WORLD DEVELOPMENT REPORT 2009

Spatial Disparities and Development Policy

OUTLINE

Report Outline

Summary of Proposed Approach and Structure

1. Economic activity is increasingly concentrated within countries. Across the world, an estimated three quarters of economic production takes place in cities; the more dynamic coastal regions of China produce more than half of the country's GDP with less than one fifth of its land area; and Greater Tokyo accounts for 40 percent of Japan's total output on just 4 percent of its land area. In the developing world, this concentration has been accompanied by sizeable—and by some accounts increasing—spatial disparities in living standards and welfare. Per capita income differentials within countries in the developing world tend to be much larger than equivalent differentials within rich countries. Paradoxically, in a world which is rapidly globalizing, one of the most important determinants of well-being is still where a person is born: in which country, in what province within the country, and whether in a city or the countryside within that province.

2. But the location of economic activity in the world is rapidly changing. During the last fifty years, the share of global GDP of today's rich countries has been about 80 percent. Over the next few decades, projections indicate that this could fall to 40 percent.[1] In other words, a substantial portion of the world's GDP will, spatially, be "in play", shifting from developed towards developing countries. Which countries, regions and cities will get this will depend to some degree on their natural endowments and their history, and perhaps even on luck. But it will depend much more on the policies that are put in place, because policy reform—at the international, national and sub-national level—can initiate large and lasting changes in economic geography. What can developing countries do to attract a larger share of global economic enterprise, and how can regions and cities within these countries get more of the benefits of this growth?

3. Well documented spatial disparities and the unevenness of growth between and within countries reflect market forces associated with economies of scale and movements of goods and factors, as well as the interplay of competing political interests. Since spatial differences are often also social challenges, two questions arise. The first is whether some people, because of their location, will always benefit much more than others or whether there are inbuilt mechanisms such as movements of labor, capital, and goods that prevent large and persisting differences in welfare across countries, regions, and cities. The second question is whether there is a role for governments to facilitate or ameliorate these responses, to the extent that these adjustments are either not automatic or have large associated welfare costs.

4. The WDR will propose that the *concentration of economic activity* is inevitable and usually desirable for economic growth, but the large *spatial disparities in welfare levels*

[1] See, for example, Goldman Sachs, "Dreaming with BRICs: The Path to 2050", Global Economics Paper No. 99, October 2003.

that often accompany this concentration are not. It will propose that the guiding principle for designing policies and institutions that can help developing countries enhance economic concentration while keeping spatial disparities reasonable is better *integration of markets*. Using the long-term experience of developed and developing countries and the recent advances in economic thinking, the WDR will discuss the approaches and interventions for exploiting the gains from concentration while ensuring that individual well-being does not depend excessively on location.

5. The WDR will present the broad stylized facts, the principal determinants of spatial transformations, and the policy implications of these findings.

- ***Three dimensions***. The WDR will summarize how the economic topography of the developing world is changing. It will document the increase in *density* of economic activity, the decline of *distance* between economic agents and markets, and the persistence of *division* between and within countries due to natural, cultural and policy-related barriers.
- ***Three determinants***. The Report will analyze the determinants of how concentration takes place, by distilling the literature on economic geography for policy-relevant insights. It will illustrate the interplay between *scale economies, factor mobility* and *transport costs* by examples from developing and developed countries.
- ***Three debates.*** The Report will complement the analysis of *why* economic activities are concentrated with an understanding of *where* they are located by recognizing the influence of natural endowments and political and social institutions. It will inform the debates on the *rural-urban transition* and *territorial development* within countries, and *regional integration* among countries.

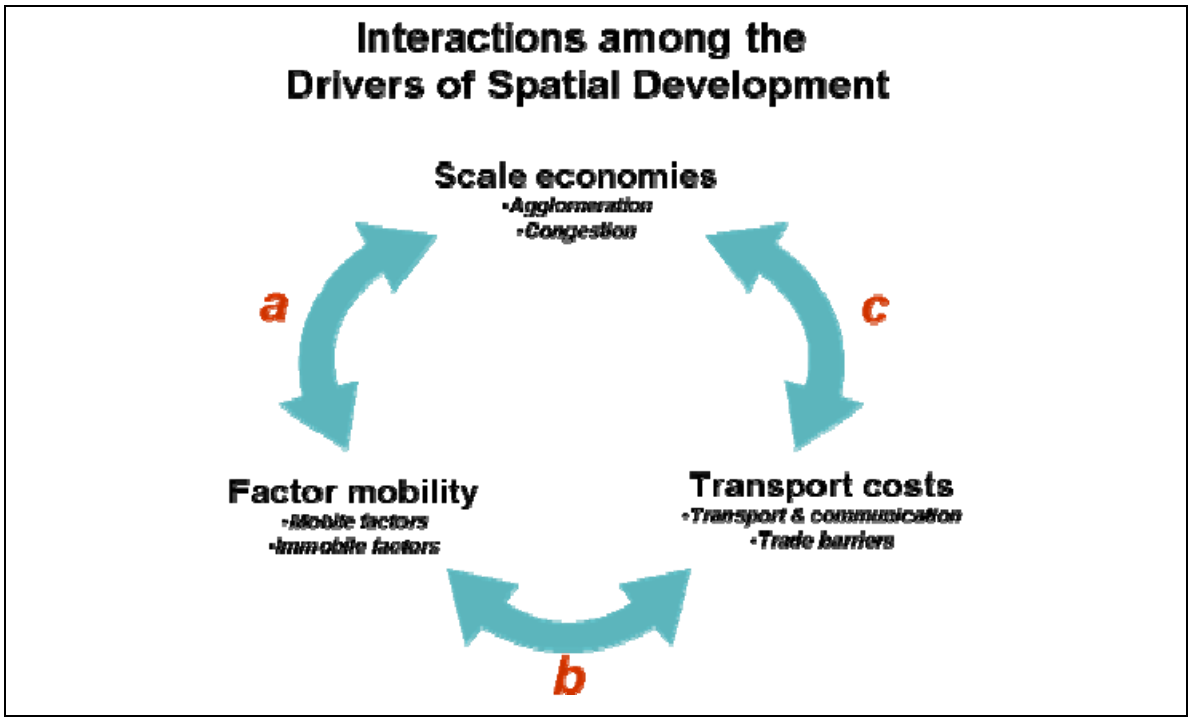
6. Figure 1 illustrates how the insights distilled from the literature can be used to inform policies—essentially by determining which of the interactions (denoted as *a, b,* and *c*) are most important in shaping each of these transformations.

- ***Rural-urban transformation***: Scale economies, falling transport costs and factor mobility accelerate the rural-urban transformation. But too much of an "urban bias" in development can lead to high "grime, crime, and time" costs: congestion, slums, and pollution. And with the right policies, rural areas can also benefit from scale economies. Policymakers should aim for progressively deeper integration of rural, peri-urban, and urban factor and goods markets; all three interactions *a, b,* and *c* are relevant for effecting a healthy rural-urban transformation of the economy.
- ***Territorial development.*** Many developing countries are seeing widening welfare gaps between leading and lagging regions, partly due to agglomeration economies coupled with falling transport costs. Interactions *a* and *b* are especially relevant for exploiting the benefits of concentration while keeping spatial disparities manageable. While policies should aim to improve market links between leading and lagging regions through greater domestic factor mobility especially of that labor, other spatially targeted policies may also be needed.
- ***Regional integration.*** International boundaries still matter, although scale economies and lower transport and communication costs have increased trade opportunities. The

greatest divisions remaining in the developing world are often between neighbors. Interaction *c* may be especially important: regional integration can best help developing countries leverage scale economies and lower transport costs.

Regional initiatives paralleling the WDR will provide more specific policy messages tailored to each region's circumstances.

Figure 1



Note: 'Transport costs' includes the costs of transportation, communication, and regulatory and other barriers to trade within and between countries

7. Figure 2 provides a schematic summary of the Report, highlighting the "horizontal" and "vertical" links between the proposed chapters. Part I will provide stylized facts related to the main spatial transformations accompanying development around the world, using density, distance and division as shorthand for the relevant dimensions. Part II will discuss the main drivers of these changes—scale economies, factor mobility, and transport costs—illustrating their interactions using historical and contemporary examples from developing and industrialized countries. Part III will propose policies to improve urbanization processes, territorial development policies, and regional integration initiatives, using a scope that is progressively widened to focus on cities, regions, and countries, respectively. Figure 3 lists the proposed table of contents of the Report.

Figure 2

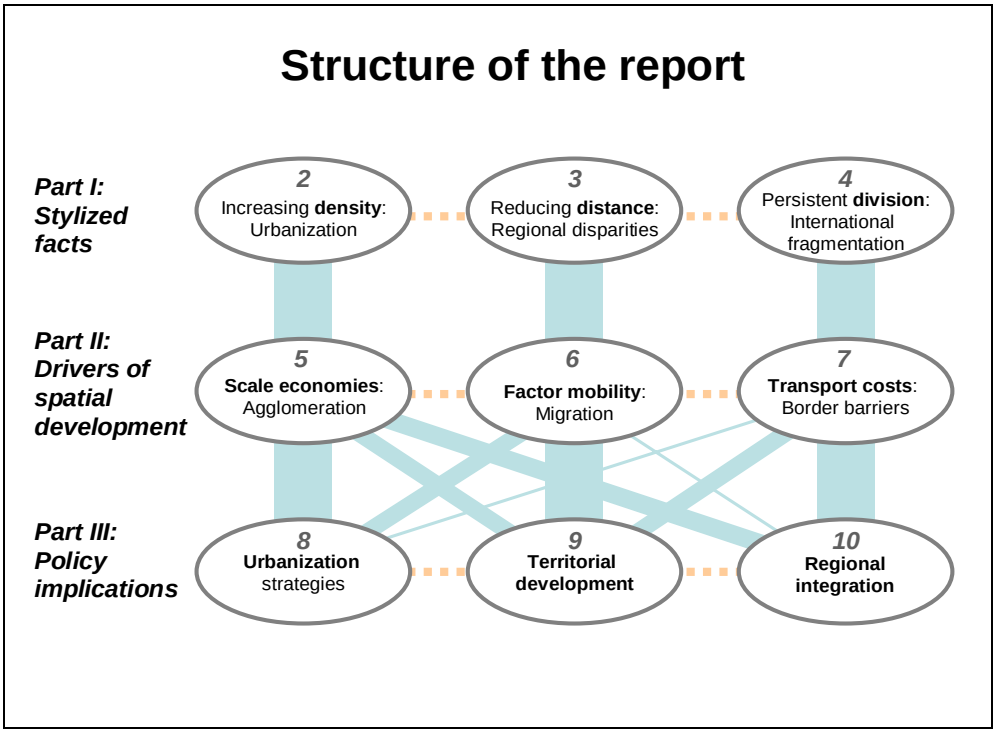


Figure 3

Table of Contents

1. What this WDR will do

8. The 2009 World Development Report on *Spatial Disparities and Development Policy* will address what governments can do to facilitate the spatial transformations needed to sustain economic development, and to efficiently address the social and environmental challenges that arise during this process and threaten its sustainability. The Report will:

- Propose a framework for understanding the dimensions and significance of spatial factors in shaping economic development.
- Summarize the salient features and evolution of spatial patterns in the developed and developing world.
- Assess the development strategies and policies through which governments have, intentionally or otherwise, shaped these disparities.
- Discuss how governments and the international community can better address the spatial consequences of development policies and promote more balanced and sustainable outcomes.

9. The WDR will address three questions that, at their core, are about balancing the geographic concentration of economic activity with spatial equality in living standards. These are:

- First, while an estimated three quarters of the world's economic activity takes place in cities, three quarters of the poor live in the countryside. What urbanization patterns can best bridge the gaps between poor people in rural areas and economic opportunities in cities?
- Second, although the mass of poverty is in leading regions, the incidence of poverty in lagging regions is much higher. How can these poor places best be helped—by bringing economic activities to these places, or by connecting their inhabitants to dynamic regions within the country?
- Third, while growth is faster and more sustained in countries that have better access to world markets, there is a sizeable population living in countries that are effectively cut off from economic opportunities by geographic and political barriers. How can connections between countries be improved so that the poorest, more isolated, countries can integrate internationally and grow faster?

