OVERVIEW

Place, Productivity, and Prosperity
Revisiting Spatially Targeted Policies for Regional Development

Arti Grover, Somik V. Lall, and William F. Maloney

WORLD BANK GROUP
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Productivity accounts for half of the differences in gross domestic product per capita across countries. Identifying policies that stimulate productivity is thus critical to alleviating poverty and fulfilling the rising aspirations of global citizens. In recent decades, however, productivity growth has slowed globally, and the lagging productivity performance of developing countries is a major barrier to convergence with income levels in advanced economies.

The World Bank Productivity Project seeks to bring frontier thinking to the measurement and determinants of productivity, grounded in the developing country context, to global policy makers. Each volume in the series explores a different aspect of the topic through dialogue with academics and policy makers and through sponsored empirical work in the World Bank’s client countries.

*Place, Productivity, and Prosperity: Revisiting Spatially Targeted Policies for Regional Development*, the sixth volume in the series, takes up the geography of productivity within countries—the regional inequalities in production and poverty, and their persistence over millennia. These issues take on new salience as climate, technology, and trade shocks leave once prosperous areas behind, generating demand for specifically targeted and costly spatial policies whose track records are, fairly viewed, mixed. In its anchoring of discussion of the key drivers of spatial economic patterns in novel empirics from the developing world, and development of a new approach to assessing spatial policies, the team aspires to fill an important void in the existing development literature.

This volume is unique in its tight links with both academia and frontline World Bank staff. The core of the assessment framework (chapter 6) through which spatial policies are viewed was contributed by Gilles Duranton (University of Pennsylvania) and Anthony Venables (Oxford University), acknowledged experts in the field of spatial economics. They, in turn, joined the team meeting with Bank task leaders to understand how the leaders designed and assessed projects on the ground. The two-way learning process has ensured that the approach is both solidly grounded conceptually and in the current empirical literature and is relevant to policy makers everywhere.

Somewhat surprisingly, the finding of minimal agglomeration externalities in many developing country cities brings us full circle to the first volumes in the series on innovation and productivity; fundamentally, altering spatial patterns requires an underlying
structural transformation that, in turn, requires a well-functioning enabling environment along with the human and entrepreneurial capital to populate it. Building physical infrastructure may in many cases be necessary, but it will rarely be sufficient.

This book is a joint effort of the Urban, Disaster Risk Management, Resilience, and Land Global Practice of the Sustainable Development Vice Presidency and the Equitable Growth, Finance, and Institutions Vice Presidency.

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Other Titles in the World Bank Productivity Project


All books in the World Bank Productivity Project are available free of charge at https://openknowledge.worldbank.org/handle/10986/30560.
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Overview

This great city of Tenochtitlán is as big as Seville or Cordoba. It has many plazas where commerce abounds, one of which is twice as large as the city of Salamanca … and where there are usually more than 60,000 souls buying and selling every type of merchandise from every land … There are as many as 40 towers, all of which are so high that in the case of the largest there are 50 steps leading up to the main part of it and the most important of these towers is higher than that of the cathedral of Seville. The quality of their construction, both in masonry and woodwork, is unsurpassed anywhere.

—Hernán Cortés, La Gran Tenochtitlán, Segunda Carta de Relación (1522)
(authors’ translation)

A Virtuous Cycle of More Economic Concentration, Higher Productivity, and Greater Prosperity

The transformation of the ancient capital of the Aztec empire into modern Mexico City offers insights about place and its role in fostering prosperity and productivity that are relevant to today’s debates about urban and regional development. First, the conquistador Hernán Cortés chose to build the capital of New Spain literally and figuratively on the foundations offered by Tenochtitlán, which he so vividly extolled. Then, as now, it was precisely the benefits of the concentration of skills, markets, amenities, and information—so-called agglomeration externalities—that make cities and regions attractive and major drivers of national productivity. Second, Tenochtitlán’s location appears to have been nearly arbitrary, and in fact, extremely disadvantageous. Allegedly revealed in a dream, it was more likely the last resort of a despised nomadic people who were relegated to a swampy area by more powerful neighbors. Yet some combination of agglomeration economies and other forces have led it to retain its perch as the central hub of Mexican economic activity for 700 years—a perch from which it would be impossibly costly to dislodge. Finally, the spatial income inequalities of the time have also persisted over the centuries: the per capita income of Mexico City is six times that of Mexico’s poorest region, Chiapas.

Around the world, place remains central to prosperity, and especially so in developing countries. Contrary to expectations, income disparities across regions within a country—that is, within-country spatial income inequalities—are high and have not
been shrinking over time. As figure O.1 shows, household consumption in the most prosperous areas of today’s low-income and middle-income countries is more than twice that of similar households in the lagging areas, compared with high-income countries where this ratio is only 50 percent higher. Although large disparities in income have narrowed somewhat in some places, progress has been limited among low-income and middle-income countries. Further, these disparities are mimicked within cities, whose fragmentation, congestion, and dangerousness seem to belie the promise of growth-fomenting urbanization.

Even within advanced economies, progress has been mixed. For most of the twentieth century, incomes in poorer states in the United States had been catching up with those in richer states, but the rate of convergence halved between 1990 and 2010 and since then has fallen to nearly zero. Despite massive public expenditure to promote development in the north of England, the economic gap with the prosperous south of England has widened (Martin et al. 2016). Even in Europe, differences in GDP per capita across metro areas in the 15 original member states of the European Union (EU-15) converged in the 1980s, stabilized in the 1990s to early 2000s, but have been diverging since the mid-2000s (Ehrlich and Overman 2020). As a barrier to equity, these spatial contrasts in prosperity remain center stage as a policy concern. In addition, very visible changes in the fortunes of specific cities and regions due to automation, trade, and now climate change have created new pockets of poverty and variants of political stress.

Place remains central to productivity and growth—and becomes more so as areas and countries develop. From prehistoric times, coastal areas have been and continue to be favored for regional and international commerce, while in successful countries, the
centripetal forces of agglomeration economies, wherever set in motion, drive a virtu-
ous cycle of economic concentration, higher productivity, and more prosperity. In the
United States, three coastal cities (New York, Los Angeles, and Chicago) covering
1.5 percent of the land mass account for 20 percent of the country’s GDP, while Mexico
City alone accounts for 17 percent of Mexico’s GDP, with only 0.1 percent of the area
(World Bank 2009). Figure O.2, panel a, shows that economic activity—as proxied by
satellite measurement of the intensity of nighttime electric lighting—increases
with city size and population density. More generally, even in the least developed

FIGURE O.2 Economic Activity Is Highly Concentrated, Even in the Lowest-Income
Countries

Sources: Data for panel a are accessed from NASA (https://earthdata.nasa.gov/earth-observation-data/near-real-time/download-nrt-data/viirs-nrt). Panel b is based on calculations for this volume using nationally representative firm-level data from each of the seven
countries.

Note: Panel a shows the distribution of very high-resolution nighttime lights, as a proxy for economic activity, and plots nighttime light intensity against population. Data for 1,185 cities across the globe with more than 100,000 people are used. The sum of nighttime lights is based on the monthly composites (from March to May 2019) of VIIRS Nighttime Day/Night Band (DNB). The DNB radiance values were calculated based on the 20 km buffers from each city center. Panel b presents the distribution of manufacturing total value added for firms with 10 or more employees from each of the seven countries into four categories of population density distribution—the top and bottom deciles; and those between the 90th to 50th percentiles and the 50th to 10th percentiles.
countries, industry value added tends to be concentrated in the largest cities, as shown in panel b. Around the world, productivity rises with the density of economic activity.

Historically, the inequalities and productivity differentials emerging from this process of concentration have been mitigated by diffusion of capital and technology to the hinterland and, critically, by migration from lagging regions to urban areas with high levels of productivity. These two dynamics of diffusion and migration, combined with social transfers to ameliorate the often-lengthy transition processes, have led to the convergence of subnational regions in advanced economies. However, this volume highlights three emerging dynamics that are changing the development processes generating inequality. Policies proposed to ameliorate inequality must take these emerging dynamics into account.

**Three Emerging Dynamics**

1. **Premature Urbanization and Sterile Agglomeration: Solving the Developing Country Urban Productivity Puzzle**

Traditionally, productivity gains have been closely linked to urbanization through their ties to structural transformation and industrialization. As countries urbanize, workers move from rural to urban areas in search of better-paid and more productive jobs. Similarly, entrepreneurs locate their firms in cities where agglomeration economies will increase their productivity. However, this volume points out a developing country urban productivity puzzle: Despite recent econometric estimates that suggest these forces (measured by the elasticity of wages with respect to concentration) are multiples higher in developing countries than in advanced economies, the actual situation in developing countries does not match such estimates. For instance, night light intensity in the largest cities of low-income economies (more than 5 million people) is around the same level as the smallest cities of high-income economies (100,000 to 249,000 people), as shown in figure O.2, panel a. The pattern suggests premature urbanization. People are concentrating—but not because industrial dynamism is attracting them. They are simply crowding together. This raises the prospect of sterile agglomeration—concentration without productivity gains.

