World Bank’s Collaborative Program of Analytical and Advisory Work: Post-Crisis Russia’s on Growth and Regional Development

Chorching Goh¹, the World Bank

Summary

Russia is the largest country in the world, covering 17 million square kilometers and spanning 11 time zones. Location decisions perhaps matter more in Russia than in any other country in the world. Besides, Russia has the longest legacy of a non-market economic system. Since location decisions are sticky, Russia must overcome perhaps the most difficult economic geography of any nation. Despite the gruesome internal geography and distortions from history, Russia today has the most fortunate location on the globe. It abuts Western Europe, the richest region, and East Asia, the fastest growing part of the world. How can Russia handle the longest domestic distances, overcome the longest legacy of distorted economic decision-making, and take advantage of its fortunate location on the globe? By policies that better appreciate the market forces of agglomeration, migration and specialization. This program of analytical and advisory work will identify the most important policy measures for Russia to facilitate the spatial transformations necessary for making the transition to high income country status.

I. The Question

Russia aspires to be a modern, diverse, and high-income economy. This is a shared aspiration among middle-income countries. In recent memory, however, only a handful of such countries have made this transition—Singapore and South Korea are the prime examples. By contrast, many of the rest have remained middle-income for decades. For some, middle-income status has been the status quo for more than a century.² Moreover, even for countries which have successfully transitioned, the process has been far from easy. It has been arduous for Singapore, a compact city state with an area of 700 sq km. It will be no less grueling for Russia, blessed with 17 million sq km of land mass.

A major factor determining the speed and smoothness of the transition from middle to high income status is the geographic organization of economic activity. This is because successful development requires not only an economy’s structural transformation, but also its spatial transformation. The key question addressed in this study, therefore, is how public policy can facilitate market-driven adjustment processes in the geographic distribution of economic activity in Russia, while ensuring access to basic amenities and social services throughout its enormous territory. That is to say, how can the enhancement of spatial efficiency, which tends to be

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² Based on data from Angus Maddison (2008), Statistics on World Population, GDP and per capita GDP, 1-2006 AD”, several Eastern European countries and a few from Latin America were middle-income in the late 19th century.
associated with agglomeration, migration, and specialization be achieved without unduly compromising spatial equity?

The location of economic activity will be among the most important determinants of Russia's ability to transform into a modern high-income economy. The reason is simple. Russia is the largest country in the world, spanning 11 time zones (Figure 1). Where economic activity is located matters much more since vast distances hinder access to domestic and international markets. For firms, location decisions will decide the difference between profitability and demise. For large nations such as Australia, Brazil, Canada, China, the United States and Russia, policies that influence such decisions can make the difference between being a superpower or an also-ran (Table 1).

Figure 1. The largest country in the world, Russia, spans across 11 time zones.

![Map of the World](http://www.travel.com.hk/region/timezone.htm)

Table 1: Vast countries—some statistics

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<tbody>
<tr>
<td>Russia</td>
<td>17.1</td>
<td>7.4</td>
<td>142</td>
<td>65</td>
<td>1,071</td>
<td>7,560</td>
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<tr>
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<td>6.4</td>
<td>21</td>
<td>76</td>
<td>756</td>
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<tr>
<td>Brazil</td>
<td>8.51</td>
<td>7.0</td>
<td>102</td>
<td>64</td>
<td>1,133</td>
<td>5,910</td>
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<td>5.0</td>
<td>33</td>
<td>71</td>
<td>1,300</td>
<td>39,420</td>
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<tr>
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<td>11</td>
<td>1320</td>
<td>37</td>
<td>3,121</td>
<td>2,360</td>
</tr>
<tr>
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<td>9.63</td>
<td>19</td>
<td>302</td>
<td>72</td>
<td>13,887</td>
<td>46,040</td>
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Policy decisions that affect economic geography, i.e. those that impinge or affect the location decisions of firms and workers should not be made independent of market forces. Likewise,
governments do not want the market to work independent of their actions. Policies should harness market forces for the progressive objectives of efficiency and growth on the one hand and equity on the other. How can this be done?

- Market forces of agglomeration, migration, and specialization bring about a more efficient spatial structure of production where economic activity conglomerates in few parts of a country. A progressively more uneven landscape of economic activity (Figure 2) is a natural part of the development process. To try to spread out economic production too much, too far, or too soon is to discourage economic growth and development.

- By harnessing the productivity and benefits from economic concentration, governments can institute policies to ensure spatial equity in living standards. Universal provision of basic amenities and social services; robust, versatile, and responsive land and labor market regulations are the institutional bedrock of policies that can lead to a more even landscape of social welfare. Such institutions that help to unify large nations allow even those who start their lives far away from economic opportunities to benefit from the rising concentration of economic activity in relatively few places.