10. These questions are reflected in three important policy debates in developing countries: on **urbanization** strategies; **territorial development** approaches; and **regional integration** initiatives, respectively. The objective of the WDR 2009 is to inform these debates.[2]

[2] The policy challenges arising from spatial disparities in Sub-Saharan Africa, and the growing gaps between the region and the rest of the world, will feature prominently in the report. The interaction of government policies and economic geography may be important in understanding why growth has, until recently, lagged in Sub Saharan Africa, a continent characterized by abundant but unevenly distributed

11. The WDR will present the principal stylized facts of the spatial transformations during development, assess the forces underlying these transformations, and discuss the policies that can facilitate them. It will be structured in three parts:

- Part I will describe the rural-urban transformation; the evolution of gaps between lagging and leading regions within countries; and the divergence between countries within world-regions. It will also summarize the policy debates associated with these developments.
- Part II will identify the primary forces driving these long-term changes, using insights afforded by economic analysis and history. It will highlight the interactions between economies of scale and concentration; the movements of people and capital that help to realize gains from scale and concentration; and the ease of transport and communication that make concentration possible or unnecessary.
- Part III will propose policies to shape these transformations, to take advantage of the spatial concentration that accompanies the growth of urban areas, leading regions, and well-connected countries, while addressing the distributional concerns that arise for rural areas, poor regions, and isolated countries.

12. The WDR will be broadly guided by the principles of the new economic geography which focuses on the human induced changes that shape the economic landscape—the so-called "second nature" geographies. But the distribution of economic activity—especially the livelihoods of the poor—also depends on "first nature" geography: natural resource endowments and other physical factors over which humans have relatively limited control (e.g., mineral resources, water availability, and soil quality). These factors are also not static. Arguably the most important agent of change in natural systems—and therefore on human geography—may be global climate change which is expected to have serious impacts on agriculture, water supply, and the severity and frequency of natural disasters.

13. In this Report, rather than treating natural resource issues and climate change in a separate chapter, these issues will appear in parts of the Report where their relevance is highest. In the context of urbanization, for instance, climate change may change the suitability of large areas of land for agriculture, thus setting off large-scale rural out-migration to cities which have no capacity to absorb large numbers of people into the labor force. Conversely, the spatial organization of cities has strong implications for commuting patterns and thus traffic and air pollution, and will influence climate.

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natural resources and an ethnically diverse population divided into a large number of countries, that are balanced evenly between resource-rich, landlocked resource-poor, and coastal resource-poor economies. Until now, spatial development in the continent has not conformed to global patterns. Coastal resource-poor countries are not the best performers, as they are in Asia. While in other regions, the gaps between leading and lagging regions have generally been most acute in faster growing economies, this divergence is found even in stagnant economies in Africa. And while urban populations and national economies have expanded together in much of the world, urbanization has come without growth in many African countries.

2. Overview of the Report

What exactly is spatial inequality? What are its determinants? How has it been evolving? Why does it matter? And what, if any, should be the policy response to spatial inequality?

Ravi Kanbur and Anthony Venables (2004): "Spatial Inequality and Development"

14. **Part I of the Report will be descriptive.** It will assemble existing and new data to chart trends in the spatial transformation of countries over time. The chapters in this part of the Report will essentially examine three spatial dimensions of development: *density*, *distance*, and *division.*

15. The three chapters correspond to three spatial changes: increasing density of economic activity and populations associated with urbanization as firms and workers seek the advantages of market size; the disparities in economic activity and living standards that emerge within countries as firms and workers attempt to reduce their distance to markets; and the persisting influence of political, social, and natural boundaries as well as the presence of neighborhood effects, for a country's prospects and performance. In each of the three chapters, observed changes in spatial indicators will be correlated with economic growth and poverty. From this analysis of the data, stylized facts will be drawn to characterize the spatial transformation across countries and world regions and, possibly, to derive a typology of countries by their stage of spatial transformation.

16. **Part II of the Report will be analytical.** The chapters in Part II will examine the forces that shape the economic geography of countries and developing world regions. This part of the Report will use economic theory and empirical evidence (including current and historical examples from high-income countries) to illustrate the strength and determinants of these drivers of spatial transformation. Part II will have three chapters, each of which will emphasize a different aspect of the interaction among *scale economies*, *factor mobility*, and *transport costs.*

17. The chapters in Part II will examine the importance of concentration (stressing the balance between agglomeration economies and congestion costs), factor mobility (stressing the movements of labor to take advantage of agglomeration economies), and transport costs (broadly defined to include both changes in the distance to markets and border-related barriers). The three chapters will have a generally uniform structure. The first section of each chapter will examine why the force in question (scale economies, factor mobility, and transport costs) is important in the spatial transformation; the second section will show what promotes/generates these forces at different stages of development; and the final sections will examine the obstacles placed on that force, including how institutions and politics can lead to outcomes far from what theory would consider optimal. These chapters will illustrate the importance of irreversibility, non-linearity, and coordination failures emphasized by economic analysis that incorporates space and emphasizes increasing returns, imperfect competition, intra-industry trade, and innovation.

18. **Part III of the Report will discuss the policy implications.** The chapters in Part III will bring together the observations and analysis from earlier parts of the Report to frame a discussion of three areas of development policy: *urbanization* (or the rural-urban transformation); *territorial development* (or the convergence between leading and lagging areas); and *regional integration* (or the integration of geographically more and less advantaged countries into regional and global markets).

19. Each of the three chapters in this part of the Report will include examples of policies that have worked, those that have not and an assessment why not. These examples will be drawn from parallel initiatives being conducted by regional staff on the themes of the WDR that are especially relevant for the region (see Box below). Each chapter will highlight the novel policy insights for developing countries afforded by the new economic geography, and the experience of high-income countries. The first chapter in Part III will be global in scope. The second chapter will put particular emphasis on the larger middle-income countries with distinct regions and relatively decentralized political structures. The final chapter in Part III will propose an approach to addressing spatial challenges to economic development in fragmented regions of the world. It will pay special attention to Sub-Saharan Africa: a region characterized by the greatest fragmentation, i.e. the largest number of countries per unit area; and the highest share of its population (40 percent) in land-locked countries. Africa merits particular attention as low population density is accompanied by persistently high internal transport costs that have been estimated at nearly double those in other developing world regions.

20. The rest of this note provides a chapter-by-chapter outline for the proposed Report. An annex summarizes the treatment of economic geography and spatial disparities in previous World Development Reports.

Box 1 Regional Work on Operational Implications

Separately, Bank regions are commissioning work on these issues to provide both illustrative country cases and region-specific operational implications:

- In Africa, PRM and SDN staff are collaborating with Oxford University's Center for Study of African Economies to commission work on selected issues of interest.
- In East Asia, 20 country case studies have been commissioned which will be compiled into an edited volume, to be completed in time for the WDR launch in the region.
- In Eastern Europe and Central Asia, work on regional development sponsored by the region over the last two years will be continued and consolidated.
- In Latin America and the Caribbean, a program of policy-oriented case studies on the poverty and social implications of spatial disparities is being launched.
- In Middle East and North Africa, the WDR team will collaborate with regional staff who have begun work on a regional policy report on spatial disparities.
- In South Asia, the WDR team will collaborate with staff working on a study on lagging regions in South Asia, and ongoing country economic reports.

More information about these initiatives is available upon request.

3. Chapter-by-Chapter Outline

"Far from being a process of smooth convergence, development is highly spatially differentiated. This poses a number of questions….

"The first is why do these spatial disparities develop? This question can be addressed by drawing on the economic geographer's distinction between first nature and second nature geography. First nature simply says that some regions are favored by virtue of endowments or proximity to rivers, coasts, ports and borders…Second nature emphasizes the interactions between economic agents, and in particular the increasing returns to scale that can be created by dense interactions….These forces have been extensively researched in recent years although much remains to be done, particularly in the context of developing countries….

"The second question is: how do spatial disparities evolve during development, and to what extent are they self-correcting or persistent?... What factors are conducive to the spread of activity or the persistence of disparities? Is there a 'normal" pattern that countries might be expected to follow?...

"A third set of questions are to do with real income and welfare, in both the short- and the long-run. Are developing country cities too large or too small, and are there too many or too few of them? Should new city development be promoted or neglected? Most importantly, just as growth shapes the spatial structure of the economy, so also the spatial structure shapes the growth process. If a country's spatial structures are wrong then this may reduce the returns to modern sector investment and thereby damage long run growth."

Anthony Venables (2003):
"Spatial Disparities in Developing Countries: Cities, Regions and International Trade

Chapter 1 Place, Progress, and Poverty: Motivation and Framework

1.1 This chapter will highlight the importance of spatial transformations that accompany and shape economic development, and the gains from incorporating space into policy analysis.

1.2 Spatial transformations in countries as they grow from low to high income are not as well documented or understood as other changes, such as the better stylized demographic and sectoral transformations of economies. But it is just as important to understand these spatial transformations, because they both reflect and shape economic growth. With development, the spatial distribution of economic activity becomes more concentrated, in urban areas, in regions of any country that are closer to domestic and international markets, in countries that enjoy access to world markets, and in world regions that are better integrated. Spatial concentration of economic activity will happen in any case. But managed one way, it can foster growth; managed another way, it can result in stagnation or even encourage conflict.

1.3 The chapter will present a simple framework that is distilled from two decades of relevant economic analysis, to help characterize and better understand the main spatial transformations that are necessary for development. It will present a short road map of the rest of the Report.

Part I. The Spatial Transformation: Stylized Facts

"A dozen years ago, it seemed to some of us that we were facing a stark choice of world visions. One vision was the traditional vision of international trade theory, in which countries were discrete economic points, whose location in space is irrelevant. Another was the pure geography vision, in which location in space is all and borders are irrelevant. Finally, there was the vision of a spaceless, borderless world in which distance had been abolished—not a world that yet exists, but possibly one just over the horizon.

"What seems to have emerged from the empirical work of the past dozen years is a compromise vision. Distance matters a lot, though possibly less than it did before telecommunications. Borders also matter a lot, though possibly less than they did before free trade agreements. The spaceless, borderless world is still a Platonic ideal, a long way from coming into existence.

"The compromise view isn't as radical as some would like. But it's a significant change from the way most of us viewed the world economy not too long ago."

Paul Krugman (2006): "The 'New' Economic Geography: Where Are We?"

Chapter 2 Rising Density: The Rural-Urban Transformation

2.1 Chapter 2 will describe stylized facts on various aspects of the rural-urban transformation, and how they are related with economic growth, poverty, and disparities in living standards. These relationships will be examined using both conventional and alternative concepts of urbanization, for countries that span the full spectrum of income levels (including industrialized countries) to provide comparisons among the world-regions. The likely conclusion will be that there is a robust positive relationship between per capita incomes and urbanization rates; there are identifiable relationships among sectoral shifts, changes in density, and urbanization rates; and urban-rural disparities vary systematically at different stages of urbanization.

2.2 The likely messages of this chapter are:

- **The rural-urban transformation is related to—but is not the same as—the sectoral transformation that accompanies development.** In addition to the dynamic rural-urban transition characterized by the shift from primary to secondary sectors, there are within-rural and within-urban sectoral transformations. The Report will investigate the transformation of rural areas as non-farm activities become more important relative to agriculture. The Report will present evidence of a stylized within-urban transformation characterized as concentration of industrial activities at earlier stages of development, followed by deconcentration of industry from large cities and its replacement by services at later stages. The robustness of this transformation, its implications for city size distributions, and its relationships to economic growth and poverty indicators will be examined.

- **Spatial disparities along the rural-urban spectrum show a stylized pattern with economic development.** The focus here is the spatial disparities of living standards (such as access to basic services) between the rural, peri-

urban, and urban areas, and how these disparities change during economic development. The robustness of the hypothesized relationship will be assessed, analogous to Kuznets Curve, where disparities first widen and then narrow as average income levels increase. The patterns will be compared among the world-regions.