To resolve the puzzle, this volume presents a schematic and conducts some novel empirics to ascertain what is driving the ubiquitous econometric estimates of urban productivity and then empirically attempts to tease out the true productivity effects on the ground. Meta-analysis of existing studies suggests that average agglomeration benefits measured in terms of wages in developing countries are not significantly different than the 2 percent to 4 percent range estimated for advanced economies (Rosenthal and Strange 2003)—and are far below other recent double-digit estimates found for certain specific countries and regions, including China (19 percent) and India (11 percent) (Chauvin et al. 2017), and parts of Africa (17 percent) (Henderson,
Nigmatulina, and Kriticos 2019). Even these benefits are completely offset by the higher costs of operating in these cities, consistent with findings from France and Colombia (Combes, Duranton, and Gobillon 2019; Duranton 2016). Higher wages are merely reflecting higher prices, not higher productivity.

Further, the volume offers the first estimates of how a more refined measure of true efficiency gains, physical total factor productivity (TFPQ)—standard revenue total factor productivity (TFP, or TFPR) stripped of price effects owing to market structure and other costs—changes with agglomeration. Grover and Maloney (2021), in a background study for this volume, find for Chile, Colombia, Ethiopia, and Indonesia that the elasticity of wages with respect to density is somewhat higher (and decreasing in income) than that of the advanced economies. However, these elasticities appear to be driven largely by the higher costs of congestion and higher prices that accompany agglomeration (figure O.3). The elasticity of TFPQ with density is in fact negative for all these countries except Chile—the only country for which productivity gains rise faster than costs. These findings lend support to the hypothesis of sterile agglomeration.

**FIGURE O.3 Evidence of Sterile Agglomeration: Physical Measures of Total Factor Productivity Decline with Population Density, While Costs Rise in Lower-Income Countries**

Source: Grover and Maloney 2021, for this volume.

Note: Estimates using industrial census data. Estimates of TFPQ presented in the figure use the Foster, Haltiwanger, and Syverson (2008) method, although results also remain robust using alternative methods along the lines of De Loecker et al. (2016). Each dot presents the point estimate from regressing the log of wages, firm-level physical total factor productivity (TFPQ), and marginal costs on the log of population density at the district level. All regressions include firm age and four-digit-industry-year fixed effects. Population density is the population in each administrative location.
Sterile agglomeration partly reflects the fact that cities in many low-income and middle-income countries in Latin America and the Caribbean, the Middle East and North Africa, South Asia, and Sub-Saharan Africa have experienced concentrations of population without the historical structural transformation into manufacturing. Figure O.4 shows that while urbanization has accompanied economic transformation in most parts of the world, it has not in Africa. In Nigeria and South Africa, for example, the share of manufacturing in GDP has been declining as these countries have urbanized. By contrast, the share of tradables in Asian cities, at about 70 percent, is 20 percentage points higher than in African cities, Lall, Henderson, and Venables (2017) show.

So, what is driving the concentration of population? One diagnosis is that these are consumption cities, possibly fueled by recycling economic rents from natural resources, but not by the virtuous productivity-enhancing dynamics that accompany manufacturing, as was most recently the case for cities in Asia (Glaeser, Kolko, and Saiz 2001; Gollin, Jedwab, and Vollrath 2016). Another diagnosis, however, finds little correlation with resource sectors and argues that it is the unusually low agricultural productivity and poor service provision that propel migrants to the cities (see Henderson and Turner 2020). Even within cities, 25 percent of the urban population in Sub-Saharan Africa, and about 30 percent in Mozambique, Sierra Leone, and Tanzania, is still

**FIGURE O.4 Urbanization and Economic Transformation Have Not Gone Hand in Hand in Africa**

Sources: World Bank elaborations based on World Development Indicators (accessed 2021).

Note: SSA = Sub-Saharan Africa.
reported to be employed in agriculture. This pattern counterintuitively but clearly puts agricultural productivity, and rural and lagging region development, squarely on the urban agenda and indeed, on the agenda for national growth policy—a point explored in an earlier volume in this productivity series concentrating on agricultural productivity, *Harvesting Prosperity* (Fuglie et al. 2019). Both hypotheses are consistent with the presence of sterile agglomeration.

These findings clearly support the ongoing agenda to make cities function better and reduce congestion costs. But more profoundly, they point to the need to undertake the necessary economywide reforms to boost growth and structural transformation, including in the agricultural sector.

2. The Promise of Migration: A Mechanism to Improve Living Standards in Lagging Regions, but Only If There Are More Productive Places for People to Move to

People move more readily within national territories than across borders. Nearly three times as many people (763 million) move within national borders, compared with 214 million across borders (Bell and Charles-Edwards 2013). New analysis on internal migration done for this volume shows that mobility in high-income countries is twice that of low-income and middle-income countries (figure O.5).

The importance of such internal migration in determining how countries adjust to shocks, grow, and distribute the fruits of growth cannot be overstated. Whether the emphasis is on internal migration or international migration is the main conceptual difference between development policy oriented toward the regional level versus the

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**FIGURE O.5  Internal Migration Increases with Economic Development**

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<tr>
<th>Income Group</th>
<th>Internal Migration Rate (percent)</th>
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<td>Lower-middle-income</td>
<td>16</td>
</tr>
<tr>
<td>Upper-middle-income</td>
<td>15</td>
</tr>
<tr>
<td>High-income</td>
<td>34</td>
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Sources: D’Aoust and Lall, forthcoming, for this volume. Data are drawn from Arab Barometer Wave IV (2016–17) data and the University of Minnesota’s Integrated Public Use Microdata Series (IPUMS) International database.

Note: The figure shows lifetime internal migration at different stages of economic development, using World Bank classifications of country income groups.
national level, and it has two countervailing effects. On the one hand, migration permits individuals to seek out better lives in more prosperous areas. On the other, it can condemn a region to be unviable. In international trade theory, countries have a comparative advantage based on their endowments, which are largely immobile and hence can be made attractive to investors by market pressures or currency depreciations that make local factors of production cheaper. However, within countries, regional depreciations are not possible, and internal labor mobility ties local wages to those in more prosperous parts of the country, and hence makes downward adjustment difficult. Thus, a region can be permanently “priced out” as an investment destination, leaving it with no competitive advantage. The market’s response to a negative shock is not to move more capital into the area, but to move labor out.

This equilibrating mechanism is dampened if mobility is limited, leaving stranded workers in jobless regions and factors of production in inefficient allocations. For instance, Brazilian labor markets have not evenly distributed the costs and benefits of the trade liberalizations of the 1980s and 1990s (Dix Carneiro and Kovak 2017). Research for this study suggests that a 20 percent increase in migration in Brazil could boost the aggregate national welfare gain from a positive export shock to a particular region by 14 percent (Artuc, Bastos, and Lee 2021). Even in the United States, a country traditionally celebrated for its domestic labor mobility, the slowdown in convergence mentioned earlier has been driven in part by a decline in migration over the past 40 years (see Ganong and Shoag 2017). There is a tendency for low-skill workers to migrate away from high-income areas partly because their returns to migration in high-income states have eroded in recent years. Given the importance of internal migration to both equity and growth, the volume examines the reasons for such rigidities in migration, especially the frictions posed by explicit barriers to mobility; implicit barriers from residency-based access to public services and safety nets; and distortions in financial, land, and housing markets. The diagnosis is followed by a discussion of some potential policies to free up internal migration.

However, even if migration were very fluid, the finding that moving people into areas that amount to sterile agglomerations leads less to increasingly productive density than just overcrowding complicates the message for lagging regions to “invest in people, not places.” More people migrating to cities to take advantage of better provision of services such as health care and education, for example, merely moves a problem of human needs from one place to another. This problem makes us look harder at possibilities such as broadly stimulating agricultural productivity and enhancing human capital, but also highlights the point that more generally, the long-term amelioration of poverty in lagging regions requires advancing the overall national agenda of structural transformation and productivity growth. Only then will there truly be more productive places for people to move to.
3. The Changing International and Technological Context: The Future Isn’t What It Used to Be

The spatial development and structural transformation paths followed by many European countries and parts of North America over the past two centuries may no longer be available to today’s developing countries. When the advanced economies were young, transport costs were still relatively high, so urban agglomerations and nascent local industrialization arose in multiple agricultural regions and the high costs of trade protected local industry (Henderson et al. 2018). Today, transport and communication costs have fallen well before structural transformation has advanced, so economic activity tends to agglomerate in relatively few, often coastal, locations. In China, the decline in international trade costs and rise of information and communication technology (ICT) have enabled export-oriented industries to emerge close to ports at the expense of other regions (Coşar and Fajgelbaum 2016) and have pushed remote regions to specialize in agricultural products (Baum-Snow et al. 2017). In the period immediately following India’s trade liberalization episode of the 1990s, inequality between secondary regions closer to the ports and the hinterlands worsened (Dasgupta and Grover 2021). Similarly, in Ethiopia, trade-related industrial policy reforms increased economic concentration in the capital city, Addis Ababa (Grover 2019). This greater integration with the global economy may come at the expense of domestic market integration and more equitable regional allocation of growth.