Figure 2. Geographic distribution of economic activity is uneven

![Figure 2](http://gecon.edu.yale)

II. Motivation

Over the last two decades, Russia has demonstrated a preoccupation with targeted interventions which have been designed to skew the location decisions of firms towards certain (lagging)

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These forces have been identified as fundamental determinants of spatial transformation needed for development in the 2009 World Development Report, *Reshaping Economic Geography* (World Bank 2008).
Regulations and subsidies have been used by various levels of government to steer or influence specific plants or industries towards certain locations. In doing so, policymakers have exhibited at best an under-appreciation of the market forces of **agglomeration, migration, and specialization** that help to shape a country's economic and social landscapes. At worst, these policies reflect a disdain for markets. While targeted spatial policies may indeed serve short-term political objectives well, they come at the obvious costs on public budgets. Less obvious but far more important are the long term efficiency losses these policies involve.

This discussion gives rise to three specific policy questions that will be analyzed in this report:

1. **How can Russia promote urban development that supports industries and services in well-functioning metropolitan areas?**

   To quote Arkady Dvorkovich, the assistant to President Medvedev, “…innovation and knowledge economy are fashionable … the buzz words … in Russia these days…”. Indeed, there has been much policy focus on cluster strategy, innovation development strategy, and promotion of the intellectual services sector. International experience, however, indicates that such narrowly focused interventions are seldom successful without an adequate foundation of institutions, and reasonable infrastructure networks.

   Moscow is the best placed of Russia's cities to drive the country's modernization. It is the country's capital and primary city, endowed with financial and human resources, economic diversity, and administrative capacity to deliver urbanization economies. Yet its metropolitan area has barely grown from 7.5 million in 1975 to 10.5 in 2007. Moscow’s economy is still dominated by lower-value services, in contrast with Tokyo, New York, and London which—the recent downturn in the world economy notwithstanding—continue to thrive on financial, insurance, wholesale and retail services. The tepid growth of Moscow masks the trend of absolute decline in population of large urban centers (e.g., St. Petersburg, Nizhniy Novgorod, Samara, Yekaterinburg) which mirrors the country’s declining population.

   Why are the forces promoting the growth, upgrading and diversification of Russia's major cities so weak compared to other countries? What is hindering agglomeration and, in particular, the dynamic urbanization economies that are provided by metropolitan areas? How can policies facilitate Moscow to propel Russia into the realm of the knowledge economy?

2. **What are the constraints to mobility of firms and families that prevent a more efficient geographic organization of economic activity and convergence in living standards?**

   Russia is the largest country in the world, and has the strongest, longest legacy as a planned economy. For both these reasons, more critically than others, Russia must promote the mobility of factors of production—labor, capital and intermediate goods—to create an efficient spatial structure.

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But capital mobility has remained low. Market institutions such as capital market mechanisms and corporate governance are still at formative stages. Labor mobility is low. An American on average moves 13 times during his lifetime; a Briton moves 7 times, but a Russian just twice. Furthermore, dwindling migration flows indicate a deteriorating trend. In 1995, over 3 million people moved between regions but in 2005, only 1.6 million relocated.

Why don’t more Russians “up their roots” to seek prosperity elsewhere? How can barriers to mobility be removed to facilitate both agglomeration and the convergence of living standards across the country?

3. **How can Russia better integrate with its neighbors and into world markets to benefit from rising trade driven by specialization and scale economies?**

Russia, in spite of its vast size, historically distorted spatial structure of production, and relatively small economy, is located between two of the world's most promising neighborhoods (Figure 3). To the east, lies East Asia, the fastest growing region during the last 30 years. Meanwhile, to the West is the European Union, one of the largest and most prosperous markets for world exports.

**Figure 3. In a map of the world’s economic geography, Russia is a thin sliver that abuts two promising neighborhoods**

However, Russia is not taking advantage of the extensive production networks binding Southeast and Northeast Asia nor the purchasing power in EU markets. In 2007, Russia’s trade volume of $500 billion was similar to that of Singapore, an economy only 10 percent of the size of Russia’s. Furthermore, the composition of Russia’s exports was dominated by the defense sector and extractive industries. Why has Russia not exploited the economies of scale and specialization?

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that have contributed to the exponential growth in trade of intermediate inputs in other world regions? Global integration can also be gauged by arrival of tourists. During 2007, 4 million tourists visited Moscow, in contrast with 46 million to New York City, 30 million to Paris, and 26 million to London.10

Can regional and global integration help Russia grow to high-income and diversify into a modern economy? What are necessary steps to reform its institutions; harmonize trade, financial and employment regulations; and intensify trade and transport facilitation with its more prosperous neighbors?

III. Approach

This program of work will be carried out in a collaborative approach with Russian experts, policy advisors, and government officials.

