focus 6 on *regional inequality*

The role of public policy in addressing spatial inequalities

The persistence of regional disparities within countries is a major policy concern confronting many governments in rich and poor countries alike. Clarity on the causal factors of weak regional performance and careful consideration of potential tradeoffs are needed to guide policy choice over regional interventions.

The average income in Brazil's northeast is less than half the national average. Poverty rates are far higher than the national average in India's densely populated states of Bihar, Uttar Pradesh, and Orissa, and the regional income gap appears to be widening. In 1990, children in the northwest region of Nigeria were four times less likely to receive any immunizations and 50 percent more likely to die by age five than those near the capital in the southwest; by 1999 they were five times less likely to receive any immunizations and 85 percent more likely to die before age five. Chronic regional underperformance can give rise to many concerns and threaten national unity—lost economic potential, unfairness in regional opportunities, potential instability, loss of social cohesion, and adverse social consequences, including higher crime and disease.

The geographic and historical factors underlying interregional inequality are complex and overlapping. Weak resource endowments and distance from markets can constrain development in lagging regions. In many cases, economic differences are linked with long-standing, unequal relations of power between advantaged and lagging regions, and institutional weaknesses within the latter.[1] When actors in advantaged regions control the assets, decision-making and policy formation processes, and the terms of the policy debates on which lagging regions depend, regional "catch up" is much more difficult.[2]

When historically disadvantaged ethnic, racial, and social groups are concentrated in particular regions, group-based inequities become reflected in regional inequalities. This is the case in parts of Latin America, where indigenous groups are both poorer and concentrated in poorer regions,[3] and in Vietnam and in India where tribal groups (*adivasis*) are spatially concentrated.[4]

In the absence of redistributive fiscal transfers, recent reforms in many countries toward greater decentralization may aggravate regional disparities. The positive effects of decentralization may be lost in regions that have weaker fiscal capacity, such as in Argentina's experience with decentralizing reforms in education.[5] In poor regions where regional elites have particularly concentrated power, decentralization may also deepen both intra- and inter-regional inequalities.[6]

Trends in inter-regional inequality have varied considerably across countries. The United States has experienced convergence and lower interregional income disparities. Indonesia shows convergence of provincial incomes since the 1970s. Brazil has seen divergence over many decades, but recently has shown convergence. Evidence on India also suggests divergence. China's pattern of growth has reduced gaps in the 1970s and 1980s, which widened in the 1990s. And in Mexico a long-run trend of slow convergence in incomes shifted to one of slow divergence after an opening that started in the late 1980s.

Characteristics of lagging regions

The reasons for regions to lag varies, and we present a simple taxonomy.

Low poverty density, low market access. These regions are sparsely populated, remote, and face particular geographic challenges. Distance and poor resource endowment—often with weak social indicators, generally poor infrastructure, and weak regional voice—place these regions at the periphery of national economic activity and opportunity. Supporting development of these regions may be desirable on poverty grounds, but it is likely to be expensive.

Low poverty density, high market access. These regions typically have been booming at one point in history, and were well integrated with the national economy. But changing demand patterns or resource exhaustion became sources of decline, even though political influence may have persisted. For such "rustbelt" regions, there is a case for public support for movement of people and resources out of declining industries, backed by social safety nets for the affected workforce.

High poverty density, high or low market access. These regions are most often considered for targeted interventions: poverty is concentrated in them, population density is relatively high, and the lack of market integration is due to history rather than geography. Possible culprits include weak governance, poor institutional capacity and human capital, a history of sociocultural conflict and domination, a poor investment climate, and security problems. Such regions are often home to socially, racially, and ethnically disadvantaged groups. Where such groups are dispersed or patron-client relationships dominate, the challenge of fostering organization, agency, and political influence is especially great.[7]

Regional development policies and tradeoffs

Regional development policies involve interventions to facilitate inward investment, enhance income opportunities and well-being in lagging regions, help households move to opportunities elsewhere, and shift interregional power relations. Policies are context specific and involve tradeoffs. If lagging regional performance reflects geographic disadvantages or an absence of

Market access (population density, transport costs)

Poverty density (poor or disadvantaged people per square kilometer)		Low	High
	Low	• Chile's "zonas extremas" • Russian North (state-sponsored settlements) • Northern Canada	• N.E. China's "rustbelt" region • Developed country "coal towns" (France, U.K., U.S.)
	High	• Thailand's northeast • Mexico's southern states	• India's "Hindu Belt" poor and populous states • Italy's southern Mezzogiorno

agglomeration and scale economies, public interventions may be particularly expensive. But when public policy is designed to correct market failures (such as underdeveloped insurance or credit markets), address specific social or historical factors handicapping regional performance, or capture externalities intrinsic to national welfare (cultural, environmental, security), there may be few or no efficiency tradeoffs.