Technological progress is also a double-edged and disruptive sword. On the one hand, accelerated automation may displace unskilled labor across the globe, and increased connectivity may facilitate rapid offshoring—again, leaving pockets of unemployment and poverty (Maloney and Molina 2019; Hallward-Driemeir and Nayaar 2020). On the other hand, the decline in connectivity costs through digital means is permitting new forms of national integration. The telegraph cables of the 1860s, the mobile phone revolution in developing countries during the 1990s, and the advent of Amazon fulfillment and delivery or e-commerce in the 2000s have progressively lowered trade costs, with dual effects. They permit dispersion of certain routine activities, while encouraging agglomeration of complex productive activities, improving connectivity and matching between producers and consumers. For instance, merchants in the 3,202 “Taobao villages” in 24 provinces, municipalities, and autonomous regions of China sell clothing and other consumer items, mostly obtained from small local factories, on Alibaba platforms. Broadband access is increasingly seen as the key to bringing to displaced workers—from coal miners in the US state of West Virginia to farmers in the Sahel—new sources of productivity-increasing information and employment. A systematic review by the What Works Centre (2015) of 16 robust impact evaluations on the impact of broadband access suggests that the effect on the local economy is usually positive but varies by types of firms, workers, and areas, and may not be large in the aggregate.
The COVID-19 (coronavirus) experience has demonstrated the potential for teleworking from previously excessively remote regions, with some observers forecasting the demise of the city. However, the “dislike of distance” remains a potent force, as Greenstein and Fang (2019) argue. They show, for example, that the banks of servers undergirding the digital network in the United States remain concentrated around established cities, even though they could be more economically located near cheap energy and in colder climates. The roots of this “dislike of distance” are still unclear—among the possibilities, delays of even fractions of a second matter for rapid financial transactions and supercomputing; transaction congestion increases with distance; the need to respond quickly to breakdowns of the servers prioritizes proximity; and tech personnel may have a preference for urban amenities. But whatever the cause, the pattern suggests that rumors of the death of the city may be premature. Both increased globalization and the new technologies of our era simultaneously function as hard parameters within which policy makers must work while posing unpredictable long-term challenges.

The Attraction of Place-Based Policies

These broad trends have given rise to increased concern, even alarm, in policy circles about dysfunctional cities or “places left behind.” Spatially targeted interventions are increasingly advanced with varying motivations. On the grounds of economic efficiency and growth, there is a desire to exploit the “untapped potential” of lagging regions, implicitly assumed to be underperforming because of market failures or barriers to a more efficient allocation of capital and technology. Beyond efficiency considerations, the political and social value of place-specific, job-creating policies is being championed, along with an emphasis on the intrinsic value of work that enhances a person’s well-being. Finally, concerns abound that sufficiently pronounced and sustained territorial inequalities can sow social discontent, tensions, and political unrest, which in turn can fuel the rise of populist movements, leaders, and parties. Place-specific consequences of free trade have been identified as contributing to the populist backlash in the United States and the Brexit vote in the United Kingdom, while armed revolts in Colombia, Indonesia, Nigeria, Peru, and Thailand have been either ignited or facilitated by territorial inequalities (Rodríguez-Pose 2018).

Such place-based policies encompass initiatives ranging from infrastructure construction/upgrades, to special economic zones (SEZs) that attempt to cultivate economic activity in particular locations through fiscal and regulatory incentives with infrastructure support, to a variety of urban interventions. The common feature is that they target a particular place rather than a class of individuals (as does education policy), economic sectors (as does industrial policy), or institutions (as do governance reforms). Sometimes such policies are implemented in response to revealed needs, such as infrastructure to relieve congestion in a booming region. In other cases, they are intended to be “transformative,” triggering economic development in a lagging region, such as support to businesses and tax incentives in targeted deprived areas.
Vast resources are being dedicated to place-based policies. The European Union allocated €180 billion in the 2014–20 programming period to less developed regions to “reduce disparities between the levels of development of the various regions and the backwardness of the least favored regions” (Article 174 of the Treaty on the Functioning of the European Union).

In the United States, about $95 billion is spent annually on place-based economic development programs by federal and state governments (Kline and Moretti 2014b). As another metric of increased interest, the number of SEZs has sextupled in the last two decades, to reach 5,400 across 147 economies as of 2018 (figure O.6). For example, zones approved by the Bangladesh Economic Zone Authority increased from 2 in 2015 to 88 by the end of 2018. The total value of expected investment in just three of Bangladesh’s economic zones amounts to nearly $17 billion—more than two-thirds of the country’s GDP in 2017. Likewise, Africa’s first free trade zone, launched in 2018 in Djibouti, will cost $3.5 billion (UNCTAD 2019).

However, as the volume documents, the record of such interventions to date has been mixed at best. Part of the disappointment is due to poor execution. But two other factors are at least as important, or even more so. The first is an incomplete understanding of the forces that lead to spatial inequalities to begin with and that eventually constrain policy. The second is the absence of a framework to structure sound cost-benefit analysis of often-complex projects. Such a framework could help counterbalance the overly optimistic predictions of success (optimism bias) (or wishful thinking).

**FIGURE O.6** Special Economic Zones Have Increased Six-Fold over the Past Two Decades

![Graph showing the increase in the number of SEZs and the number of economies with SEZs over the past two decades.](Source: UNCTAD 2019)

*Note: SEZs = special economic zones.*
by the advocates of place-based policies or lobbying by self-interested individuals, sectors, private interests, and regions expecting to be beneficiaries. This volume offers such a framework, as well as providing the most recent thinking on the dynamics of the spatial allocation of economic activity, grounded in the experience of both advanced economies and developing countries. It also seeks to help policy makers use the framework by interpreting insights from recent analytic advancements and empirical work around the economics of spatial development—and in particular, five underlying themes that emerge from that work.

**Breaking Up Established Economic Geography Is Hard to Do: The Persistence of Place**

When policy makers formulate place-based policies, they are not painting a blank canvas. The persistence of place—however arbitrarily initiated—and the weight of history constrain the best laid plans to reshape economic geography. Modern Latin American spatial patterns of income track the precolonial (1500) patterns of meso-American settlement, Maloney and Valencia Caicedo (2016) show. In Africa, cities formed along the colonial railroads persisted even after these locations lost their initial relative advantage (Jedwab and Moradi 2016), and cities including Cairo and Tunis trace their origins back millennia. The current distribution of Japanese cities broadly tracks those of settlements 10,000 years ago (Davis and Weinstein 2002). The three largest US cities began their economic lives respectively as a Dutch fur trading post (New York), a Spanish trading pueblo (Los Angeles), and a meeting place at a river mouth known to Algonquin residents for its distinctive wild garlic (Chicago) (Allen and Donaldson 2018). Many North American cities—including Augusta, Georgia; Chicago, Illinois; Montreal, Quebec; Sacramento, California; and Washington, DC—were founded as trading posts at river portage sites where inland and ocean traders met but grew to be major cities long after technology obviated the need for portaging (Bleakley and Lin 2012).

Patches of wild garlic and waterfall bypasses became irrelevant long ago, but the agglomerations they seeded persist because of, in varying proportions, (1) natural geography; (2) today’s human geography—agglomeration economies; and (3) the human geography of the past—sunk factors such as building and infrastructure. Being “set” in space can mean a good spatial equilibrium (San Francisco, Sydney, Cape Town) or being dealt a bad hand by history. Mexico City’s weather was, from the beginning, bad for agriculture; the fetid Lake Tenochtitlán was a breeding ground for disease; and later, the gelatinous dried lakebed that served as a foundation for buildings amplified tremors, making recurrent earthquakes devastating. Similarly, the collapse of the Roman Empire allowed Britain to take advantage of declining maritime trade costs to pivot to a more efficient coastal spatial allocation of activity, while French towns remained unmoved, with all roads leading to a dying imperial center (Michaels and...
Policy makers need to be clear-eyed about inertia as they move to shape their national space. For instance, efforts to establish new cities need to be cognizant of the gravitational pull of the existing agglomerations.