- **The relationship between urbanization, economic growth, and poverty depends on how 'urban' and 'rural' are defined.** In addition to illustrating these relationships based on official measures of urbanization—which vary across countries—a more uniform alternative measure that uses a population concentration (density) criterion will be used, and its relationship with economic growth and poverty across world-regions examined. With a density-based measure coupled with other indicators on local characteristics the Report will depart from the dichotomous characterization of 'urban' versus 'rural', and develop a typology that explicitly incorporates settlements such as non-agricultural rural and small urban centers.

Relationships among urbanization, economic growth, and poverty

2.3 To what extent is the world population concentrating in cities? Does the relationship between urbanization and growth differ across the world-regions? How does the relationship between poverty reduction and urbanization differ across regions?

2.4 To answer the first two questions, the relationship between urbanization and economic growth will be examined. The Report will make use of conventional data on urbanization based on each country's official definition of "urban". This chapter will also investigate an alternative, and perhaps more meaningful, definition of urbanization that incorporates population density. The advantage of the density-based measure is the departure from dichotomous "urban" versus "rural" to continuous and gradient-based characterization of settlements. The Report will explore a new typology for settlements by coupling the density-based measure with indicators such as major sector in the region (e.g., agriculture/non-agriculture) and proximity to large city center to characterize non-agricultural rural regions, peri-urban, and small urban centers.

2.5 The relationship between urbanization and poverty in both rural and urban areas will be examined. Slums will be considered as part of this exercise. In particular, the Report will attempt to assess whether slums can be regarded as temporary phenomenon—as was the case for many cities in currently developed countries including London, New York, and Tokyo—or whether today's slums are here to stay. This could have an impact on the how urbanization affects overall poverty reduction. This section will provide as many specific cases as possible, along with the general trends across the world-regions.

Sectoral transformation, the countryside, and cities

2.6 In the most general terms, as a region develops, the composition of economic activity first shifts from agriculture to industry, a shift that is concurrent with a movement of population from rural to urban areas. Driven by agglomeration economies, the

concentration of industries in urban areas continues—a process known as 'urban specialization'—until the negative externalities of concentration such as congestion costs (and land prices) become high. With improved transportation technologies, which reduce cost (and lower land prices outside the business center), industrial activities gradually move out of urban centers and are replaced by business and personal services.

2.7 In addition to the above one-dimensional characterization of urban specialization, the literature suggests that a greater variety of transformation patterns are observed in industrialized countries. For example, research has shown for the US and South Korea, respectively, that smaller cities are more specialized than larger ones; similar results were obtained for Brazil. Smaller cities tend to be more industrial while larger cities are more service-oriented. Specialization is usually higher at the city-level but lower at state or provincial levels. This implies that each city may be specialized in different industries, and that large regions are composed of many cities with different specialties, and also with different sizes corresponding to the industry that the city has specialized.

2.8 This section will compile and present the data to examine whether these trends can be generalized in developing world-regions as well. The informal sector, which is considered as a valuable entry point for low-skilled migrant workers, will receive attention. The results could potentially inform urbanization policies, as they suggest that not only do both the process of urbanization and changes in city size matter, but the composition of specialized industries must be taken into account if the two are tightly correlated.

Rural and urban integration and economic development

2.9 The chapter will discuss the disparities in living standards between rural and urban areas, and how these change over the course of urbanization and economic growth. According to theories of economic geography, real income levels will initially diverge, but as urbanization progresses they eventually converge or the divergence will diminish; a phenomenon analogous to the well-known Kuznets Curve. A similar pattern may be expected to emerge for living standards such as education and health, i.e., the disparities between the rural and urban areas widen initially but then converge. The "urbanization Kuznets hypothesis", and its relationship with rural development efforts (including their types), will be examined and contrasted among the world-regions.

Chapter 3 Reducing Distance to Markets: Regional Disparities

3.1 This chapter will present the stylized facts related to the uneven pattern of development across different regions within countries. The chapter will discuss how countries define a "region", and how these regions are classified into leading and lagging sub-economies. It will document the growing concentration of economic activities in the "leading" regions, as firms and workers move closer to domestic and international markets. It will trace the evolution of poverty differentials and disparities in living standards between leading and lagging regions as the center of economic gravity shifts as countries integrate internationally.

3.2 The likely messages of this chapter are:

- **Greater openness to trade and financial flows increases domestic concentration of economic activity, and initially widens regional disparities in incomes.** The chapter will present correlations of measures of international integration and changing spatial distribution of economic mass within countries.

- **Leading regions often have large economic and poverty mass, while lagging regions have low economic mass and high poverty incidence.** There are big differences in poverty incidence and mass across regions within countries. Poverty maps for selected countries will be presented to illustrate the difference between 'poor places', and places where a majority of the poor live. For selected countries where data are available, the Report will also present poverty maps that show the changing distribution of poverty incidence and mass as countries integrate with the world economy.

- **Domestic labor mobility is correlated with growth concentration and welfare convergence.** The chapter will present indicators of labor mobility in selected countries, and simple correlations of these measures with concentration indices and interregional welfare differentials.

Spatial concentration is part of the development process

3.3 Over a broad range of incomes, growth is associated with greater spatial concentration of economic activity, as firms and workers move closer to areas with greater market potential. The overall pattern is one of rising spatial concentration of economic activity (e.g., in China's coastal provinces, Brazil's South-Central provinces, Java in Indonesia) followed by some dispersion at higher income levels. The Report will examine the robustness of this observation, and identify the countries that have not conformed to this pattern.

Spatial disparities in welfare and growth

3.4 Spatial disparities in welfare levels (as measured, for example, by headcount poverty) do not follow a clear pattern. The Report will present the trends (convergence and divergence) and examine if regional patterns can be identified, whether these patterns are correlated with political/fiscal structures such as decentralization, and the degree of openness to foreign trade and international financial flows.

Internal migration patterns and spatial disparities

3.5 The Report will present stylized facts related to internal factor mobility, especially domestic labor migration. It will document the changing skill composition of labor force in leading and lagging regions. For selected countries, it will examine whether places with higher initial education levels also have the greatest increases in the share of educated workers.

Chapter 4 Persisting Divisions: International Fragmentation

4.1 Borders influence the geographic distribution and productivity of economic activity across countries. Physical and non-physical trade barriers reduce the flow of goods and factors of production. This can prevent economies and societies from reaching optimal—or even merely functional scale—by limiting the benefits from agglomeration, market size and the supply of necessary inputs. This can be a severe problem especially for smaller countries and fragmented world regions. This chapter will summarize evidence on the effects of borders within the context of the spatial distribution of economic activity across countries. The focus will be on regional border issues—where the implications of economic geography are most direct—rather than on global integration.

4.2 Chapter 4 will pick up themes from Chapter 3 on spatial disparities within countries where pure transport costs dominate the effects of intra-country barriers (e.g., ethnic divisions, physical geography or local trade barriers such as the Indian octroi system). The chapter will then be linked most directly to Chapter 7 on transport and other trade and transaction costs, and will provide the context for Chapter 10 on regional integration policies.

4.3 The likely messages in this chapter will be

- **Borders matter.** Divisions between and within countries continue to pose significant barriers to the flow of goods, labor, capital and even of ideas, and some of these divisions can be quantified. Physical and non-physical factors contribute to this “spatial friction”. Economic wealth is inversely correlated with the strength of these barriers.

- **Neighborhoods matter.** Positive growth spillovers across international borders are significant in most parts of the world. Much of Africa is an exception. The fragmentation of the continent and poor regional integration can mean that countries do not take advantage of economic dynamics in neighboring countries. The problem is most severe for landlocked countries.

- **Cooperation matters.** Economic indicators in countries that are members of functioning regional agreements tend to converge. Agreements that lower non-physical trade barriers and other transaction costs need to be complemented by regional integration and upgrading of physical infrastructure that lower transport costs. Regional integration comes in many flavors, and focused, single-issue or technical agreements can facilitate the emergence of more comprehensive treaties.

Borders matter

4.4 International borders continue to significantly hinder interaction between countries. This reduces the emergence of scale economies at international levels through trade-induced specialization, thick labor markets for skilled and unskilled workers and larger buyer-supplier networks for intermediate goods.

4.5 "Borders" in this context refer to various forms of spatial friction that pose more or less discrete barriers. These include monetary and time costs beyond pure transport cost, policy barriers to trade such as tariffs, duties and regulations; restrictions on the flow of labor, capital and ideas; informal barriers such as bribes and cumbersome inspection procedures; and poorly integrated physical infrastructure that exacerbates the effect of distance and of natural geographic divisions, and prevents the exploitation of scale economies. Different currencies in countries can also be a barrier.

4.6 Evidence for this section will be drawn from the recent literature on border effects and trade costs, and on analysis of trade data in relation to geographic factors.

Neighborhoods matter

4.7 The impact of borders varies significantly between countries and regions. This is demonstrated by the variations in growth spillovers between neighboring countries in different world regions. Globally, these are very significant—countries benefit if their neighbors do well. But these effects are weak in Africa. The small size of countries, poor infrastructure and the limited effectiveness of regional economic agreements reinforce a fractionalized economic system without significant agglomeration benefits. These problems are particularly severe for landlocked countries that depend on the cooperation and infrastructure endowments of neighboring countries for access to input and output markets. Improvements in telecommunication and air transport have not yet significantly contributed to overcoming these barriers.

4.8 The ECA region provides an informative recent example on how rigid borders can distort economic geography. The "forced neighborhoods" of the former Soviet Union and former Yugoslavia prevented infrastructure networks from evolving in response to market demand. Successor countries are still in the process of reorienting trade links to take advantage of external opportunities. Similar examples exist in post conflict situations.

4.9 This section will draw on the literature on neighborhood effects, fractionalization and economic growth, and economic history; and it will explore empirical patterns related to trade, migration and capital flows and geography.

Cooperation matters

4.10 Making borders more permeable can have big economic payoffs. Regional agreements on trade facilitation, labor markets and capital flows promote economic convergence among member countries. Regionally integrated infrastructure programs, such as those considered under NEPAD, reduce the negative effects of geographic divisions. This enables productivity-enhancing adjustments in the geography of economic activity.

4.11 Regional integration can take many forms, from global trade agreements to regional economic cooperation treaties, single purpose agreements (e.g., regional power pools), and *de facto* integration, for example, when light border enforcement allows informal labor migration. Smaller, single purpose agreements seem to be easier to launch

successfully and can build mutual trust and institutional capacity that paves the way for more comprehensive economic and political integration. Integration may work best where agreements simply formalize already existing interactions between countries.

4.12 Integration has varying impacts on the spatial structure of economic activities. There is conflicting evidence whether increasing trade integration leads to concentration or dispersion of economic activity. This may be due to context specific factors (e.g., initial conditions, scope of the agreements), but also because of the dynamic nature of adjustment processes which may lead to initial concentration and subsequent deconcentration.

4.13 This section will draw on recent work on trade-transport linkages, the experience in regional economic integration around the world (e.g., EU, NAFTA, Mercosur; but also more limited efforts such as the Nile Basin Initiative documented in the recent MNA water report "*Making the most of scarcity*", or the Greater Mekong Subregion in EAP), and on natural experiments from historical events (e.g., German reunification and the disintegration of the Soviet Union).

Part II. Drivers of Spatial Development: Analysis and Experience

"The hallmark of the new economic geography is the presentation of a unified approach … that emphasizes the three-way interaction between increasing returns, transport costs (broadly defined), and the movement of productive factors...

"The observed spatial configuration of economic activities is considered to be an outcome of a process involving two opposing types of forces, that is, agglomeration (or centripetal) forces and dispersion (or centrifugal) forces.... With the gradual changes in technological and socioeconomic environments, the spatial system of the economy experiences a sequence of structural changes, evolving towards an increasingly complex system."

Masahisa Fujita (2006): "Globalization, Regional Integration, and Spatial Economics"

Chapter 5 Growing Cities: Agglomeration or Congestion?

5.1 Chapter 2 presented the stylized facts for the rural-urban transformations that accompany development. This chapter will discuss the importance of spatial concentration of activities—through urbanization—in driving productivity and economic growth; and analyze the role of agglomeration during different phases of urbanization. It will assess the effects and nature of scale economies; analyze impacts and forms of diseconomies associated with urbanization; examine the determinants and types of externalities; and contrast the experiences of today's developed and developing countries. Findings in this chapter are intended to inform Chapter 8, which will discuss effective strategies for rural-urban transformation at various stages of development.