1. Partnerships with think-tanks across Russia. The team has sought and found partners among think tanks and universities in Moscow and St Petersburg (e.g., the Center of Strategic Research, the Leontief Center, the New Economic School, State University’s Higher School of Economics, the Russian Academy of Sciences, the Russian Academy of National Economy, The Carnegie Moscow Center, the Institute of Economics in Transition, and Bauman Innovation), the Urals region (Urals State Gorky University), and the Karelia region (Petrozavodsk State University). As the work unfolds, the team plans to initiate and build partnerships with other regional partners, especially from Siberia and far eastern republics.

2. Building a base for policy dialogue. The expertise of collaborators ranges from purely academic research, to policy analysis and advice, to policy formulation and policy execution. Thus, the form of Bank’s collaboration with these partners will be shaped by their expertise and influence. Some have the convening power of policymakers and thinkers and will co-host discussion forums. Some offer analytical excellence and will contribute background papers. Some with topical expertise will provide literature reviews. Those with policymaking experiences or in regular engagement with policymakers will serve as advisors. Others with broad knowledge of the Russian economy, extensive experience working on Russia and other countries, and in-depth expertise of these issues will serve as either peer reviewers or advisors.

3. A program of seminars. There will be a series of regular workshops to discuss ongoing work, and maintain an engaging dialogue with the government throughout. The series of seminars will mirror the staged-approach in the Program. The Center of Strategic Research (Moscow), the Leontief Center (St. Petersburg) and our regional partners have agreed to co-host the initial wave of seminars. Additional partners will be sought to co-host the latter wave of seminars.

A collaborative approach—with a stream of substantive intermediate outputs in the form of three sets of notes—will (a) help to make the program of work relevant and timely; (b) allow important topics to be added mid-stream; and (c) sharpen the final policy messages. In addition, this approach will (d) make the Bank’s policy dialogue more engaging and inclusive; (e) expand beyond Moscow the network of Bank partners and collaborators; and (f) expand the Bank’s outreach into the regions and oblasts, opening new business opportunities with sub-national

authorities.
Local and foreign experts, academics, and former policymakers have agreed to serve as advisors. Their experiences and expertise will ensure analytical rigor and depth, and that the Report’s messages reach policymakers. Early draft of this concept note has been discussed with these advisors.

The panel includes from Russia:

- Evsey Gurvich (President of the Economic Expert Group), Yegor Gaidar (former Prime Minister, Minister of Economics, and Minister of Finance and President of the Institute for the Economy in Transition), Dmitri Trenin, (Director, Carnegie Moscow Center), and Natalia Zubarevich (Director of regional program, Independent Institute for Social Policy, professor of Moscow State University);

and outside of Russia:

- Vernon Henderson (Brown University), Mun S. Ho (Harvard University and Resources for the Future (DC)), Yukon Huang (former World Bank’s country director for Russia and China), Dale Jorgenson (Samuel W. Morris University Professorship, Harvard University), Oleg Lugovoy (Environmental Defense Funds (DC)), Homi Kharas (Brookings Institution), and Philippe Martin (University of Paris).

Peer reviewers of the study are William Maloney (DECRG), Richard Auty (Professor, University of Lancaster), Leonid Limonov (Director General, the Leontief Center), Mikhail Dmitriev (President, Center of Strategic Research), and Ekaterina Zhuravskaya (Hans Rausing Professor, New Economic School and Academic Director, Center for Economic and Financial Research).

IV. Contents

This Program will focus on three policy areas: urban agglomerations as the drivers of economic growth, inter-regional mobility to adjust to a changing economic landscape, and regional and global integration to benefit from neighboring and world markets. In each policy area, the analyses will be based on aggregate data, micro-household survey data, and comparable cross-country data. The methodology is primarily quantitative, and wherever appropriate, econometrics will be applied. Case studies and qualitative techniques will be used as supplementary methods.

- Agglomeration. The first policy area will explore the hypothesis that Russia has not sufficiently exploited its urban agglomerations as major drivers of growth. Work on this policy area will start with a documentation of Moscow’s evolving economic structure and profile its labor force (industrial composition, age structure, skill profile etc), trends in FDI, infrastructure investment, R&D spending and innovation or knowledge outputs (e.g., patents). Moscow's performance in each of these areas will be compared with other high-income mega cities. In parallel, work will be done to understand the constraints and policy barriers which might have stifled competition and agglomeration forces within the city, thereby contributing to its tepid growth. There will then be in-depth work to assess the workings of land markets. How secure are private property rights? How fluid and responsive are zoning laws, land use conversion rules, and density regulations? How robust are the institutions governing land administrations, transactions, and conflict resolutions? Addressing such questions is vital because well functioning land markets are central to a city’s ability to continually evolve and upgrade itself. Besides Moscow, St. Petersburg and other secondary cities will also be examined, more on a case study basis. The study of other urban areas will shed light on the
government’s “cluster strategy”—where has this strategy been effective, where it has failed, and what are the reasons explaining success and failure?