Two Tales of Cities: Natural and Historical Conditions Determine the Viability of a Region and Possibilities for Spatial Transformation

Nor is the canvas policy makers are painting especially flat; it cannot be assumed that a given set of policies will yield equal success in all locales. The volume presents two tales of cities with radically divergent growth trajectories. There are unquestionably places with untapped potential to be realized by reforms and interventions. Lifting Spanish trade restrictions on the natural port of Buenos Aires in 1775 transformed it from a backwater to one of the world’s richest cities, with arguably the premier opera house on the planet. The construction of the Uganda Railway through the Kenyan highlands, and the subsequent immigration of skilled farmers, led to the development of a dynamic tea industry and the emergence of Nairobi from swamp to great capital city. In China, the establishment of the SEZ and associated policy “rules of the game” in 1979 allowed Shenzhen to take advantage of its labor force and position across the straights from Hong Kong SAR, China, to attract foreign direct investment and transform from a fishing village to China’s Silicon Valley. In each case, policy altered the spatial distribution of national activity, but could do so only because there was a fundamental latent source of economic advantage that could be released by eliminating distortions, providing necessary complementary factors, or resolving market failures.

However, history also documents regions with no such potential or cities that withered after the loss of their initial attracting fundamentals: they became unviable, permanently. A survey of famous nineteenth-century US mining boomtowns—many with populations at their peak greater than the portage sites chronicled by Bleakley and Lin (2012)—would be largely a list of ghost towns today. Kolmanskop, Namibia, once produced 12 percent of the world’s diamonds and was one of the richest towns on the planet yet is now abandoned (see box O.1). These cities may have been the first sterile consumption cities, largely providing goods and services to local rentier economies, without generating positive production externalities. Their experience illustrates the double impact of migration: on the one hand, it offers a better life to those willing to uproot and move elsewhere; on the other, it seals the fate of boom towns like Kolmanskop.

What this volume calls “viability” might be better thought of as a continuum of endowments of natural and historical factors, complemented by a successful policy intervention and thereby realizing a greater social return than other policy priorities. Hence, whether a place has a latent source of comparative advantage waiting to be unlocked, is reeling from a bad trade or technological shock but could recover, or is, in fact, nonviable is precisely what a sound appraisal must ascertain. Distinguishing
between regions where a package of interventions would yield a rate of return comparable to other priorities, and those where it would not, is challenging but essential: the world is littered with badly placed SEZs and resistant lagging regions absorbing resources that could have been better directed elsewhere. The lesson to be drawn is the necessity of undertaking as comprehensive, objective, and well-grounded analysis as possible to determine the likely returns to place-based intervention—tempered by caution that the analytical tools to do this are rudimentary.

**Market Failures Love Company**

There are some cases—such as releasing export restrictions on Bueno Aires harbor, or building a railway to Kenya's highlands—where reforming a single regulation or investing in one piece of infrastructure is sufficient to turn around fortunes. However, a persistent theme of this volume is that this is not usually the case. Market failures,

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**Box 0.1**

**The Case of Kolmanskop, Namibia: Insights on Migration and Nonviable Regions from a Mining Boom Town**

One evening in 1908, Zacherias Lewala, a Namibian railway worker, spotted some stones shining in the low light of dusk while shoveling railroad tracks clear of sand dunes. His German employer identified them as diamonds. While Lewala was not rewarded for this find, hordes of prospectors descended on the area. By 1912, a town had sprung up producing one million carats a year—12 percent of the world's total diamond production. Kolmanskop's economy started booming.

A butcher, a baker, a post office, an ice factory, pipelines and connections for fresh water, rail services, and a tram soon appeared. A school was built for the children of the families who flocked to the town. A hospital reputedly had the first X-ray machine in the Southern Hemisphere.

Yet now, the town is abandoned. An inventory of the hundreds of nineteenth century US mining cities would likewise yield a list of ghost towns. These experiences highlight a critical feature about the dynamics of within-country spatial dispersion: the ability of labor and other factors to move between regions. In international trade, countries have a comparative advantage based on their endowments, which are largely immobile. A textile worker will receive a lower wage in Vietnam than a comparable worker in the United States and hence Vietnam can build an industry based on this comparative advantage. However, with mobility possible within countries, the wages of an engineer or X-ray technician (as in Kolmanskop) are set substantially in whatever other industry center they can migrate to. Hence, after diamonds played out, Kolmanskop had no comparative advantage in engineers or much of anything else. Modern-day examples of this dynamic can be found where trade competition or technological progress eliminate the comparative advantage that a region may have once enjoyed (Autor, Dorn, and Hanson 2016).

However, worker mobility within countries can be limited by various barriers. The growing demand for specialized skills creates a mismatch whereby workers in declining industries may not have the skills profile to be absorbed in dynamic urban economies where cognitive and social skills command a premium (Lall, Henderson, and Venables 2017). Land and housing market rigidities also limit worker mobility (Hsieh and Moretti 2019).
missing complementary factors, and distortions often accompany one another. Hence there are few silver bullets that can be fired with success in the absence of other complementary initiatives. In Japan, analysis of household data on online sales of products suggests that regional variation in the intensity of e-commerce sales is almost entirely driven by the share of college-educated people (Jo, Matsumura, and Weinstein 2019) (see figure O.7), while lack of interventions in business training or access to credit explain the minimal effects of e-commerce on local rural economies in China (Couture et al. 2018). In India, more new businesses have been started along the Golden Quadrilateral—the major highway system connecting the four major cities to the north, south, east, and west (Delhi, Kolkata, Mumbai, and Chennai)—along corridors where financial and land markets function well (Grover, Maloney, and O’Connell 2021). The volume emphasizes the importance of these “soft complements” to “hard investments” such as infrastructure. Two main implications can be drawn. First, appraisal of any one policy requires recognizing the presence or absence of necessary complements. Second, government policy may need to be multidimensional and coordinate across multiple ministries. This leads to another underlying theme.

**Government Capabilities Are Limited**

Governments have finite capabilities to appraise and execute policies. This reality must be taken into account in laying plans—even the best of plans. There is a spatial analogy

**FIGURE O.7 The Use of E-Commerce Is Positively Associated with Higher Skills and Education in Japan**

![Graph showing the relationship between percent of college-educated population and percent of online expenditures in Japan.](source: Jo, Matsumura, and Weinstein 2019.)

*Note:* Data are at the level of a prefecture, Japan’s first level of jurisdiction and administrative division. The figure shows the share of online sales versus the share of college education in Japanese prefectures. Specifically, it uses data from a representative survey of Japanese households that reports the purchase channels of products to regress the share of a prefecture’s expenditures online on the share of a prefecture’s college-educated population over the age of 15.
to the *developing country policy dilemma*, discussed in previous volumes of the productivity series: the number of market failures that a potentially viable region suffers from—and hence the multiplicity of necessary policy interventions—increases with distance from the frontier, while policy capability to appraise and implement decreases. A prime example can be found in the Integrated Rural Development programs of the 1970s and 1980s in Colombia. These programs sought to bring together agricultural credit, extension, technical assistance, supply of inputs, and marketing assistance in a coordinated fashion, precisely to resolve multiple market failures holding back poor agricultural communities. They were appraised internationally and were asserted to have passed the cost-benefit analysis. However, in the first phase of the Rural Development Investment Program, governments in some departments found it more politically compelling to give the separate components to different villages, thereby eviscerating the initial concept, and high-level bureaucratic competition impeded coordination. The second phase focused on more prosperous areas that already had several key complements well established.

Further, failures in vertical coordination among tiers of government can result in an oversupply or undersupply of public goods and services, whereas horizontal coordination failures may end up in beggar-thy-neighbor policies (Bartik 2016) or bidding wars (Rodríguez-Pose and Arbix 2001). For example, in Indonesia, district governments had trouble coordinating with the central government under the Integrated Economic Development Zones program and often lacked the capacity to manage and implement many of the responsibilities that were transferred to them (Hofman and Kaiser 2004). Hence, not only are governments facing a spatial landscape with vast inertia and with regions that are simply not viable, but their tools to sort out what is feasible and then implement policy are bounded. The bottom line is that if limited government capacity prevents the accurate diagnosis of market failures, the development of the correct policy mix, and then coordinated implementation, no matter how bright a region’s future looks in theory, in practice, it is nonviable.

**Entrepreneurship: The Lifeblood of Local Economic Development**

The importance of complementary “soft” investments in the skills and entrepreneurial capital of the people and the environment in which they operate alongside the physical interventions of place-based policies cannot be overstressed. These complements range from human capital to enterprise support services, to well-functioning institutions, to fiscal incentives. These constitute critical complements to the programs of infrastructure, city renewal, or SEzs. Investments in these areas can be broadly grouped under the heading of local economic development policies.