5.2 The likely messages are:

- **Urbanization is necessary for growth, but is not sufficient to ensure it.** Scale economies associated with agglomeration are a principal driving force of productivity and economic growth, but a growing share of the urban population does not always mean that agglomeration economies are being generated in cities.

- **Size is necessary to generate agglomeration benefits, but is not sufficient to sustain them.** The structure or makeup of a city encompassing its amenities, employment structure, and transportation networks determines the tradeoff between scale diseconomies and external economies.

- **Good urban management facilitates positive feedback mechanisms in cities, and rural investments can strengthen these cumulative processes.** While urban management—especially the regulation of land markets in the urban core and the urban fringe—is the main driver of productivity and growth, rural development remains an important complement to city management throughout the various phases of urbanization.

Urbanization matters, but agglomeration matters more

5.3 Urbanization or the concentration of economic activities in urban areas is closely connected with growth, and the literature on economic growth has correctly identified cities as the drivers of development. As a country transforms from a rural agrarian economy to an industrial or service-based economy, firms and workers increasingly cluster in cities. External economies of scale that outweigh diseconomies from concentration associated with urbanization drive productivity gains and growth in cities. However, urbanization can also take place without economic growth. Signs of poorly managed urbanization are high grime, crime, and time costs (together called 'congestion costs'[3]) borne by urban residents. But this can happen not just because of urban mismanagement; poor economic and social development prospects or insecurity in the countryside can also strain cities.

5.4 In early stages of development, economic analysis suggests that a favorable urban environment depends on basic city services, good management, and keeping inflows of rural workers manageable, to attract producers and consumers to cluster. By spatially concentrating incipient industrialization, an economy can be frugal with investments in physical infrastructure such as transport and telecommunications. This concentration results in thicker markets for labor, capital and goods, together called "pecuniary externalities" in the literature. Taking advantage of them does not require specific product or factor market interventions by governments, since private enterprise moves quickly to "internalize" these externalities. Even in these early stages, however, governments must ensure that congestion costs do not overwhelm agglomeration economies, so that private firms and workers continue to benefit from increasing returns in production. Such congestion costs are a negative "technological externality", and do require government intervention.

Size matters, but composition matters more

5.5 Market size as reflected in density remains an important factor for efficiency gains in production. But as industrialization progresses and cities grow, spatial concentration also enhances specialization, information spillovers—knowledge accumulation through frequent interactions—and innovation. The composition of workers and firms in these cities, since it implies different degrees of complementarity of economic activities that influence the size of positive technological externalities, starts to matter more as a determinant of the productivity gains from agglomeration.

5.6 Large cities tend to accommodate diversified firms within and act as incubators where new products are invented and brought to market and where new firms learn how to become competitive. Once firms mature, they tend to relocate to more specialized and smaller cities. Larger cities are more service sector oriented (e.g., entertainment, culture,

[3] They are costs associated with inadequate urban transport and access, the rents associated with poorly functioning land and housing markets, the extra costs born by urban enterprises to access services not made available by the local sector, the loss in air quality and quality of living associated with poor urban environment as well as safety and amenities.

financial, and IT) while smaller cities are more manufacturing sector based.[4] Government policies aimed at sector composition affect urbanization and its pattern indirectly.

Rural investments matter, but urban management matters more

5.7 Theory and evidence—from developed and developing countries—surveyed in this chapter will likely indicate that today's developing countries should view integration of rural and urban markets as a long-run objective and outcome of the rural-urban transformation. To ensure economic growth and to enhance the natural role of cities to explore agglomeration economies, rural investments are important at all stages of urbanization. During the initial stage of urbanization, cities may have limited capacity to deal with large inflows of young, low-skilled, or desperate migrants seeking jobs, schools, or safe haven. At this stage, providing basic education, health, and public security in rural areas, as well as removing biases against agriculture and other rural occupations are the most critical ingredients of an effective rural-urban transformation strategy. As urbanization consolidates, rural development stays important. As the experience of developed countries illustrates, vibrant rural (agricultural and non-agricultural) sectors continue to contribute to national economic growth (e.g., Brazil's soy industry), and serve as both consumers of goods and services supplied by and input providers for urban enterprises.

5.8 Decisions that distort the spatial transformation and are hard to reverse can derail economic growth. Management of the balance between diseconomies and external economies becomes more complex as the economy becomes more sophisticated. Diseconomies create incentives for cities to specialize in activities that have positive externalities for one another. Consequently, there is greater pressure for city governments to intervene to ensure that land markets work efficiently (to prevent distortion in land regulation and zoning that can result in misallocation of residential and industrial activities); that industrial composition (or economic structure) in cities yields scale economies; and that that infrastructure and transportation networks, the types of new firms and migrants, and the quality of services and amenities help a city perform at its peak potential. An assessment of how developing countries are managing this urbanization and the appropriateness of instruments being used will be discussed in Chapter 8. Chapters 5 and 8 will attempt to answer the question: why are so few cities in developing countries economically well-managed? The Report will assess whether the reason for this is the importance of land markets, and the difficulty that even developing countries have in regulating urban and peri-urban land markets well.

Chapter 6 Factors on the Move: Mobile Capital or Mobile Labor?

6.1 While chapter 5 will highlight the importance of land markets, this chapter will focus on the market for labor. The chapter will analyze the geographic implications of mobile labor, human and physical capital, as forces that on one hand drive rising density

[4] This could be related to the price of fixed factors (e.g., land).

and on the other can reduce spatial disparities across regions and countries. Interacting with (relatively) fixed factors—like land, water and other natural resources—the discussion will center on how mobile factors can help to smooth welfare disparities while economic activity becomes more concentrated spatially. The chapter will exploit a well-developed literature on factor returns and labor migration, as well as novel insights from the recent work on endogenous growth and economic geography. It will draw the implications of increasing returns for internal and international migration of labor and talent—mainly that in contrast to the predictions of conventional economic analysis, human capital appears to earn higher returns where it is abundant, not scarce. It will examine the implications of this against the backdrop of observed changes in the flow and composition of labor migration over the course of countries' spatial transition.[5]

6.2 The likely messages are:

- **Mobility of workers—particularly of the more skilled—helps to exploit scale economies.** Labor migration has been the subject of a large theoretical and empirical literature, which has had a substantial impact on policy in poor and middle-income countries since the 1950s. Preoccupied with urban unemployment and squalor, and presuming a fixed rate of job growth in the manufacturing sector, this research has been used to justify restrictions on migration to urban areas. However, with the incorporation of implications of the new economic geography, the pay-off to policies that facilitate movement of labor has become increasingly apparent. The chapter will highlight how the recognition of scale economies and the endogenous positive effect of human capital on economic growth alter the policy prescriptions of the early migration literature.

- **Labor mobility helps to reduce spatial disparities despite rising economic concentration.** Policymakers are confronted with the challenge of supporting agglomeration and avoiding congestion, while facing the political risks associated with high urban unemployment. Rather than imposing restrictions on the movements of workers and their families, policy makers in low and middle-income countries should focus on eliminating disparities that "push" households from rural areas to cities (such as the lack of adequate health, education, and other social services, ambiguous property rights, poorly functioning credit and insurance markets, and violence and famine); and augmenting the forces that "pull" individuals toward cities and towns where they can get a higher return on investments in human capital. Allowing people and households to move freely—underpinned by selective investments in infrastructure and social services in rural areas and lagging regions—can ameliorate regional disparities while aiding the economic concentration necessary for development.

[5] The chapter will exploit a large body of recent empirical work undertaken by the World Bank's Research Program on International Migration and Development.

- **International labor mobility is sub-optimally biased against unskilled workers and poorer countries but a large part of the welfare gains lost due to this can be recaptured through greater trade in intermediate and final goods.** Policies governing international movement of labor (combined with restrictions to international trade) can encourage "brain drain" and block a critical channel by which the disparities in household welfare across countries are reduced. Improvements in infrastructure and technology that lower transportation costs, as well as liberalization of trade in intermediate goods, can help capture the economic benefits of relatively immobile factors (such as land, water and other natural resources) as well as reduce the demand for workers to cross borders as regions integrate and countries develop.

Scale economies and the uniqueness of human capital

6.3 With some exceptions, physical and financial capital moves freely relative to other factors of production. This chapter will argue that although the returns to capital investment vary by place (between urban and rural areas, leading and lagging regions, and between rich and poor countries), lower marginal returns in a given location are generally explained by inadequate complementary factors, rather than by frictions that slow or impede capital flows.

6.4 Thus the new policy insights to be gained from a spatial examination of economic development are to be had mainly in the debate on the movement of relatively immobile factors—labor being the most directly relevant to the question of spatial disparities in welfare. Labor migration has been the subject of a large theoretical and empirical literature, which has had a substantial impact on policy in developing countries. Preoccupied with urban unemployment and squalor, and assuming an exogenous fixed rate of job growth in the manufacturing sector, early research has been used by governments to restrict or strongly discourage migration from rural to urban areas, to little effect and possibly forgone economic growth.

6.5 However, the new economic geography's acknowledgement of externalities and of increasing returns to human capital in particular, implies that there are fundamental space-related differences between human capital and financial capital. Returns to the latter tend to equalize between regions and across countries, while the returns to human capital are much higher where there are more skilled people. Thus, owners of skills make different spatial choices than owners of capital, in terms of where to invest this capital. This has acted as a powerful driver of density both through internal migration from rural to urban areas, and from lagging to leading regions (as well as international migration from poor to wealthy countries).

6.6 A critical contribution of this chapter of the WDR will be to show how the assumptions of the new economic geography dramatically challenge the policy implications of early research on the movement of factors, and draw new insights that can help government capture the agglomeration benefits of density without surrendering to widening spatial disparities in welfare.

People on the move

6.7 As shown in Chapter 2, half of the world's population already lives in urban areas, and countries in Asia and Africa are on the cusp of the largest shift of people from the countryside to cities in history. The greatest acceleration in the growth of urban areas is expected to take place in developing countries, where many governments already wrestle with the challenges of congestion. Furthermore, since 1990 there has been an upsurge in international migration, particularly of skilled workers. Estimates show that about 3 percent of the world's population lives outside its country of origin. But this is small relative to the movements of people within countries.

6.8 As talent moves, "source" areas (whether these are rural and lagging regions or low and middle-income countries) can suffer "brain drain", though with some important exceptions discussed below. This, given the external benefits of education and talent, can have a detrimental impact on their prospects for economic growth. However, a formidable body of empirical evidence also shows that a large share of the returns to households' investment in migration often accrue to these source areas in the form of remittances, which have become the largest source of foreign capital to source countries after FDI.

6.9 The Report will highlight the importance of human capital investment strategies to migration outcomes. The discussion of labor movements will distinguish between the movement that "drains" talent from a source location, from that which can encourage strategic investment in human capital (for example, investment in medical training with the explicit intention to migrate, among households in South and Southeast Asia) for the improvement of welfare—both directly through earnings remitted by migrants, and indirectly from the contribution made by individuals who gain skills in the hope of migrating, but for whatever circumstances remain in their communities.

Integration and the reduction of spatial disparities

6.10 Theories that recognize imperfect competition and increasing returns to human capital suggest that policy should provide incentives to retain skilled workers where potential "spillovers" from their human capital are large. But quotas and other restrictions on the movement of individuals seeking to exploit their human capital can be as distorting and costly as restrictions on the movement of financial capital, dulling incentives for households to make human capital investments in the first place. These restrictions can also increase welfare disparities between regions and across countries.

6.11 However, the forces that maintain restrictions on the movement of labor are strong, and more social and political rather than economic. The potential for rising social tensions calls for a measured approach to liberalizing restrictions on workers. Within countries, labor mobility should not be discouraged, and increases in the movements of labor should go hand in hand with improved commerce in goods and services. But across countries, restrictions in the mobility of labor may be difficult to remove. In the medium term, improvements in infrastructure and technology that lower transportation costs, as well as aggressive liberalization of trade in intermediate and final goods, can deliver

some of the benefits of free movement of productive factors, and reduce the demand for workers to cross borders.