Fiscal incentives

A popular approach involves fiscal incentives to induce industry to locate and invest in lagging regions: tax advantages, insurance or risk-sharing arrangements, direct subsidies, or indirect subsidies through provision of low-cost public services. But evaluations of fiscal incentives generally indicate that they can be costly and ineffective. Brazil's efforts to develop the manufacturing center of Manaus in the north have been a success by some measures, but costs per job created are high.[8] Interregional "fiscal wars" can also occur as regions compete to attract businesses. If uncoordinated or unconstrained, these can have adverse consequences for local tax bases and public services in competing jurisdictions. Compared to the alternatives listed below, this tends to be a high-distortion strategy.

Public investment

Targeted public investment, particularly in core infrastructure, is another policy response aimed at reducing geographic disincentives to firm location, whether for existing or new firms. China has followed this strategy, first in the coastal special economic zones, and now in western regions (see box below).

Investment in regional infrastructure links may enhance productivity of existing firms and attract new firms. But, it also allows more efficient firms in richer regions to sell to lagging regions. This is one factor that has slowed development of the relatively poor Mezzogiorno region of southern Italy, despite large investments in national north-south infrastructure that has reduced transport costs.[9]

Facilitating labor mobility

Facilitating voluntary labor movement to higher opportunity areas is another strategy. In contrast to fiscal incentives and public investments that focus on bringing jobs to poor areas, this strategy focuses on bringing poor people to areas with more potential. Relocation assistance can include transport, housing, training, resettlement allowances, and portable safety nets. Examples included incentives in Russia for families to relocate from their northern settlements—developed at huge state expense for resource extraction and security purposes during the Cold War—and incentives to support movement of labor out of declining industries, such as the moribund coal sectors in Western Europe and the former Soviet Union since the 1960s. While the programs have helped ease the impact of unemployment, there are questions about cost effectiveness and long-term impact.

There is also a long history of efforts to direct settlement of remote regions or encourage migration to frontier lands. Early settlers to the Americas, including the west and midwestern regions of the United States, were beneficiaries of legal land grants to clear and use new land. More recent programs include Indonesia's transmigration program that shifted Javanese to sparsely populated outer islands in the 1970s and 1980s, or early Ethiopian resettlement programs to fertile areas in the south and southwest regions of the country. However, these and other resettlement programs have been criticized for their coercive or ethnic dimensions, raising questions about the adverse impact on indigenous population groups and settlers.

Enhancing agency

Where intergroup inequalities in agency underlie regional disadvantage, national and regional policies addressing discrimination, racism, and citizenship deficits can be important instruments for dealing with spatial inequality. Enhancing voice and participation of excluded groups is also important for national peace and cohesion. While ethnic discrimination and regional disadvantage do not necessarily lead to conflict, researchers and truth and reconciliation commissions alike have identified them as contributing factors.[10] In Aceh, Indonesia, oil rents have been transferred back to the region since 1976, yet regional conflict and demands for autonomy have increased rather than abated.[11] This suggests that transfers alone are not sufficient to address regionally concentrated grievances—they must be accompanied by meaningful political participation and dialogue.

Conclusion

The specific nature of the constraints to regional growth and investment performance in lagging regions needs to be identified and prioritized. Policies that provide fiscal incentives to investors are likely to fail if the main factors that adversely influence regional investment climate—quality of local institutions, skilled labor availability, proximity to key markets, functioning capital and land markets, security risks—still pose binding constraints.

Public investment in infrastructure that reduces transport costs for both people and goods has often proved an effective strategy for integration. And, as with other policies, well designed technical solutions are more likely to be implemented if those living in poorer regions are empowered.

Development of lagging regions in China

Unprecedented economic growth and poverty reduction in China have been accompanied by significant increases in regional disparities since the economic reform in the late 1970s. The socioeconomic costs of a sustained divergence in income between leading and lagging regions has become a major concern of the government.

In 1999, the government initiated the "Go West" strategy to develop the lagging western region. Through targeted public investments and fiscal subsidies, the central government spent some 1,000 billion yuan (US$120 billion) in the past five years, focusing on infrastructure, education, health, and the environment. A variety of investment incentives and low interest loans aimed to attract domestic and foreign firms to areas in which the western region has some comparative advantage, such as energy, agriculture, and agroprocessing.

The relative decline of the historically advantaged northeastern region has also attracted concern. China's northeast currently suffers from slow growth and high unemployment in declining industries, along with many severely distressed towns and cities. The government started the "Revitalize Northeast" strategy in 2003. This involves new initiatives, including strengthening the investment climate, developing greater flexibility in factor markets, using public funds to support rather than postpone adjustment, and mitigating social costs through improved and portable safety nets.