The elements of the “entrepreneurial ecosystem” needed to support such efforts, discussed in detail by Cusolito and Maloney (2018) in *Productivity Revisited*, remain
important also at the local level. An entrepreneur is fundamentally placing a bet, comparing an entrepreneurial project (that is, starting or growing a business) with an expected rate of return and risks against other alternatives, such as “safe” salaried work for an individual entrepreneur or simply another project for an existing firm. Such experimentation entails both a process of managing risk and a process of learning—about the investment, about running a firm, and about evaluating and managing risk (see Maloney and Zambrano, forthcoming). Two sets of factors affect this experimentation: factors in the enabling environment, and factors pertaining to entrepreneurs per se—that is, human capital. Without a supportive enabling environment, capable entrepreneurs, either from the region or from outside, will not enter the market or thrive if they do. Conversely, even in a pristine experimental environment, dynamism will be limited without capable entrepreneurs (see Grover, Medvedev, and Olafsen [2018] for a discussion on identifying high-growth firms and the instruments for supporting them).

Place-based policies may bring about change in private sector behavior that increases productivity and generates value and prosperity for a place. Choosing effective policies requires thinking clearly about the value of resources in alternative uses, and the market failures and inefficiencies that motivate the policy intervention. The framework discussed next can help in making those choices and designing and implementing those policies.

**A Framework for Appraising Place-Based Policies**

This volume provides a heuristic framework to inform policy makers’ initial assessments of proposals for place-based policy—enabling them to clarify more precisely the implications of various options and alternatives, to think critically about policy design priorities, and to navigate related challenges. The framework can help policy makers steer away from truly nonviable proposals. It can also help them identify the complementary packages that are needed to make potentially viable policies work. It expands on the policy framework for assessing place-based policies developed by Gilles Duranton and Anthony Venables (2018, 2020).

**Principles to Guide an Appraisal of Place-Based Policies**

The challenge for an appraisal of place-based policies is to provide estimates of what such policies can be realistically expected to achieve (quantity effects) and ascertain the economic and social value that policies can create for the locality, region, or country (valuation). To help meet this challenge, this appraisal framework applies seven principles.

1. **Provide a clear narrative of the main problem.** This narrative is intended to identify the key market failure(s) that the policy is meant to address. These market failures can include the following:
- **Lack of public goods.** The private sector is likely to underprovide public goods. For example, before the Uganda Railway was established, the Kenyan highlands had latent comparative advantage in exporting tea but needed transport before it could attract human capital in the form of experienced farmers.

- **Externalities: Clustering and congestion.** Externalities are created by the location—and concentration—of economic activity. Some of these are positive (cluster and agglomeration effects), and should be encouraged by policy, while others are negative (urban crowding, congestion, pollution), and should be corrected by policy.

- **Path dependence.** As discussed, firms’ or households’ choices about where to locate are typically major decisions that entail large sunk costs—and, if structures are being built, that create long-lived assets. Expectations about future returns are therefore critical. The returns to investing in a place depend on who else is (or is expected to be) there, if agglomeration economies are to operate. This in turn creates a coordination (or first-mover) problem: no one wants to move to a new place while uncertain about its future development.

- **Imperfect labor mobility.** As the volume explains, though large movements of people often occur across space, many barriers can impede mobility—especially in the short term—including absence of information, lack of resources to move, mismatch in skills, and social attachment to place.

2. **Fully describe the policy’s direct and indirect quantity effects.** Policy makers would like to know what the incremental impact of interventions will be to economic activity, compared with “business as usual.” Figure O.8 depicts the challenges in measuring direct and indirect changes (quantity effects), as well as placing a social valuation on these changes. Direct effects are relatively simple to measure, at least in principle: the number of extra people receiving health care; the number of minutes by which travel time has been reduced; the number of jobs or firms created. However, spatial policies are often implemented with the hope that there will be important indirect effects to promote private investment, create jobs, and narrow regional inequalities. This is often the case with transport or digital connectivity. India’s Golden Quadrilateral highway system and China’s Belt and Road Initiative, beyond reducing the cost of transport, are expected to stimulate private sector activity in previously unconnected areas. Given such indirect effects, analyses tend to underestimate the expected benefits. For a road project, for instance, summing the expected savings in trucking costs would be such an underestimation. Conversely, the justification for policies often hangs on overly optimistic promises of indirect effects, the mechanics of which have not been well thought through.

3. **Consider complementary conditions and policies.** In particular, policy makers need to understand the other complementary factors that influence the magnitude of the indirect effects. These include the following:

- **The natural characteristics of the place.** Is there a latent industry needing access to connectivity (as in the tea industry in Kenya) or is this a locale like...
Kolmanskop, where the natural fundamental (such as diamonds or coal) has been exhausted and no amount of connectivity will make it viable?

- **The policy environment.** Would potential businesses be supported by the necessary complementary infrastructure; relevant regulation and tax regimes; labor supply policies; public services, including for commuting and housing; and the institutional regime, including issues of property rights and contracts? The SEZs in China made progress on the institutional context that was a necessary complement to the abundance of labor. In Rwanda, it is not surprising that the SEZ in the capital city of Kigali has been associated with improved firm outcomes, given that the country ranks high on its business environment (Steenbergen and Javorcik 2017).

- **The business ecosystem.** Are there suppliers, customers (or connected markets), and other firms to learn from? Are the necessary factors of production (such as workers with appropriate skills at competitive wages) available?

Each of these elements—geography, policy, and the business ecosystem—must reach sufficient standards if a region is to attract private investment. This creates a *weakest-link problem* because failure in any one element can deter investment. It follows that there are threshold effects and discontinuous responses of private investment to policy levers that make it inherently difficult to predict the effect of policy. For example, a tax incentive to firms in a place may have no effect if other favorable conditions are not present. Or, if other conditions are met, an attractive fiscal environment may push the place across a threshold and trigger a large private investment response. These issues are particularly important in the context of lagging regions, which are not likely to have the dense network of related firms, skilled workers, access to capital, or large markets that make a place attractive for investors. This can create a “low-level equilibrium trap”: A region finds it hard to attract investment because there is little investment there. Such
first-mover problems or coordination failures cannot be solved by the market, which prompts policy makers to intervene.

Understanding the weakest links in any of these complements is necessary to thoroughly appraise place-based initiatives. This emphasis on weak links also applies to the literature on job creation multipliers initiated by Moretti (2010) and Bartik and Sotherland (2019). This literature has concentrated on advanced economies. Figure O.9 presents the first estimates of job multipliers for the developing world: how many jobs are created in the nontradable sectors if one new job is created in a tradable industry? The figure shows that multipliers are arguably higher in developing countries: values for Costa Rica, the Dominican Republic, and Mexico exceed 5, compared with values of less than 1.5 for many advanced economies. These are averages across regions and need to be viewed with respect to the local endowments and complements available in a region. However, these elasticities are country averages and as such obscure the fact

**FIGURE O.9** The Payoff (Multiplier) for Creating Jobs in the Tradable Sector Is Higher for Developing Countries

Source: Maloney, Posadas, and Taskin 2021, for this volume.

Note: The figure plots how much employment in the local nontradable sector is generated by a 1 percent increase in employment in the tradable sector. Estimates for the United States are from Moretti (2010). GDP per capita data are from the 2018 World Bank World Development Indicators (accessed in 2021). Estimates use the Integrated Public Use Microdata Series (IPUMS) census data. Data labels use International Organization for Standardization country codes. CRI = Costa Rica; DOM = Dominican Republic; MEX = Mexico.
that—as per the framework of this volume and this productivity series—whatever policy lever is thought to attract private sector investments, the desired indirect effect of more private investment depends on a host of local endowments and complementary factors in a particular region. The marginal social utility of a job created in a locale may be high, but the marginal cost of creating that job may be higher still. Both need to be weighed in prioritizing projects. It might be feasible to lure an additional high-tech company to Guadalajara, Mexico, or Penang, Malaysia, where the basic enabling environment and human capital have persuaded high-tech firms to operate for decades. But played-out mining towns like Kolmanskop, Namibia, or Bannock, Montana, simply have no chance of enticing high-end firms to move there or stimulating other firms to respond to increased demand if they would.

4. **Consider general equilibrium (overall, long-term) effects and displacement effects.** Appraisal also requires ensuring that a hoped-for plant relocated, or job created, will not be merely the mirror image of a loss elsewhere in the economy. A subsidy that simply relocates a planned investment from another area does not improve overall welfare. Displacement can arise through the product market in which, if demand is inelastic, an increase in supply in one place will be met by a reduction in supply elsewhere. This effect is most pronounced for nontradable goods, where demand comes only from a local or national market. Displacement may also occur through factor markets. If there is a fixed supply of capital or full employment of a given labor force, then expansion of one activity must be accommodated by contraction of another.