Chapter 7 Falling Transport and Communication Costs: More Concentration or Less?

7.1 Chapter 5 discussed the importance of scale economies and highlighted the importance of land markets, and Chapter 6 examined the interactions between increasing returns and factor mobility, highlighting the importance of labor markets. This chapter will discuss the interactions between increasing returns and transport costs, broadly defined to include the costs of transportation and communication over distances that can span both domestic and international boundaries. The chapter will focus on the impediments—both domestic and international—to the mobility of intermediate and final goods.

7.2 The likely messages are:

- **Declining transport costs lead to greater economic concentration.** Over the typically observed range of transport costs, reductions in these costs should be expected to lead to greater, not lower, concentration of economic activities, when scale economies are present. It is only for activities for which agglomeration economies are weak, or when transport costs fall to very low levels and congestion costs begin to outweigh agglomeration economies, that some activities start to disperse again.

- **Declining transport costs lead to increased trade in intermediate goods**. As a consequence of increasing returns to scale and greater specialization due to an expanded market size made possible by falling transport costs, intra-industry trade (that usually takes place among neighboring countries and cities that have similar endowments) increases by more than inter-industry, which takes place among countries that have different endowments and are usually more distant. This somewhat counter-intuitive result—because one should expect trade in goods and with countries that are more distant to increase by more when transport costs fall—is because of the presence of scale economies in production.

- **Low costs of communication lead to increased demand for human capital.** Very low costs of transport and communications—as have been observed due to advances in ICT—should theoretically lead to de-concentration of economic activities, but preliminary observations indicate that this dispersion has occurred only where human capital is available. While some countries have benefited from the rapid decline in communication costs, the activities have gone to large cities in these countries. A similar dispersion to smaller cities has been observed only in developed countries, where skill differences between large and smaller cities and towns and, sometimes, even rural areas, are not large.

7.3 The chapter will examine the evidence for these hypotheses, using historical data and empirical analysis of recent developments.

Transport Costs and Concentration

7.4 Falling transport costs are expected to ultimately result in the "death of distance". But this does not mean the demise of concentration; if anything, the presence of increasing returns to scale can imply exactly the opposite. As transport costs decline, it becomes possible to spatially separate consumers and producers, but there is an incentive to choose locations that are close to large markets, and service smaller markets at long distance.[6] Production takes place where firms can reap the pecuniary and technological benefits of proximity to other firms. Falling transport costs mean that intermediate goods can be more easily transported from where they are found or produced, and final goods can be transported to where the consumers are located. The chapter will examine whether the evidence from developing countries is consistent with this prediction of the theory.

Transport costs, trade in intermediate goods, and regional integration

7.5 It is hypothesized that transport and communication costs have fallen differently during two waves of globalization. During the first wave, based on steam power and the telegraph, transport costs declined enough to make large scale trade possible, but only between countries with big differences in comparative advantage. This happened to be between distant countries because distance is often associated with large differences in climate and natural endowments (e.g., England and India). During the second wave, that happened over the last half-century, transport costs fell enough to make small differences in products and tastes fuel trade, hence the rise of intra-industry trade and intra-regional trade.[7] It has also meant a change in the nature of long-distance trade, mainly in the form of a rise in manufacturing exports (based on differences in labor abundance) and a fall in the share of agricultural goods (based on climatic differences) from developing countries.

7.6 With a fall in transport costs, physical geography matters less; but in the presence of scale economies, economic geography matters more. The chapter will assess whether the evidence from developing countries supports this view.

Communication costs, dispersion, and human capital

7.7 The ICT revolution and the fall in costs of communications to very low levels raises the possibility of a reversal of concentration, since—as proposed by theory—at these low costs, it is no longer necessary to concentrate production of services that rely on communications. The most widely cited example is the outsourcing of service centers to India and the Philippines.

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[6] This leads to what is called the "home market effect": countries, regions, and cities should, other things equal, export goods subject to increasing returns which have large local demand.

[7] The most striking example is that of UK's trade composition. In 1910, Asia's share of the total was about 25 percent, and Europe's was 35 percent. By 1996, Asia's share in UK's exports had fallen to about 10 percent, and Europe's had risen to 60 percent.

7.8 But there is growing evidence that while these changes do imply that some economic activities that were located in richer countries will be moved to poorer countries, they will be spatially concentrated in those countries. The causes are believed to be related to the availability of skilled workers, or to the thickness of the market for human capital. The chapter will examine the consequences of the rapid technological progress in information and communications technology for the possibility of exploiting scale economies without geographic concentration.

Part III. Reconciling Concentration and Spatial Equity: Policy Implications

Chapter 8 Urbanization Strategies: Integrating Rural and Urban Areas

"The study of urbanization and growth focuses on five related questions. First, why do cities form and why is economic activity so geographically concentrated in cities? …

"[The second set of questions are] how do cities interact with each other, at any instant in time? What are the trade patterns across cities in final and intermediate outputs and how does that correspond to the roles of big and small cities? In what ways are cities specialized by either products or functions, and why? How do these patterns of specialization and diversification relate to city labor force compositions and human capital accumulations?

"Given the role of cities at a point in time, the third set of questions asks how urban growth intersects with, or even defines national economic growth? … How are the two tied together? In addition the stochastic forces that shock production processes, invention, and technological progress must also play out in an urban form. How does that occur?

"The fourth set of questions asks how governance, institutions, and public policy affect urbanization, which then in turn affects economic efficiency and growth. …

"The final set of questions has to do with where cities locate and the economic geography of urbanization. In what regions do cities cluster and why are some regions so sparsely populated? What first nature forces of natural resource locations, including rivers and natural harbors, drive the location of economic activity? How do transport costs and technological change in transport costs affect the extent to which coastal versus hinterland regions are inhabited? And what is the role of second nature forces and history on location – how does the accumulation of economic activity based on historical market forces affect the current spatial patterns of economic activity?"

J. Vernon Henderson (2005): "Urbanization and Growth"

8.1 Chapter 2 presented the stylized facts regarding the relationship between urbanization, growth, and poverty across the world, and Chapter 5 summarized the theory and long-term experience of countries. This chapter will focus on the prerequisites for and policy implications of an effective rural-urban transition in developing countries. It will draw from the findings of the preceding chapters and will discuss how policies have changed over time and across countries. It will take into account the WDR08 messages for rural development and economic growth.

8.2 The likely messages are:

- **Rural development policies should change during the development process but will remain important throughout the rural-urban transition.** Coordination at all levels (spatial and across government levels) is critical to ensure that growth and poverty reduction remain rapid. The specific policy measures may differ depending upon the stage of development, with the

emphasis changing from removal of biases against agriculture, to investment in rural social services, to investments in rural infrastructure. An integrated policy framework is perhaps the most essential tool for crafting a relatively smooth transition.

- **Urban development policies should aim to reduce congestion-related external diseconomies and then, progressively, to maximize the positive agglomeration economies.** Specific policies will differ depending on the stage of urbanization and the socio-political context. For early developers, the priority would be to facilitate externalities associated with market size, by providing basic city services, public infrastructure and minimum urban planning to guide private-led development. At later stages of urbanization, city development strategies could aim to minimize negative externalities due to congestion (including pollution, crime and violence, etc.) and to address market failures. At more advanced stages; the policies should include measures to maximize positive technological externalities, such as those associated with knowledge spillovers. At this stage, overall investment climate and amenities play a crucial role in maintaining the growth momentum of productive cities.

- **Urban finance and city management play a central role at all stages of urbanization.** City, state and national government can help ensure a robust rural-urban transformation, through provision of good investment climate, urban transport, and reliable physical and informational infrastructure, and basic public services. while minimizing congestion costs (pollution, crime, etc.). Land markets are especially important.

- **The rural-urban transformation affects and is in turn affected by global climate change.** City managers are increasingly aware of the need to adopt measures to reduce pollutants (mitigation) but also to prepare for the consequences of global warming in their physical conditions (coastal cities), production costs (especially energy), and potential inflows associated with displacement. Over the short term, rural areas may be more severely affected by the predicted global warming than urban areas. Over the longer term, cities could be affected more seriously, especially those in coastal areas.

8.3 The messages will be organized using a typology of countries along the following lines:[8]

[8] These categories are somewhat different from WDR 1979, which identified three distinct groups: Latin America (relatively urbanized, reliant on large cities, with urban poverty a major concern), Sub-Saharan Africa (predominantly rural, rapid urbanization, but urban poverty not a major concern relative to high rural poverty), and South Asia (predominantly rural, slow urbanization growth, and persisting rural poverty). The urbanization patterns of other developing regions lay between these three prototypes: the Middle East and North Africa, Southern Europe, and East Asia "… are less troubled by regional disparities in economic activity and income, though important pockets of urban poverty and regional stagnation exist in some nations such as the Philippines and Turkey."

- Countries such as those in Sub-Saharan Africa and South Asia that are urbanizing rapidly but economic growth have been low and/or erratic and poverty rates are high. Examples of Senegal, Nigeria, Kenya and South Africa will be used to compare different approaches used by these countries.

- Countries such as those in East Asia which are urbanizing and developing at record rates (with unique changes in the landscape transformation and the creation of local entrepreneurial class) that have not yet reached high levels of urbanization and still have high levels of poverty. Countries in Middle East and North Africa are a variant of this type, with relatively low levels of poverty.

- Countries such as those in Eastern Europe, Central Asia, and Latin America that have already reached high levels of urbanization, and which are both urbanizing and growing at a slow pace, but which have low levels of poverty reflecting economic and political structures that accentuate inequality and lack of social mobility.

8.4 For reference, the experience of OECD countries, especially of European countries since the industrial revolution will be outlined to serve as reference of how rural-urban transitions involve discontinuities and social costs that can be smoothed through policies and planning.

Lessons from the developed world

8.5. The lessons from two centuries of rural-urban transition in European countries will be useful in understanding the rapid changes occurring in developing countries and the relative merits of past policies. Of particular interest will be the understanding of the triggers that precipitated migration to cities in the European cities of the 18^{th} and 19^{th} centuries, the policies that enabled a quick improvement in farming productivity, the role of the private sector during the transition period, and the importance of social policies to cushion the cost associated with the social change and economic structure. Of equal importance will be an understanding of the pattern of policies and investment that led to a relatively balanced city system in some European countries and the specific policies addressing poverty. It would be also important and interesting to understand whether "historical accident" can explain the emergence of major economic centers in the last two centuries and how other (both enabling and discouraging) factors have contributed to their development

How urban growth will stimulate rural areas

8.6 The conclusions of WDR 2008 will be summarized as background for this section. Policies aimed at rural development can be of several types. From the transition view point, it would be crucial to understand that as cities develop and urbanization progresses, labor force skills become a key ingredient in the growth process. To ensure that urbanization is driven by people seeking better economic opportunities and not just

better access to social services, rural social service provision should become an important component of urbanization strategies. Investments in rural education, for example, have the effect of increasing rural productivity, enhancing the well being of the rural residents but also softening rural-urban migration and helping cities deal with urban growth in a more gradual way. And rural workers today may be urban workers tomorrow: enhancing the capability and skills of rural populations will contribute to the economic growth of cities in the future. Besides social service provision, policies related to land reform, secure property rights, and access to credit markets will be important.

8.7 At more advanced stages of development, investments in infrastructure in rural areas become progressively important. First, rising urban rents and wages due to agglomeration begin to push lower value-added activities away from cities or at least to their suburbs and peri-urban areas. Firms that benefit from increasing returns to scale (or from market niches or innovations) remain in cities since they can afford the high rents, while those who cannot exploit scale economies find it profitable to relocate. Rural areas and peri-urban areas (including smaller cities) have to provide a suitable environment for productively absorbing these relocating firms. Second, rural and urban markets become more integrated. Rural and urban residents supply intermediate inputs to production in both cities and the countryside, and consume final goods and services produced in both rural and urban areas. Thus, investments in rural sectors—typically agriculture and agro-based activities—are necessary throughout various phases of development. Gains in agricultural productivity as well as improved profitability from agro-activities that exhibit increasing returns to scale will contribute to rural and overall growth.

