, the ability to build social and political compromises and to renegotiate them when required by major structural changes.

5. The *Qualitative Comparative Analysis* can be used to detect in contemporary world, but also back in history, the various implementations of *successful anti-poverty growth regimes*. It is still more important to mobilize this inductive method in order to explicit the various factors that may trigger *the transition* from a stagnant and poor society to a dynamic and rich economy. The complete case studies undertaken for the UNRISD program on "Poverty Reduction and Policy regimes" could be the starting point for a more systematic search for the characteristics of *political processes* that are determinant in the emergence of pro-poor coalitions.

6. The extension of *Growth diagnoses* to the search of *poverty determinants* opens another research agenda. Some case studies already show that adequate policies and institutional reforms can enter into *synergy* and deliver simultaneously an acceleration of growth and a structural reduction of poverty. In some instances, the breaking down of built-in inertia is up to *a radical change in the political sphere*, such as the end of a form of apartheid, or a transition to democracy.

7. This is an invitation to overcome a typical *technocratic illusion* that considers that the best practices, since they are Pareto improving, are self implementing. Quite on the contrary, it is crucial to detect, identify and support the groups and political coalitions which are able to design, implement and sustain the institutions and policies of a development state over a period of time sufficiently long for reaping the benefits of growth and poverty reduction.

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