5. **Conduct a valuation of quantity changes.** Often, the net value (benefits minus costs) of the expected quantity changes cannot be calculated at market prices as a private investor could in appraising an investment project. This could be due to the following reasons:
   - **Externalities and nonmarket effects.** Some of the changes brought about by a project do not have a market price at all, in which case a social value must be inferred indirectly. For example, a project may improve health and safety, provide environmental amenities, or reduce levels of pollution.
   - **Clustering and productivity spillovers.** In many contexts, firms create positive spillover effects for other firms in the neighborhood. For example, knowledge spillovers may arise from the development of skills in the local labor market. Demand and supply linkages often occur because a firm benefits from having customers and suppliers nearby.
   - **Un(der)-employment; inputs not priced at the true social opportunity cost.** Often policies are designed to remedy a perceived market failure or disequilibrium that affects the true costs of inputs. For instance, public investment to address a lagging region implicitly assumes there is unemployed labor unable to migrate, whose true “shadow price” therefore is far below the going wage.
6. **Assess whether better policies exist.** Identifying the salient market failures is crucial to sound diagnostics and policy design. The process also may highlight why particular place-based policies may not be the “first-best” way to address a market failure. If unclear land rights hamper investment in infrastructure and housing, then the first-best policy is to clarify these rights. If sluggish migration leaves populations concentrated in nonviable places, the focus should be on barriers to mobility rather than resuscitating the place. Place-based policies are likely to be the second-best (or nth-best) policy; policy makers should be aware that better policies may exist. *Equity per se is not a sufficient motivation for spatial policies.*

7. **Be brutally honest about government capabilities to diagnose, appraise, and implement the place-based policy.** As noted, governments have finite capabilities to appraise and execute policies. The farther a region is from the frontier, the larger the number of market failures and hence the multiplicity of necessary policy interventions. At the same time, policy capability to evaluate and implement decreases with distance from the frontier. Identifying “doable” combinations of policies becomes as important as designing policies that, if perfectly implemented, would yield the highest returns.

**Appraisal Challenges: Using the Framework as a Heuristic Tool**

Ideally, even the simplest road project would be preceded by a full appraisal that would allow planned projects and their alternatives to be clearly ranked by their social value added. This would offer some channeling and disciplining of the often-formidable pressures to “do something” to either reverse the declining fortunes of an area or kick-start a long-standing laggard. However, while the direct effects can often be quantified, doing the same for the indirect effects is expensive, time consuming, and often unconvincing to the public and even academics. Even 150 years after the fact, debate continues about whether the transcontinental railway contributed in a major way to the development of the United States (Donaldson and Hornbeck 2016). Similarly, general skepticism about the value of the Uganda Railway—rather than any objective concerns about the precariousness of the venture related to the engineering—led it to be dubbed the “lunatic line.” Hence, often simpler rules of thumb are employed, sometimes based more on the symptoms than the underlying disease. For example, to be eligible for the local economic growth initiative (popularly called LEGI) in the United Kingdom, a local area had to rank fiftieth or worse against any of six indexes of multiple deprivation in 2000 or 2004. Similarly, the French urban enterprise zones program also selects lagging areas based on an “index” measuring socioeconomic conditions in the area (Mayer, Mayneris, and Py 2017). But none of these are focused on viability per se. By both measures, Kolmanskop might be slated for revitalization. These issues become more acute the further one moves from the development frontier and more government capacity weakens, as discussed. *Hence, this framework should be viewed less as a*
mechanical valuation device and more as a heuristic tool that suggests the dimensions that should be taken into account, and that disciplines debate and surfaces some policy guidelines.

The framework offers eight policy guidelines.

1. **Clearly identify market failures and distortions particular to the region that are impeding its viability.** For instance, asking why capital is not flowing to a lagging region in the first place is a first step toward appraising viability and likely returns to investment. Asking whether a proposed transport initiative is addressing the binding constraints on a region’s growth can help validate project appraisal and suggest what additional complements are necessary. Full transparency in the appraisal process facilitates the discovery of constraints. Given the difficulties in quantifying the contribution of releasing these constraints, testing the sensitivity of the cost-benefit analysis to a range of values will give greater confidence in the wisdom of the project. Of course, knowledge of what policies have been generally successful in overcoming such failures is central to the appraisal process. Here there is an increasing bank of experience. An invaluable reference is an exhaustive review of ex post evidence, primarily from advanced economies, archived by the What Works Centre for Local Economic Growth, headed by Henry Overman.10

2. **Test the sensitivity of assumptions.** Given the difficulty of quantifying many elements feeding into the appraisal, testing the sensitivity of the cost-benefit analysis to assumptions and presenting alternative scenarios is useful for ranking projects. For instance, if a road project would be worthwhile only if very large clustering effects emerge among local industry as an indirect effect, it may be ranked lower than a project whose risks are smaller.

3. **Reduce the number of dimensions addressed, tailoring the program to true shortfalls, and accept the possible.** The limitations in governance capabilities dictate an objective view of the limits to project complexity given diagnostic and implementation constraints and put a premium on minimizing the dimensionality of a project. Identifying “doable” combinations of policies becomes as important as designing policy mixes that, if perfectly implemented, would have the highest returns. This partly requires identifying what the main shortfalls are and which may be important in theory but may be less critical in practice. This is made easier where some markets are functioning well, some infrastructure is already in place, and so on. Colombia, for instance, shifted the emphasis of the third phase of its Integrated Rural Development Strategy to regions that were better endowed with infrastructure, education, and facilities for technological transfer, thereby reducing the number of components that needed to be coordinated. Value chains, by virtue of consisting of more advanced firms, can fill in some missing markets or factors, such as entrepreneurial ability or financing. Thus, more focus can be placed on providing necessary infrastructure,
upgrading workers, skills, or ensuring a more favorable environment for contracting, for instance.

4. **Build on existing dynamic areas.** Linking lagging areas to existing dynamic areas, rather than attempting to kick-start backward regions from zero, improves the chances of avoiding investments in nonviable areas. Further, these regions are likely to have more market failures resolved over time as the interactions with the linked dynamic regions increase.

5. **Partner with agents that can furnish information, help resolve market failures, and provide credibility.** Identifying an anchor industry can help ascertain what the binding constraints on local growth truly are and provide a fixed point around which agents can coordinate. Attracting a piece of a local or global value chain can also provide evidence of the viability of a region, and will surface missing complements, such as worker training programs (see *Harvesting Prosperity* [Fuglie et al. 2019], as well as World Bank [2020] on global value chains). On the other hand, if there is no private sector interest, that suggests a project’s lack of viability.

6. **Ensure explicit coordination among critical actors.** Regional policies will necessarily involve actors at various levels, including the national level. Establishing explicit protocols can help avoid coordination failures that lead to waste and lost momentum. Spatial public expenditure reviews (PERs) could track the flow of funds from different agencies to lagging regions, improve resource allocation across different programs and instruments, and achieve budget savings. Spatial PERs could be modeled analogously to the World Bank’s public expenditure reviews for innovation and small and medium enterprises. “Thinking smaller” may also make sense. That way, there are fewer moving parts and fewer actors to coordinate. This approach is more likely to be bottom up and coordinate among, and raise resources from, actors who have known one another for years.

7. **Prioritize projects based on feasibility and fund them accordingly.** Governments face hard budget constraints. Hence, prioritization of place-based policies is necessary to ensure sufficient resources are available. In the United States, the Tennessee Valley Authority, for instance, invested the equivalent of 10 percent of local incomes in a relatively targeted fashion over 20 years. By contrast, EU funds support an extremely wide variety of interventions from innovation and job creation to labor market inclusion, training, and infrastructure, but represent only about 0.35 percent of European GDP and are spread widely. Argentina’s Plan Belgrano to provide its 10 (lagging) northern provinces with infrastructure, private sector development measures, and housing construction represents only about 0.25 percent of the country’s GDP annually for a period of 10 years. Such modest commitments are unlikely to generate large gains. This highlights the need to prioritize regions and ensure sufficient funding. This is easier said than done, as denizens of regions that are not targeted also vote.
8. **Weigh the costs and benefits of a place-based policy relative to migration or transfer-type policies.** Diverting resources to a region with limited potential for growth from regions with high potential may address equity but reduces national growth and welfare over the longer term.

Box O.2 examines the challenges the World Bank has faced in assessing planned place-based interventions.

**The Framework in Practice: Three Examples**

This section illustrates applications of the framework outlined in the previous section to typical place-based interventions. These include transport corridors, the revival of lagging areas, and SEZs.

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**Box O.2**

**How Is the World Bank Group Assessing Place-Based Interventions?**

A review undertaken for this volume of the economic analysis in many World Bank project appraisal documents (PADs) finds that the appraisal generally provides a careful and rigorous cost-benefit analysis of *direct* effects, reporting a net present value and economic rate of return on the project. Treatment of *indirect* effects is highly variable and, in many cases, questionable.