Urban development

8.8 While urban policies should ensure an unbiased development of city systems and urban-rural exchanges, public policies may have at times fostered excessive (or too little) concentration of economic activity. For example, national policymakers could favor the national capital for political or personal reasons. The assessment of such policies, and to what extent they have distorted the urbanization pattern, will also be part of this chapter.

8.9 Scale-based growth will necessarily lead to concentration of economic activities and increase in urban populations. Some of this increase will be in large cities, but several projections indicate that more than half of it will be in cities that are smaller than one million. While this pattern is recognized, the policy question is how to help smaller cities to improve their management and infrastructure capacity to be able to absorb the predicted inflow of activity and residents and also connect to world markets. This chapter will discuss the priorities for the management of cities as various stages of the rural-urban transformation, avoiding the false dichotomy between large and small cities but emphasizing the systemic nature of cities and the ingrained interdependence across the spectrum of farm agglomerations, small and large cities.

8.10. Regardless the size of the city and its expected growth, the functioning of factor markets and social services is essential to ensure benefits from agglomeration.

- **Land markets.** Urban land markets need to work properly to allow for efficient allocation and pricing. This affects the competitiveness of the city (and sector composition), wellbeing of households, shape of the city, and distance of the new entrants (often poor) from the job market. Zoning, construction permits, space regulations, height constraints and overall planning restrictions have a major impact on land prices. For example, Mumbai has the highest office space prices in India (sometimes higher than in Hong-Kong) due to urban restrictions that limit the height of the buildings in the central business district). Restrictions on the use of land, minimum plot size and unclear property rights often limit the capacity of poor residents to afford formal housing and encourage informality and squatting.

- **Housing markets.** Representing an average of 25 percent of family wealth, shelter has a major impact on growth and poverty alleviation especially during the transition phases. Developing countries rarely have the capacity to deal with the exponential demand associated with newcomers. The experience in many countries shows how national housing policies can have a significant impact in the conditions of the newcomers as well as in providing opportunities for low-skill migrants and small and medium enterprises. Experiences in Europe, China, Morocco and Africa will highlight the importance of looking at housing as a major amenity for working class and asset for the poor.

- **Local finance and infrastructure:** Finance is a binding constraint to the provision of local infrastructure and services required for the exploitation of urbanization benefits. Poor countries have a weak fiscal base, and have limited opportunities to use cost recovery, tax increase or access to credit markets. Cities and central governments need to consider alternative approaches adopted by committed countries faced with growing needs but weak economic and fiscal base. This includes private and public partnerships to provide intermediate financing and infrastructure services.

- **Urban poverty:** Urbanization is generally accompanied by increasing numbers of urban poor as migrants join the ranks of the poorest workers. Data indicates that at least in Latin America newcomers are integrated into urban labor markets in about five years. But the short-term impact of increased urban poverty often is a policy concern. While informality is a transient form for low-skill workers to adapt to a new environment, cities have difficulty in helping their transition into formality. In addition, cities can be highly segregated.[9]

- **Urban governance.** Effective governments not only pick the right goals, they also have the technical skills and financial resources that enable them to deliver on them (e.g., Barcelona and Bogota). Effective governments also take into account how urbanization is dramatically altering the political balance of cities.

[9] . In many Latin America countries, local firms spend more than 10% of their expenditures in security measures; workers fear for their lives and are not available to work the night shift; education and social functions are disrupted. Local governments have a key role in crime and violence prevention

Large numbers of migrants tilt the equilibrium from political representation to political direct participation, demanding "instant solutions" at the expense of existing rules and institutions. How to manage this change is a challenge.

8.11 The development of new cities needs to be part of the rural-urban expansion. Where to locate new cities is an important issue in many developing countries. Egypt, for example, has established several new cities, but the results are at best mixed. In addition to developing vital industries, these new cities need to be attractive enough for migrants to come, who otherwise would have gone to already overcrowded mega-cities. However, such a choice requires a careful cost benefit evaluation given the high cost of infrastructure and the less tested benefits. In China, in order to absorb the urbanization surge while diverting migrants from Shanghai and other coastal cities, new cities were built between the prosperous coast and the poorer interior. The characteristics of the urbanization process in China are probably unique as China uses controlled migration policies. The Report will assess the outcomes associated with different approaches taken to decide where new cities should be built and how this fits into a strategy to facilitate the rural-urban transition.

Adapting urbanization strategies to global climate change

8.13 Cities are both victims and perpetrators of climate change. Urban areas are responsible for more than 75 percent of all energy use and greenhouse gas (GHG) emissions. They generate the lion's share of solid waste, electricity demand, transport-related emissions, and space-heating and cooling demand. On the other hand, cities and local governments are best positioned to set the enabling framework for a healthy, safe, and pollution–free environment, as well as for taking a leadership role in addressing the challenges related to hazard management as countries adapt to climate change. For example, hundreds of cities in the US recently signed the US Mayors Climate Protection Agreement, committing their cities to reach Kyoto emission reduction targets.

8.14 For both cities and rural areas, adaptation to climate change may soon become urgent. Many cities are located along the coast or on floodplains, for obvious reasons such as nearness to markets. However, attributes that conferred natural advantage to these settlements now are becoming risk factors. Heat waves and drought threaten cities located in arid areas such as those in the Middle East and North Africa, with shortages of water supply. Many of the world's most populous cities that are on coastal lands face the threat of inundation due to rising sea levels, increased exposure to communicable diseases, water shortages, and exacerbated urban pollution.[10] In addition, large scale movements of 'climate refugees' will also put cities under stress, especially the poorest.

8.15 There are considerable spatial disparities in the emissions of pollutants and their effects: many developing countries are not the biggest polluters, but may well be the most affected. The Report will discuss the promising ways to increase the knowledge and awareness across cities, evaluate examples of sustainable urban transition and policies;

[10] Two-thirds of the world's cities with populations in excess of 5 million inhabitants are in low elevation coastal zones (less than 10 meters above sea level).

discuss the links between city management and climate change, especially when decisions regarding on land occupation patterns and transport alternatives; the role of cities in mitigation and the challenge of adaptation; and how climate change is heightening the risks faced by about one billion people living in high risk slopes and unsuitable places.

Chapter 9 Territorial Development: Linking Lagging and Leading Regions

"Policy makers often argue that a strong rationale for decreasing regional inequalities is that it is part of the wider objective to decrease inequalities between individuals. Spatial cohesion is part of an overall objective of social cohesion. This is based on the belief that there is a strong relation between spatial inequalities and individual inequalities, so that regional policies that decrease spatial inequalities can also decrease individual inequalities.

"Public economic intervention must either be based on efficiency or on equity considerations. …On the efficiency motive,…increasing returns, which explain spatial economic concentration, also point to the efficiency gains of this process. ..Recent econometric evidence shows, in the European context, that these gains should be taken into account when defining regional policies. In the light of the recent enlargement, this is a crucial tradeoff. On the equity motive, the evidence suggests that national redistribution schemes (income taxes, social transfers, etc) that are not spatially defined do reduce spatial inequalities … but may not be sufficient instruments to reduce social inequalities."

Philippe Martin (2005): "The Geography of Inequalities in Europe"

9.1 Chapters 2, 3 and 6 present stylized facts on the spatial distribution of economic activity within countries and identify how national growth acceleration and openness to international trade are accompanied by spatial differences in economic mass within countries. This chapter will discuss the effectiveness of alternate strategies that governments have used to manage the 'spatial divide', and outline the elements of effective development strategies for both leading and lagging regions in developing countries. This chapter will provide a framework for assessing specific spatially targeted interventions in the context of stimulating national economic performance.

9.2 The likely messages are:

- **The goal of regional development policies should be to offset the disadvantages of economic opportunity associated with lagging regions, not to equalize economic mass across territories**. Spatial redistribution that leads to equity of opportunity moderates spatial disparities in living standards can help long run development. Realizing this goal involves identifying spatial redistribution programs that stimulate local potential and improve quality of life, but which are not inconsistent with national growth objectives; and identifying appropriate financing mechanisms for these programs. These programs are often financed through inter-governmental transfers or direct expenditures by higher levels of government. But these transfers may affect the incentives of sub-national governments to foster their tax base. Alternative

strategies that stimulate local revenue sources, such as exploiting natural resource rents, should be explored.

- **Effective regional development strategies should aim to integrate leading and lagging region factor markets.** Enhancing factor mobility holds the key for territorial development, which include strategies that stimulate out-migration from areas of low opportunities and promote capital flows into disadvantaged regions. The overall development challenge is to balance spatial redistribution objectives with national growth objectives. The difficulty in increasing capital flows to lagging regions is to offset the advantages that leading regions offer in terms of agglomeration and access to markets. The difficulty associated with increasing labor flows to leading regions is that there are households in lagging regions who are less mobile due to cultural preferences or other constraints.

- **Industrial policy to promote capital flows to lagging regions has had ambiguous local effects and adverse national growth effects**. While industrial policies have been used in many developed as well as developing countries to correct regional imbalances, there is no conclusive evidence to suggest that these policies have succeeded in transforming the fortunes of lagging sub national regions. The limited success of industrial policies is due to the fact that they generally focused on the wrong goal, relied on the wrong instruments, and were often poorly implemented.

- **Policies that both increase national growth and reduce spatial disparities involve increasing inter-regional flows of human capital. The spatial effects of infrastructure policies will depend on the type of infrastructure.**

  - Human capital formation in lagging regions has both direct productivity effects and indirect positive externalities. By helping workers take advantage of opportunities in dynamic labor markets, often in leading regions, these policies can increase growth in lagging and leading regions.

  - Infrastructure policies in telecommunication, internet, and passenger transport that increase between-region flows of knowledge help in bridging the spatial divide.

  - Better within-region transport infrastructure that helps intra-regional trade and link farms to markets stimulates growth in lagging regions. However, there may be national growth costs if these investments take resources away from supporting dynamic but congesting agglomerations.

  - Infrastructure policies that increase between-region trade in goods and services will increase national growth rates but could exacerbate gaps between lagging and leading regions.

The record of territorial development programs

9.3 Widening regional disparities is a major concern for policy makers. Many governments have opted for directed interventions to offset spatial imbalances in economic outcomes associated with structural transformation and have tried to promote relatively balanced territorial development. While some public interventions have been topic or sector specific national programs which tend to have spatially differentiated effects due to initial conditions and lags, much of the focus of territorial development activities has been on spatially targeted programs.

9.4 This section will outline the experience with territorial development policies, and provide the reasons for the generally negative assessment of such initiatives.

Elements of a successful approach to territorial development

9.5 The chapter will propose that, in the broadest terms, the aim of territorial development strategies should be to integrate lagging and leading region markets. The most effective way to do this is to stimulate inter-regional mobility of labor, capital, and technology. It will propose the specific instruments for doing policies that are most likely to do this, given the stage of development of the country.

9.6 Specific policies and programs can be classified into two main groups: Out-migration or labor flow strategies to “move people to jobs” (e.g., programs in Korea, Indonesia, Mexico, Thailand). And interventions to “move jobs to people”, which include promoting capital flows, economic base diversification through expansion of industrial sectors (e.g., Thailand, Mexico, Northeast Brazil, Northeast Malaysia, Argentina, India), and decentralization of economic activities (e.g., Thailand, Kenya, Argentina, Mexico).

9.7 The instruments include some combination of: *investing in education*—which can stimulate local productivity and increase mobility of workers; *investing in inter regional and local infrastructure*—which can increase market access or connectivity and build local comparative advantage respectively; and *industrial policy*—which includes investment subsidies, tax holidays, industrial estate development.

9.8 The chapter will synthesize the experience of Europe’s economic integration in speeding convergence in per capita income among countries, and the more debatable performance of EU structural funds in fostering within-country equality and convergence among regions, highlighting the differences between cross-regional and within-region infrastructure investments. It will review the more successful experience of convergence in living standards among the US regions despite greater concentration of economic activities, highlighting the role of labor mobility.