- **Migration.** The second policy area investigates whether limited labor mobility has restricted beneficial shifts in the geography of economic activity. In this policy area, the team will first verify the extent of labor mobility and how this has changed over time by using census, samples of cross-section, and panel data. Comparisons with other countries will be drawn. For example, we will document the unusual evenness with which Russia's population is spread across its territory.\(^\text{11}\) In contrast, roughly half of the US population today is located in only five states.\(^\text{12}\) Following suit will be an assessment of the barriers to labor mobility: what is the economic rationale of households for staying put? e.g., artificially high wages in remote places? What are policy-induced factors? e.g., place-based, non-portable welfare benefits? What are the social constraints that are discouraging mobility? What are the distortions or rigidities in the labor and related (e.g. housing) markets? Lastly, we will document other country experiences and discuss how their policies could be adopted in Russia to facilitate convergence and economic integration between poor, remote, and scarcely populated areas and prospering places but with large numbers of poor people. (Figure 4).

- **Specialization.** The third policy area takes an international perspective and investigates Russia’s integration in regional and world markets. It will begin with a stock-taking of Russia’s (i) trading partners; (ii) composition of trade with different neighbors; and (iii) depth of integration with various neighborhoods of countries over the last two decades. There will be background work to understand the slow progress in economic diversification and international integration. There will also be narrowly focused topical pieces on FDI and tourism to shed light on structural policies about Russia’s international outlook and policy stance on globalization. Borders around Russia are thick—entry into Russia for tourists and business interests is not easy. What is the rationale for forgoing substantial foreign revenue or curbing competition? There will also be work to assess the effectiveness of “cluster strategy” in different regions, and how in some areas, localization economies flourished but not in others. Finally, the team will propose how other countries’ experiences to reform their institutions, harmonize trade, financial and employment regulations, and intensify trade and transport facilitation to access world markets can provide lessons for Russia.

**Figure 4. Economic interactions among poor and prosperous areas are key to development**

Poor places with high poverty incidence vs. Prospering places with many poor

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V. Stages of work

The program of work draws from the inspiration, ideas, and insights of the World Development Report 2009 (WDR). It uses the WDR as a starting point and builds on World Bank studies, including Country Economic Memorandums, Regional Development and Growth Agglomerations (2009) and From Transition to Development (2005), and the Poverty Assessment, Addressing the Challenge of Chronic Poverty and Vulnerability (2009). Additional analyses --- making use of findings and messages of these reports --- have been planned and internalized for this work. This program of work will be coordinated closely with the ongoing Public Expenditure Review led by Karlis Smits (ECSPE) and the Social Expenditure Review led by Alex Ivanchenko (ECSHD).

We will have multi-staged analyses summarized in brief notes, delivered in a few waves of seminars and policy dialogues, held in Moscow and St Petersburg, co-hosted by different think-tanks in varied settings. Discussions will also be held in Yekaterinburg, Petrozavodsk and other (to be finalized) regions. We also have plans to use GDLN facilities to enhance outreach and collaboration with sub-national authorities.

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Stage 1

- The first series of notes will be descriptive. They will document the evolution of disparities in living standards and economic structures across oblasts, and present facts about agglomeration, migration, and specialization. These overview notes will be factual, laying out the working hypotheses for the next series of notes. A series of seminars will be co-hosted by Russian think tanks and held at varied Economic Forums to initiate dialogues and discuss the work.

Stage 2
• The second series of economic notes will be **analytical**. They will examine the drivers—economic and policy-induced—of these trends. In addition to quantitative analyses, drawing from micro data, case studies across Russia will bring in some rich details. Several seminars will take place in Moscow, St Petersburg, and the regions to discuss these issues during October 2009–January 2010. Policy dialogues with counterparts around the background notes and economic notes will have been in full swing by this time. These economic notes are about the why’s, providing ingredients and evidence to lay the analytical groundwork for the next series of notes on policy recommendations.

• The last series of policy notes will be more **prescriptive**. They will document the achievements of policy reform as well as shortcomings or distortions of policies. International experiences will be drawn upon as a menu of options to Russian policymakers. These policy notes will be discussed with academics, experts, policy analysts and advisors, and the governments (central and sub-national) from March through May 2010 in varied settings.

**Stage 3**

• The third stage consists of putting together the final Report based on the feedback received on the series of overview notes, economic notes, and policy notes, and the additional information yielded by the seminar series from participants and discussants, and taking into account any other developments in 2010. This stage will begin in May 2010, with the delivery of the report scheduled for mid-2010. By getting the facts right—documenting the “what”—and understanding the “why,” then reasoning through policy implications and proposing the “how,” the final Report aims to answer the “where” of economic decisions.