Among transport projects reviewed, for example, some PADs make no attempt to assess indirect effects; one is based on a full (if not fully described) computable equilibrium model deriving the impact of the policy on unemployment; some take the entire value of trade generated as a net benefit, offering no rationale for so doing; some appear to double count (adding in the appreciation of land values as well as direct benefits); some refer to impacts on agglomeration, access, and multiplier effects, possibly producing numbers yet without saying exactly how. The economic—or logical—basis for some of these approaches is not made clear, and in some cases seems incorrect.

In many cases it is nearly impossible for a reviewer to understand the basis of calculations that were undertaken. The cost-benefit analysis often sends the reader back to some external documents that cannot be easily accessed. There is no summary, back-of-the-envelope approximation of the bottom line that would allow the reader to assess where the important drivers in the cost-benefit analysis are coming from. Predicted economic rates of return often fall in some “happy region” of 13 percent to 14 percent—high enough to justify the investment but not so high as to raise skepticism.

The lack of a consistent framework for thinking about how to handle indirect impacts is disturbing and stands in marked contrast to the generally systematic approach of the PAD as a whole and of the cost-benefit analysis of direct effects. This systematic approach is needed to inform final decisions on whether to authorize particular projects and, perhaps more importantly, to shape World Bank Group thinking on place-based policies, to influence the set of projects taken forward to proposal stage, and to shape the detailed design of these projects.

*Source: Duranton and Venables 2018, for this volume.*
Transport Corridors: Overcoming the Tyranny of Distance

The narrative advocating improvements in medium- or long-distance transport typically is one of furnishing a public good to reduce costs or congestion for users of the route; providing a necessary public good to activate potentially viable regions along its length (as with agricultural corridors), often with relatively immobile inhabitants; or serving as a coordinating signal to firms that others are likely to invest in a region. However, even the act of building a road is challenging to evaluate. Predicting the direct effects implies knowing the response to lower vehicle operating costs. Hence the narrowly measured gains—such as more and higher value trade, and lower prices—will depend on the ability of the transport operators to adjust the supply of their services, and the structure of the transport industry. In parts of Africa, for instance, only a few transport firms operate; they can thus charge high markups for their services. This induces distortions that can dwarf physical improvements related to infrastructure.

The indirect gains expected, for instance, by transforming a transport corridor into a development corridor that can connect centers of productive activity to generate indirect effects depends on a broader array of factors. First, while no one would doubt that a completely isolated place will be poor, or that most rich places are well connected, it does not follow that lack of connection is the missing factor that will suddenly make a place viable. And, as discussed earlier and shown in work for this volume, even if it is the case, policy may need to ensure the supply of complementary factors such as land and municipal services; address the health of the overall business climate, including access to finance and skills; focus on government policies related to access to land and municipal services that enable businesses to start up; and concentrate on improvements in the business environment and on local institutions and governance that protect rights of investors. A thorough and objective appraisal of the state of these factors is necessary for an overall impact evaluation.

Further, improving transport also has two potentially opposing effects. It may improve access to markets, as promised by India’s Golden Quadrilateral highway system or China’s Belt and Road Initiative, but it may also open the local market to import competition. A number of models examining the interplay of market access and production costs find that reducing transport costs from a high level to an intermediate level can create divergence because one of the connected points may expand at the expense of others (displacement effect), while reducing transport costs further yields the opposite result, leading to convergence (see Fujita, Krugman, and Venables 1999; Helpman 1998; Combes and Lafourcade 2005). The ambiguity arises because market access matters a lot when transport costs are very high, but production cost differences become all important once “globalization” has reduced transport costs to low levels.

Such analysis is often sufficiently difficult that political forces impinge more than dispassionate evaluation. Some investments, such as the Golden Quadrilateral in India,
when accompanied by the necessary complementary factors, seem to accomplish their purpose. Others, however, such as the Ciudad Real Airport in Spain or the high-speed rail line between the Spanish cities of Toledo, Albacete, and Cuenca, with a combined population of only 310,000, have proven to be a poor use of money.

**Reviving Lagging Areas: Addressing the Persistence of Place**

Regions hit by adverse technology or trade shocks, or even just left behind by the development process, may languish for generations without attracting new industries that would move them toward the country’s frontier. To assist such lagging regions, many countries attempt ambitious programs with multiple instruments that include (1) transport investments to improve connections within lagging regions and between lagging and more prosperous regions; (2) fiscal incentives and direct provision of various complementary services; and (3) a package of measures that aim to foster skills, enterprise development, and innovation in specific parts of a country (Duranton and Venables 2018, 2020). At the heart of such “big push” types of policies is the notion that a local economy may be shifted from a less desirable equilibrium to a more desirable equilibrium. The justification for large comprehensive packages lies in either strong complementarities between policy instruments or the existence of local poverty traps (and often both).

However, it is often difficult to obtain an extremely detailed understanding of the nature of the frictions and market failures justifying the elements of the package or to conduct sound appraisal that measures the impact of their likely joint effects, not simply their individual ones. In addition, big push policies imagine huge valuation effects through scale and spillover effects: if we just invest enough in areas like Kolmanskop, the argument runs, these effects could again let them prosper. Such effects are extremely hard to measure in advance, which makes it difficult to conduct even a basic appraisal of viability. In such cases, private sector interest is less of a guide. Firms might not be interested now but would be in the high equilibrium attained by coordinated policies. Further, empirical evidence on whether such ventures work is extremely scarce. The modest amounts usually invested, the difficulty of attributing benefits when other economic developments occur simultaneously, and the possible displacement of activity from “untreated” regions all have limited robust research on big push interventions (Neumark and Simpson 2015). An exception is the Tennessee Valley Authority program (Kline and Moretti 2014a) in the depressed Appalachian region of the United States, which starting in the 1930s brought to bear programs in energy generation, transport, and education. While judged a success, the transfers amounted to up to 10 percent of local incomes for two decades. Many big push programs, such as Argentina’s Plan Belgrano, and some European initiatives, commit far smaller levels of investment and are unlikely to reach the thresholds envisaged.
Further, even if it were theoretically possible to push a region to a better equilibrium, this does not necessarily imply that in practice this achievement is feasible, or that displacement effects would not leave national welfare unchanged. Both New Jersey and Silicon Valley had potential to host a high-tech cluster, but once California had “moved first” and generated associated agglomeration and clustering externalities, shifting activity to the East Coast would have been prohibitively costly. And even if New Jersey were to succeed in displacing Silicon Valley, it is not clear that the country would be better off for it. A more modest approach may not imagine a shift to a new equilibrium, but rather to incrementally remove barriers to growth in an already viable but lagging or recovering region. Here the focus is on building the capabilities of entrepreneurs and workers while improving elements of the business climate. Evaluation of combinations of such policies is still challenging, but simpler: it would not need to concentrate on the scale effects of a big push approach, and thus would not have to attempt to place an accurate valuation on their hoped-for gains.

In the end, however, the success of either type of policy will depend on the degree of viability of a region—whether the discounted value of direct and indirect effects relative to the cost exceeds that of other uses of funds. It will also depend on the ability of governments to correctly diagnose and then implement a coordinated set of interventions at scale. If either is not the case, then some combination of other options should be considered instead, such as facilitating migration to other regions, providing income transfers, or improving service provision. In a similar vein, policy makers should be aware that some seemingly spatially blind policies addressing other social ends, such as income taxation, minimum wages, or carbon taxes, can also generate spatially biased distortions. Spatial differences in urban land market policies (such as land ceilings and sales taxes) can have critical implications for misallocation of factors of production, as demonstrated for the case of India (Duranton et al. 2016).

**Special Economic Zones: Encouraging Productive Agglomeration at a Manageable Scale**

The focus on SEZs implicitly recognizes the changing global landscape by focusing on attracting foreign direct investment. However, SEZs can also be seen as an attempt to reduce the dimensionality of plans to assist lagging regions. The economic case for pursuing SEZs is based on two arguments. First, there are efficiency gains from spatial concentration in the provision of infrastructure and development of clusters. Second, in developing countries where financial and governmental resources are strained, the associated fiscal costs (tax and customs regulation, infrastructure) and political obstacles (for example, acquiring land and implementing regulatory reform) are too challenging at a countrywide level.

Estimating the direct quantity effects of attracting investment depends on assessing the gains from solving the weakest-link problem: The returns to improving roads,
energy, land, or the business environment in isolation are limited if other critical constraints are not reduced or removed. For example, Farole and Akinci (2011) examine data across 77 countries and find that improvements in infrastructure and trade facilitation have a significant positive impact on investment, while tax and other financial incentives are much less important without them. But again, natural location is the critical complementary factor determining viability. Frick, Rodríguez-Pose, and Wong (2019) highlight that zone size and proximity to a large city are important predictors of SEZ success, with cities offering many of the human and physical capital complements. A World Bank (2016) evaluation of SEZ performance identifies the placement of the SEZs in the “wrong areas”—far from markets or trade hubs—to be a key contributor to their failure, along with the absence of complementary human and physical capital. For instance, only one of Peru’s seven SEZs generates substantial jobs and exports; it is Paita CETICOS, which is the largest and close to a port (Rodríguez-Pose and Wilkie 2019; World Bank 2016).