Informational and institutional pre-requisites for success

9.9 Designing effective territorial development strategies requires answering three questions. First, what instruments are best suited to reduce spatial disparities within a country, subject to local political and resource constraints? Second, where should policies

be targeted (leading regions, lagging regions, intermediate regions)?[11] And third, are policies aimed at increasing spatial equity consistent with strategies of accelerating national economic growth—or is there an efficiency equity trade-off in pursuing specific territorial development strategies?

9.10 The chapter will provide an assessment in terms of local and national growth, of a representative set of instruments used in developing countries, using a lens that explicitly takes into account the influence of agglomeration forces and clustering on strategies that try to influence factor mobility.[12] The instruments assessed will include Brazil's constitutional funds, India's centrally sponsored schemes and highway development programs, Kenya's secondary city development program, and Mexico's large city de-concentration program.

9.11 Case studies that highlight the local and national cost/benefit of specific instruments will be drawn from Brazil, Mexico, Russia, India, China, the Balkans, Indonesia, Kenya, Uganda, and Ghana. The countries represent a range of developing countries at varying levels of development where the spatial divide in economic outcomes is an important policy concern. The spatial challenge is particularly acute for low income countries where modern sector growth engines are in early stages, and their national governments face severe trade-offs in spatially distributing resources (both financial and skills). The aim of these case studies will be to identify the informational and institutional pre-requisites for effective regional development policies, at different stages of development.

Chapter 10 Regional Integration: Connecting Poor Countries to World Markets

"The most striking difference between Africa and other developing regions is in the proportion of the population in landlocked resource-scarce countries. Put another way, outside Africa, areas with these poor endowments seldom became independent countries; rather, they became hinterlands of countries that are overall more fortunately endowed. In hindsight, the creation of so many such countries in Africa may have been a mistake, but it is now difficult to change. Indeed, recent political secessions are adding to the number of such countries.…

"Globally, there are some obvious examples of success, such as Switzerland and Austria. However, these countries have benefited enormously from their neighborhood. In effect, being landlocked has not cut them off from international markets but rather placed them at the heart of a regional market. More generally, historically, the most promising strategy for such countries has been to orient their economies toward trade with their more fortunately endowed neighbors. This shows up in the growth spillovers. Globally on average, if neighbors grow at an additional 1 percentage point, that raises the growth of the country itself by 0.4 percent. Outside Africa, the

[11] There is evidence from China that improving regional transport links outside lagging regions that connect them to the coast has high growth impacts—so improving neighborhoods may matter. Dysfunctional urban systems may trap low value industry in large cities—inter-regional transport improvements allow firms to locate in secondary cities as they can still be connected to large city markets, but face lower wages and rents.

[12] In particular, lowering transport costs and improving education.

landlocked resource-scarce economies on average gain larger spillovers, at 0.7 percent. Thus, they are consciously orienting their economies towards making the most of these growth spillovers. In Africa, the growth spillover for the landlocked resource-scarce economies is a mere 0.2 percent."

This suggests that the critical path for the landlocked resource-scarce countries to succeed is first that their more fortunate neighbors need to harness their opportunities, and then that the subregional economies need to become radically more integrated.

Paul Collier (2007): "Africa: Geography and Growth"

10.1 Chapter 4 describes the persistence of division in developing world-regions through fragmentation, poor physical geography, and negative neighborhood effects. Chapter 7 highlights the interaction between the decline in transport costs and the presence of scale economies that leads to trade in intermediate goods which catalyzes regionalization. This chapter will use these facts and mechanisms to make the case that a regional integration policy encompassing economic, physical and institutional integration as well as global integration through markets and suppliers' access will address the development challenges of developing world-regions that are highly fragmented and poorly connected to world markets.

10.2 The likely messages are:

- **Regional integration matters in scaling up the supply capacity of developing countries, while global integration scales up the demand they face.**. A regional integration policy based on trade-related reforms and multi-country infrastructures cooperation at the regional level can help to scale up the supply capacity of developing countries. A global integration policy based on the improvement of markets and suppliers' access can scale up the demand faced by developing countries. The EU, the East Asian and the North-America cases show that a good regional and global integration policy helps to build viable neighborhoods.

- **The experience (successful and unsuccessful) of developing world-regions confirms that the drivers of agglomeration can be enhanced through regional trade-related as well as multi-country infrastructures cooperation.** Trade-related initiatives include domestic business climate, trade and transport facilitation and liberalization of production factors movement. Multi-country infrastructures include productivity-enhancing infrastructures such as power pool systems, connectivity-enhancing infrastructures such as roads, railways and ICT infrastructures, and factor mobility-enhancing infrastructures such as supra-national education and research centers.

- **The development challenges of Sub-Saharan Africa can addressed by such two-pronged policy involving regional and global integration initiatives.** The interaction between geography and history of Sub-Saharan Africa has resulted in three types of countries: resource rich, resource poor

and coastal, and resource poor and landlocked, each with about a third of the region's population, leading to more than one neighborhood of countries. The fate of such a region is dependent on the viability of these neighborhoods, and their accessibility to world markets and suppliers.

Regional integration to scale up supply capacity, global integration to scale up demand

10.3 The World Bank European Reconstruction loans were the first external supports to Europe after World War II, preparing the way for the Marshall Plan. This support from the international community helped launch the European integration led by France and Germany through the European Coal and Steel Council. The East Asian renaissance is acknowledged to have been led by the emergence of China to complement Japan's economic leadership in the region. The NAFTA is acknowledged to have induced the development of new economic activities along the US-Mexico border. The new economic geography models support the West European, East Asian and North America approaches: the international community has helped the development of viable neighborhoods that were able to generate scale economies and encouraged better connectedness to regional and global markets. A regional integration policy based on trade-related reforms such as behind-the-border reforms (domestic business climate), between-the-border reforms (trade and transport facilitation) and at-the-border reforms (liberalization of production factors movement); as well as multi-country infrastructures cooperation can help to scale up the supply capacity of developing countries. A global integration policy based on the improvement of markets and suppliers' access will scale up the demand faced by developing countries. International organizations can use aid and preferential access to markets to help developing countries materialize their regional and global integration policies.

Building viable neighborhoods

10.4 Some developing countries have taken the lead in the development of viable neighborhoods through better goods and capital markets integration. This helps to develop production and social networks in the neighborhood and thus spill over the positive externalities of strong growth and social peace over the member countries. The East Asia experience suggests that economic growth in some leading countries can be a key regionalization instrument. The Report will utilize ongoing work on neighborhood growth effects of middle income countries Sub Saharan Africa being coordinated by the AFR Chief Economist's office in collaboration with Oxford University's Centre for Study of African Economies. Particular attention will also be given to political, institutional, socio-cultural interactions as well as shared natural resources that could yield negative neighborhood effects such as conflicts, and thus reduce any chance of success of the regional integration.

Addressing the development challenge of Sub-Saharan Africa

10.5 This part will use the insights developed in the Report to rethink growth strategies in geographically challenged as well as better endowed countries in Sub-Saharan Africa.

The interaction between physical and human geography of Sub-Saharan Africa results in especially difficult problems: resource-rich and ethnically diverse societies, resource-scarce societies with poorly educated and diverse populations, slow-growing economies with young and diverse population, and fragmentation. All these constraints interact to form at least four neighborhoods: Western Africa, Central Africa, Eastern Africa and Southern Africa. The Report will propose differentiated country-specific strategies using endowments and economic geography to classify countries, as well as policies to improve regional integration, such as:

- Restructuring foreign aid to facilitate regional trade integration and access to ports through multi-country infrastructure projects;
- Championing initiatives to strengthen regional trade and financial integration, including reciprocated free trade with neighbors, and a low common external tariff;
- Measures to improve air-traffic and information technology, and avoiding being air-locked or e-locked;
- Improving the management of resources, not necessarily through smaller public sectors but through more accountable governments;
- Encouraging free trade policies in resource-rich countries, and better design of export processing zones to foster intermediate goods trade in coastal countries.

10.6 The Report will draw upon the Africa region initiative on these issues being coordinated by PRM and SDN staff in collaboration with Oxford University's Centre for Study of African Economies.

Annex: Economic Geography and Spatial Disparities in Past WDRs

A1. The importance of economic geography has been the subject of earlier WDRs which have covered several areas of policy relevant to the spatial transformation that accompanies economic development. These areas of development policy range from structural change and urbanization; international trade and the globalization of the world economy; to localization of political decision making, and the influence of geography on economic opportunity and poverty.

Economic growth, urbanization and poverty

A2. Thirty years ago, WDR 1979 "Structural Change and Development Policy" analyzed the processes of industrialization, urbanization, and the sectoral deployment of labor. In a remarkably prescient chapter, the report assessed the key features of urbanization in developing countries, discussed the determinants of "national spatial development", and proposed policies for efficient and equitable cities. The report argued that while "urbanization in the industrialized countries took many decades, permitting a gradual emergence of economic, social, and political institutions to deal with the problems of structural transformation, the process in developing countries is occurring far more rapidly, against a background of higher population growth, lower incomes, and fewer opportunities for international migration."

A3. WDR1979 identified three distinct urbanization patterns: Latin America (relatively urbanized, reliant on large cities, with urban poverty a major concern), Sub-Saharan Africa (predominantly rural, rapid urbanization, but urban poverty not a major concern relative to high rural poverty), and South Asia (predominantly rural, slow rates of urbanization since rural-urban differences in standards of living are small, rural poverty is still the main concern). The urbanization patterns of other developing regions lay between these three prototypes: the Middle East and North Africa, Southern Europe, and East Asia "… are less troubled by regional disparities in economic activity and income, though important pockets of urban poverty and regional stagnation exist in some nations such as the Philippines and Turkey."

A4. The 1979 report pointed to the main concerns of policymakers: urbanization is excessively rapid, concentrated and costly; urban centers lack employment opportunities, housing, and public services; cities are poorly run, becoming congested and polluted. The report then identified the main causes of these problems. Population growth, not rural-urban migration was the main cause of urban population increases. Rural-urban migrants were not imposing a greater burden on city governments than their urban counterparts. People were moving to cities in search of better education and employment. The true determinants of urbanization and spatial concentration were to be found in the pattern of industrialization, the pace of agricultural development, and the growth of transport and communication networks.

A5. WDR 1979 went on to identify the principles for "a more balanced spatial development pattern": bringing down birth rates to slow urban population growth; removal of national policies that bias pattern of development toward large cities—

subsidies for urban services, urban biases in credit allocation and public investment, and fiscal allocation rules that favor urban centers; supporting the development of existing cities of intermediate size through sustained application of decentralization policies; and directly addressing the congestion and public service problems of large cities. If increased efficiency and equitable growth in cities are the goals, the focus of policies should be to increase private employment and improve public services. The former should be pursued at the national level, while the latter are often appropriately local concerns. WDR 1979 concluded that local investment in public transport, housing, education, and health are the principal priorities.

The Focus on National and International Adjustment

A6. Throughout most of the 1980s and much of the 1990s, the spatial issues of economic development raised in WDRs were confined to structural adjustment and international trade. The consequences of economic geography and the forces of spatial transformation were found, in several reports, to have been distorted by import substitution industrialization policies with a distinct urban bias, and adverse impact on the poor.

A7. Several reports showed how changes in spatial patters could be influenced through policies governing international trade and capital flows and through changes in national production and consumption patterns. Considerable attention was paid to international trade in agriculture, which remains the chief source of income for close to two-thirds of the population in developing countries and for the vast majority of the world's poor.

A8. WDR 1986 “Trade and Pricing Policies in World Agriculture” raised considerable concern at the increase in international trade restrictions, and argued that reform of domestic institutions should be accompanied by effort towards international freer trade. The report concluded that gradual liberalization of trade should be a high priority for international action in agriculture. An examination of the policy options in developing countries suggests that economic stability and growth could be greatly enhanced by focusing on improved pricing and trade policies.

A9. WDR 1987 “Industrialization and Foreign Trade” placed emphasis on policies which affect both the efficiency and sustainability of industrial transformation, especially in the sphere of foreign trade. The report found that developing countries which followed policies that promoted the integration of their industrial sector into the international economy through trade have fared better than those which insulated themselves from international competition.

A10. WDR 1991 “The Challenge of Development” argued that one of the four main aspects of the relationship between governments and markets was the integration of countries with the global economy. While WDR 1994 “Infrastructure for Development”, made strong arguments for improving the quality of infrastructure services to modernize and diversify production, help countries compete internationally, and accommodate rapid urbanization. WDR 1995 “Workers in an Integrating World” concluded that global

integration holds out the prospect, but not a guarantee, of tremendous future gains for the world's work force. Sound domestic and international policies are indispensable for realizing the promise of a prosperous, integrated global workplace. And WDR 1996 "From Plan to Market", which focused on the challenges faced by countries emerging from the socialist experiment, concluded that international integration was vital for successful transition.

Trade globally, vote locally*: *Spatial implications of a globalizing economy

A11. WDR 2000 "Entering the 21st Century" took up geography and the economics of space by discussing the economic forces of *globalization*, the political forces of *localization*, and how these forces interact. The report argued that localization—the growing economic and political power of cities, provinces, and other sub-national entities—will be one of the most important new trends in the 21st century. Together with accelerating globalization of the world economy, localization could revolutionize prospects for human development or it could lead to chaos and increased human suffering. Improved communications, transportation and falling trade barriers are not only making the world smaller they are also fueling the desire and providing the means for local communities to shape their own future. Faced with popular demands for greater self-determination, national governments from Africa to Latin America, and from Europe to South East Asia are devolving power to the local level with mixed results.

A12. WDR 2000 points out that given the growing importance of services and information in the world economy, an increasing proportion of economic value is "weightless"—that is, can be transmitted over fiber-optic cables rather than transported by container ships. This shift has profound spatial implications. Improvements in transportation networks and technology reduce the costs of commerce, while information technology makes it easier to manage new channels of exchange. Multinational companies rely on production chains that straddle many counties. And at the same time as the world is getting spatially "smaller" in terms of production and exchange of goods, rising education levels and technological improvements allow ideas to circulate faster. The economic failure of most centrally planned economies in the 1980s and early 1990s, contributed to a push for *localization*. National governments are responding to this push in various ways, but mainly by localizing many of the decisions historically taken by central government. National governments are increasingly sharing responsibilities and revenues with sub-national levels of government that are closer to the people affected by policy decisions.

A13. WDR 2000 links the forces of globalization and localization to the spatial transformation within a country that accompanies the development process. With development, agriculture declines as a share of the economy, and manufacturing and services begin to dominate. Goods and services are often produced most efficiently in densely populated areas that provide access to a pool of skilled labor, a network of complementary firms that act as suppliers, and a critical mass of customers. For this reason sustained economic growth is always accompanied by urbanization. The forces of globalization and localization have neither diminished the pace nor the importance of the

urbanization process—the agglomerative forces and *locational inducements* that shape cities.

A14. Indeed globalization promotes economic growth which is the driving force behind urbanization. In a modern, "globalizing" economy urban areas offer clear economic benefits: firms, regardless of size are able to experience economies of scale and scope. The presence of a common pool of labor, materials and services allows large and small firms alike to profit from scale economies. Economies of scope emerge when the presence of one activity makes carrying out a complementary activity cheaper by fostering diversity in supply and specialization among firms. Proximity also facilitates the diffusion of knowledge. Firms operating in proximity to each other benefit from information spillovers, in some cases by observing what neighboring firms are doing. When firms are concentrated in cities transactions costs fall, most notably the search costs involved in matching workers with employment opportunities. Thus, while globalization opens up new possibilities for linkages around the world, it also reinforces certain advantages of proximity (density). Firms competing in the global economy (and their suppliers) still benefit considerably from access to a sizable pool of labor, materials, services and customers.

A15. Furthermore, the growth of urban populations in both large capital cities and smaller municipalities, feeds demand for increased localization of political power. Part of the spatial transformation, is that countries not only develop larger cities, but more of them. An increasing number of metropolitan areas imply more centers of political power that feed the forces of localization and raise the stakes for good urban governance. This puts pressure on national institutions of governance and encourages them to take the steps towards decentralization, devolving power to sub-national regional authorities closer to households.

A16. While acknowledging the urban transformation spurred by a globalizing economy, and the implications for governance and policy making at the local level, WDR 2000 warned against policies that seek to push the spatial transformation through economic distortions. The report observed that some national governments tax rural areas or place restrictions on the prices of rural products as a way of supporting cities, on the grounds that such policies encourage a "modern" economy. Other government concerned about the growing population of urban poor, try to discourage migration, sometimes actually restricting the movement of workers and their families. Neither course of action has worked well. Preventing individuals from moving in response to incentives generally fails and governments have not proven adept at deciding where households and firms should locate.

A17. WDR 2000 argues that these "misplaced policy efforts" are one of the main reasons why—in contrast with other developing regions—countries in Africa have experienced urbanization with very little economic growth. The negative correlation between urbanization and per-capita income observed in Africa is unique. Unlike elsewhere, industrialization did not accompany the boom of urban growth. Cities in Africa are not serving as engines of growth and structural transformation. Instead, they are part of the cause of a major economic and social crisis that has enveloped the

continent. The African pattern of urbanization without growth is in part the result of distorted incentives that encouraged migrants to move to cities to exploit subsidies rather than in response to opportunities for more productive economic activity.

A18. WDR 2000 concludes that governments should pursue development policies that benefit both urban and rural areas recognize that the process of development will spur urbanization over time, and plan accordingly. Further, local governments can take important steps to make their cities more hospitable to economic development, by maintaining a sufficient level of investment in essential infrastructure, including by working with the private sector.

Ensuring the spatial transformation is environmentally and socially sustainable

A19. WDR 2003 "Sustainable Development in a Dynamic World" addresses some of the spatial challenges of economic development in the context of competing policy objectives—reducing poverty, maintaining growth, improving social cohesion, and protecting the environment. The report argues that the spatial consequences of depleting finite environmental assets mean that "the burden of guaranteeing sustainable development must be shared locally, nationally, and globally." Environmental and social stresses reflect the failure of institutions to manage and provide public goods, to correct spillovers and broker differing interests. Because the spatial extent of spillovers from the degradation of environmental assets varies by problem, appropriate institutions are needed at different levels, from local through national to global.

A20. The report shows that the distinctive feature of global challenges—such as sustaining environmental assets like water and land—is the lack of a central authority for coordination and enforcement. However, despite this obstacle there are encouraging examples of successful trans-national institution building to table environmental problems that cross borders. Success has been greatest in cases such as stratospheric ozone and acid rain, where the problem can be made operational in precise technical terms; where international action can therefore focus on tightly defined interventions, and where the perceived benefits of collective action have been high, for key actors, relative to the costs. It will be more difficult for other environmental and social problems—where the relationship between action and impact is less well understood and where the costs and benefit of action do not coincide.

A21. Turning to the environmental implications of fighting poverty, WDR 2003 acknowledges that the provision of productive work and a better quality of life for current and future generations in developing countries will require substantial growth in income and productivity. This in turn will require that the social, economic and environmental problems and opportunities accompanying the transition to a predominantly urban world be carefully managed. The report points out that while economists focus mainly on sectoral changes that accompany economic growth, "the most fundamental social and economic transformation—from traditional rural to modern urban—is manifested spatially".

A22. High-productivity, modern economies are generally higher in density and dependent on activities that benefit from proximity and do not require a great deal of land, such as manufacturing and services. The shift to these activities and rapidly changing land use patterns generate both social and environmental problems. The increasing share of national populations that will be living in urban areas is one of the main forces of social and economic transformation. Urban areas are expected to grow and the number of urban residents in developing countries will double through a combination of rural-to-urban migration, natural population increases in cities, and the reclassification of adjacent rural areas as urban areas. The growth of urban areas will require physical expansion of the urban periphery as well as redevelopment and densification within cities. Urban land use patterns, right of way arrangements, and building standards will affect energy and water use. The massive new investment in the capital stock of cities required for the doubling of urban population by 2030 will have a definite environmental impact.

A23. WDR 2003 sheds light on the plight of the growing numbers of urban poor left to fend for themselves in the wake of the rapid spatial transformation in developing countries. This has lead to the proliferation of large informal settlements without services, where resident face environmental hazards. Neglect in these growing urban slums creates high private as well as social costs. These costs can be mitigated through corrective measures such as confirming the rights and responsibilities associated with the occupation and use of land, and regularizing tenure status. Tenure reduces some of the risks that discourage residents from investing in their houses and shops, and gives residents a stronger stake in urban society and an incentive to work with local officials to obtain services.

A24. WDR 2003 concludes by raising several critical questions about the spatial transformation ahead of developing countries and the need for sustainable development. Will rural populations—especially those on fragile lands, in more commercially active areas and agricultural frontiers—be able to overcome poverty improve their livelihoods and adapt to new opportunities including opportunities in towns and cities? Will the rapidly growing cities of the developing world live up to their potential as dynamic engines of growth and social modernization, or will they get mired in poverty, pollution, congestion and crime? Will renewable resources—particularly forests, soil, water, biodiversity and fisheries—be depleted or will they be managed as indefinitely sustained sources of livelihood and well being? Will societies be sufficiently creative, resilient and forward-looking as they undergo sweeping transformations in (spatial) patterns of growth and migration? Will poor countries be able to accelerate their growth without destabilizing social and environmental stresses?

Geography and equity of service provision and economic opportunity

A25. More recently, WDR 2004 “Making Services Work for Poor People” warns that broad improvements in human welfare would not occur unless poor people receive wider access to affordable and improved services in health, education, water, sanitation, and electricity. The report sheds light on the strong correlation between poverty and inadequate provision of critical services, often with clear spatial disparities (between rural

and urban regions; between low and high income districts; and between areas settled by ethnic minorities and the rest of the population).

A26. WDR 2004 observes that while a trend towards decentralization of many critical government responsibilities to the sub-national level, can help to improve service delivery—by putting decision-making power in the hands of local politicians and empowering voters, and forcing service providers to be more accountable to households – decentralization can also aggravate spatial disparities. Municipal authorities will vary in financial and administrative capacity. In many countries that have decentralized responsibility for critical health, education and social services, households in different localities cannot count on some minimum uniform level of service. A "post-code" lottery can result, with households in different areas able to access very different levels of service. Inadequate services can create strong pressure to migrate to congested urban areas where services are already overburdened.

A27. WDR 2006, "Equity and Development" pays considerable direct attention to spatial disparities, pointing out that "…the predetermined circumstance that most powerfully determines a person's opportunities for leading a healthy and productive life is his or her country of birth." and that "Global inequities are massive." The report documents some of the many inequities in the functioning of global markets for labor, goods, ideas and capital, all of which have a direct impact on development outcomes. Unskilled workers from poor counties who could earn higher returns in rich countries face great hurdles in migrating. Developing country produces face obstacles in selling agricultural products, manufactured goods, and services in developed countries.

A28. The report shows that the impact of reducing imperfections in global markets will vary significantly by country. The larger and fast growing developing countries stand to benefit significantly from freer global trade, migration and capital flows, helping them sustain fast growth. Countries left behind in the global economy stand to benefit much less from global markets in the short run and will continue to rely on aid. For them global action that helps compensate for unequal endowments—particularly mineral and geographic endowments—is truly essential. Action to better exploit endowments is primarily domestic, through public investment in human development, infrastructure and governance structures.

A29. WDR 2006 observed that "…for many people in developing countries, lack of access to affordable infrastructure means living in isolation from markets and services and having intermittent or no supply of power or water for productive activities and daily existence." These spatial disparities often results in a significant curtailment of economic opportunities. The report argued that policy makers can improve the equitable provision of infrastructure services by focusing on expanding affordable access for poor people and poor areas. Further, WDR 2006 observed "heterogeneity in the effects of opening a country's product markets to trade, at least in the short to medium term. This is primarily due to geographic location, illustrating the importance of interactions between domestic product markets and patterns of infrastructure provision."

A30. One of the main messages of the report was that among the most important policies for creating equity of economic opportunity, is ensuring access to service and markets. The operational implications are for governments to ensure adequate investment in critical infrastructure allow households and firms to link with the global economy and overcome regional disparities.