Indirect quantity effects include spillovers between firms, agglomeration, and productivity growth. Duranton and Venables (2018, 2020) highlight that these effects will include a horizontal element, with a large number of firms in the same sector building up thick labor markets and other agglomeration economies. There is also likely to be a vertical element, with colocation of input suppliers and the growth of forward and backward linkages. This process encounters the first-mover or “all-at-once” coordination problem: it is hard to start a cluster. Involvement of one or several large firms (anchor firms) is one route to kick-start this. This is what happened with the multinational electronics companies (including AMD, Fairchild Semiconductor, Intel) initially attracted to Penang, Malaysia, and with Philips-van-Heusen’s project in Hawassa, Ethiopia, discussed in the volume. Attracting such companies requires intense “soft policy” from government such as an enabling business environment, working closely with the companies and committing to help the firms deliver international standards.

Links from the SEZ to the local economy include development of skills and employment in the local labor market, expanding the technological capabilities of local firms, increasing the use of local firms as suppliers and as customers, and entrepreneurial spin-offs from firms in the zone. In Mauritius, the SEZ upgraded from low-value textiles to higher-value and more skill-intensive products (off-shoring low-value production to an SEZ in Madagascar). In Malaysia, the Penang SEZ focused from the start on electronics, but upgraded from basic assembly to more advanced and skill-intensive goods. In both countries, the upgrading to more skill-intensive products and operations was accompanied by a transition toward locally owned firms. Such spillovers appear to shrink to zero beyond a 10 kilometer radius from the zone (Frick, Rodríguez-Pose, and Wong 2019) and are more intense in denser areas. Hence, again, location becomes critical to success. Few spillovers have been realized in South Africa’s SEZ program, which aims to establish “new industrial hubs” in mostly rural areas rather than fast-growing cities via the Industrial Policy Action Plan. Finally, to the degree that
firms’ relocation from an existing locale to the SEZ merely displaces jobs and activity, it provides no net social benefit to the country.

**Conclusion**

In the end, the volume argues that while the forces of agglomeration, migration, and distance act as important constraints to policies dedicated to stimulating regional growth and reducing regional inequalities, geographic history is not destiny. The dramatic examples in Asia offer clear proof that regional policies can stimulate local growth and promote spatial equity. The rapid economic growth of the Republic of Korea was accompanied by economic concentration in the large cities, as well as improvements in services and living standards across the national territory (Lall 2012).

However, even successful cases must contend with the realities that economic geography is inequitable, uneven, and—as Mexico City’s origins in Tenochtitlán testify—persistent. The latter two characteristics imply that governments in pursuit of equality and growth will face difficult choices. Some regions will, coldly viewed, not be viable. *To reiterate, equity per se is not a sufficient motivation for spatial policies.* And in such cases, place-based policies will not be an efficient way to support the welfare of residents. Other regions might be invigorated with a coordinated combination of programs, but limited government capability in policy diagnosis, design, and implementation may dictate that, in practice, a region cannot realize its potential. As the 2009 *World Development Report* stresses, in such cases, it may make more sense to invest in people rather than places and facilitate their migration. That said, this approach proves easier to recommend than pursue. Mobility has proven to be a weaker equilibrating force than expected.

Hence, policy makers are often compelled to act with a mandate to “do something,” but are left without clear and palatable options. As the volume shows, there are many success stories in building transport corridors, in revivifying shocked regions, and in kick-starting backwaters, but there are many brutally expensive failures. What is needed to optimize efforts is a disciplined expectation of what is reasonable from a region, an objective view of the capabilities of government to design and execute, and a fair weighing of other options, such as encouraging migration, or providing training programs and income transfer safety nets.

More generally, extensive empirical analysis and informed theory presented in this volume support a powerful conclusion: *Spatial transformations can be effective in tandem with economic transformation—but without it, they can achieve little.* In particular, the long-term amelioration of poverty in lagging regions requires advancing the overall national agenda of structural change and productivity growth. Only then will there truly be more productive places for people to move to.
The volume highlights the necessity of undertaking as comprehensive, objective, and well-grounded analysis as possible to determine the likely returns to place-based intervention—tempered by a caution that the analytical tools to do this are rudimentary. All these elements discussed are included in the assessment framework used throughout the volume to enrich and discipline assessment of place-based policies. However, the examples offered also show how very difficult it can be to confidently identify the market failures, distortions, or missing factors, and then assess their importance as confounding factors to a program, and further estimate the hoped-for indirect and valuation effects. Despite these difficulties, the examples also demonstrate that the framework has value—if only to highlight the elements policy makers need to keep in mind as they choose among place-based policies, and the relative importance of those elements. The hope, however, is that the analysis and framework offered in this volume of the World Bank’s productivity project will help inform and improve the efficacy of place-based interventions.

Notes

1. In contrast, in Brazil, India, and Malaysia, urban farmers make up less than 7.5 percent of the urban population (Henderson and Kriticos 2018; Henderson and Turner 2020). In many African countries, this share has been rising rather than falling (Hommann and Lall 2019).

2. Only 13.8 percent of Americans moved to another county, state, or country in the previous five years according to the 2010 Census, compared with 21 percent reported in the 1990 and 2000 Census.

3. New brands of populism are on the rise in several high-income countries, including Austria, Belgium, Canada, Denmark, France, Germany, Hungary, and Poland (Mudde and Kaltwasser 2012; Greven 2016). In Thailand, support for populism “is concentrated in regions of relatively high poverty and low incomes,” Hewison (2014) notes, suggesting that inequality is a root cause.

4. This was originally termed the “innovation policy dilemma” by Cirera and Maloney (2017) in *The Innovation Paradox*.

5. The valuation should cover both outputs and inputs: that is, revenues minus the cost of the induced investment.

6. While capable government will certainly be an advantage, this is an exceptionally difficult area to appraise with precision.

7. *World Development Report 2009: Reshaping Economic Geography* (World Bank 2009) argues that policy action should start by investing in people rather than in places. However, both the policies to facilitate mobility and the strong attachment to place often put political pressure on policy makers to “do something” for a lagging or distressed region instead.


9. The local authority–level Index of Multiple Deprivation was constructed by the central government using a three-step procedure based on a number of variables predating the introduction of the local economic growth initiative, some of which dated back as far as the 1991 Census (Einiö and Overman 2020).

10. See https://whatworksgrowth.org/.

11. For international evidence on the cost of remoteness, see Redding and Venables (2004).
References


Place matters for productivity and prosperity. Myriad factors support a successful place, including not only the hard infrastructure such as roads, but also the softer elements such as worker skills, entrepreneurial ability, and well-functioning institutions. History suggests that prosperous places tend to persist, while “left-behind” regions—or those hurt by climatic, technological, or commercial shocks—struggle to catch up. This division gives rise to demands to “do something” about the subsequent spatial inequality. Such pressures often result in costly spatially targeted policies with disappointing outcomes because of a lack of analysis of the underlying barriers to growth and structural transformation and a fair appraisal of the possibility of overcoming them.

The latest volume of the World Bank Productivity Project series, Place, Productivity, and Prosperity: Revisiting Spatially Targeted Policies for Regional Development makes three broad contributions. First, it provides new analytical and empirical insights into the three drivers of economic geography—agglomeration economies, migration, and distance—and the way in which these drivers interact. Second, it argues that these forces are playing out differently in developing countries than they have in advanced economies: urbanization is not accompanied by structural transformation, leaving cities crowded and accruing all the negative aspects of urbanization without being concentrated productively. Long-term amelioration of poverty in lagging regions requires advancing the overall national agenda of structural change and productivity growth. Third, it provides a heuristic framework with which to inform policy makers’ assessments of place-based policy proposals, helping them identify the regions where policy is likely to have an impact and those that would remain nonviable. The framework enables governments to clarify the implications of various policy options; to think critically about design priorities, including necessary complementary policies; and to navigate the implementation challenges.

“This is an extremely welcome book. Three experts lay out the principles behind spatially targeted policy and the experience of countries using such policies. A must-read for anyone interested in spatial inequality and policy to address it.”

Anthony J. Venables
Professor of Economics, University of Manchester, and Research Director, The Productivity Institute

“Delivering better livelihoods for all requires tapping into the economic potential of every place, including those losing out or lagging behind. This, however, cannot be done effectively without a sound theoretical and empirical framework. Place, Productivity, and Prosperity is the right book to look for such a framework.”

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