

The Governance Market: A Vision for Paul Romer's Charter Cities

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Abstract

In 2011, the Honduran government, in a nearly unanimous vote, passed legislation to allow for “Special Development Regions” where large, independently governed “charter cities” would be built on nearly unoccupied land. The legislation in Honduras has since fallen through; however, idea of charter cities is still very much being considered elsewhere and is becoming more and more of a subject of discussion in the development community. Many are seeing them as “start up governments” that enable poorer countries to bypass the political corruption and entrenched interests that often prevent them from implementing badly needed reforms. They additionally provide people from these countries with options, creating an alternative to either staying where they are or making a perilous attempt at immigration to an already developed economy.

This article examines the charter cities idea in light of various conceptions of the role and objectives of cities in the developing world. It looks at its potential to create a highly differentiated network of cities that are incentivized to govern more effectively. It also proposes a new voucher system for the charter cities idea that may help it more effectively respond to the demands of people in less-developed regions. The voucher system effectively would create a “governance market,” in which governments would innovate and compete with each other to attract residents regardless of their wealth.

Introduction

Over the next 38 years, the United Nations estimates that 2.6 billion additional people will move into cities.¹ Scholar Schlomo Angel views this migration as the capstone in a 10,000 year old “urbanization project,” that dates back to when humans first gathered together in cities and gradually did so more and more.² Over the last century the project has been moving at breakneck speed. In 1950 roughly 30% of the world’s population lived in cities. In 2010 we reached the halfway point: more people lived in cities than those who did not.³ By 2050, the UN expects that approximately 64% of the world’s population will be urban⁴ and that, by the end of the century, this percentage will level out at around 75%, possibly ending the “urbanization project.”⁵

¹ United Nations Department of Economic and Social Affairs (2012), *World Urbanization Prospects, the 2011 Revision: Highlights 1*, available at <http://esa.un.org/unpd/wup/Documentation/highlights.htm>

² Schlomo Angel, *PLANET OF CITIES*, 76 (2012)

³ NYU Stern School of Business, *Urbanization Project*, <http://urbanizationproject.org/about/>

⁴ United Nations Department of Economic and Social Affairs, *supra* at 4.

⁵ Schlomo Angel, *PLANET OF CITIES*, -- (2012)

Nearly all of this urban expansion will happen in the cities of the less-developed parts of the world, posing significant challenges for NGO and government development agendas.⁶ However, it also presents a unique opportunity for the evolution of governance. For most people, cities have offered greater income earning potential yet have often provided only substandard living arrangements, such as extensive slums. Most city governments do not want new migrants, especially poorer ones, and attempt to cordon them off from areas they hope to use to attract foreign investment.⁷ Unless we adopt a radical new vision for city governance, we can only expect this treatment to increase as more and more of the world's poor seek opportunities in cities.

On the other hand, we could embrace this immense demand for cities as a unique opportunity to creatively expand our conception of cities and develop new innovative forms of city governance. This kind of creativity and innovation can only come about by examining the incentives that operate on city government and their capacity for responding to the desires of the world's poor.

Economist Paul Romer has come up with one idea, which he calls "Charter Cities." Charter cities are essentially autonomous or semi-autonomous city states that open their doors to migrants from poor nations and offer, in theory, better laws and institutions than the surrounding nations. In the author's opinion, Romer's idea opens up important new possibilities for responding to urbanization in the developing world, yet some questions remain unanswered. Romer's idea could be complemented with mechanisms that would help migrants to charter cities more effectively develop their capabilities and exert greater influence over the cities' governments. The first part of this article will discuss a few conceptions of what cities should be as a context with which to evaluate Romer's idea. In the second part I will describe Romer's charter cities idea and its intentions. The third part will evaluate how effective Romer's concept may be in light of the observations made in part one. The last part will suggest a theoretical model that could be incorporated into the Charter Cities idea that might help it to meet its goals more efficiently.

I. What a City Should Be

Part of the problem with our current system may lie in the way we have conceived of cities. Many scholars have noted a dichotomy between poorer cities that are viewed as a project for development and "modern" cities that serve as global hubs for for-profit investment.⁸ City managers, in response, have attempted to fit their cities into either model in an attempt to attract either assistance from non-profits and governments or foreign corporate investment.⁹ Often times the dichotomy also exists within cities themselves, with certain areas designed to meet a western conception of modernity and

⁶ Schlomo Angel, *Planet of Cities*, 13 (explaining that cities in the more developed regions will grow by 170 million, whereas cities in the less developed regions will grow 15 times larger).

⁷ *Ibid* at 4 (explaining that most migrants are incorrectly viewed only as liabilities); *see also*, Rick Su, *Local Fragmentation as Immigration Regulation*, 47:2 *Houston L. Rev.* 367, 383–390 (noting American cities' history of segregating, yet relying on, immigrant labor).

⁸ *E.g.*, Jennifer Robinson, *Ordinary Cities*, 2, 5, 92-107 (2006)

⁹ *Ibid* at 94–107.

other areas characterized as projects for development.¹⁰ City planners that seek the former category may segregate the poor, who often embody cultures deemed “traditional,” from the city’s “modern” areas.¹¹ City planners that seek the latter category may cede agency over the city’s future to the ambitions of large donor and government agencies.¹²

Our bifurcated vision of cities may have led to disastrous results. In the early 1960’s urban theorist Jane Jacobs began to espouse a new vision of cities out of resistance to what she saw as the “sacking” of New York City under the grand visions then dominating urban theory.¹³ Dense, closely knit, diverse, and vibrant city neighborhoods were being torn apart and replaced with superblocks and towering residential projects.¹⁴ Instead of communities where varied small businesses and people of all classes interacted, neighborhoods were “price tagged,” segmenting off residences from businesses and the poor from the middle class and wealthy.¹⁵ Often the aims were ostensibly altruistic; much of the development was aimed at creating better living standards for the poor.¹⁶ The result, however, was a kind of subsidized slumming and projects that were more dangerous than ever.¹⁷

Looking at the problem from a wider angle, urban theorist Jennifer Robinson criticizes the classification of the world’s cities into a hierarchy of “modern, global cities” and “traditional cities” in need of development. She proposes that we fundamentally reconceive our definition of “modern” to include not just cities that adopt a Western idea of progress but all cities that creatively refashion their institutions and choose to either let their cultures evolve and hybridize with others or stay rooted in the midst of change around them.¹⁸ She follows Jane Jacobs’ observation that cities decay and cease to provide opportunities for human development when they do not allow vibrant, diverse, and competing interests to share urban space.¹⁹

Hierarchically categorizing and segmenting cities in this way may correspond with an overreliance on one popular narrative of development. Under this narrative, poorer economies develop by making dynamic use of their comparative advantages at producing exports.²⁰ For example, an economy at the very bottom level may only have comparative

¹⁰ Ibid.

¹¹ Ibid at 80–81 (describing Kuala Lumpur’s efforts at “modernization”); *see also*, Rick Su, *Local Fragmentation as Immigration Regulation*, 47:2 Houston L. Rev. 367, 383–390 (noting American cities’ history of segregating, yet relying on, immigrant labor).

¹² Jennifer Robinson, *Ordinary Cities*, 93–107 (2006)

¹³ Jane Jacobs, *The Death and Life of Great American Cities* 6 (Modern Library ed. 1993) (1961)

¹⁴ Ibid at 6–7.

¹⁵ Ibid at 7 (“People who get marked with the planners’ hex signs are pushed about, expropriated, and uprooted much as if they were the subjects of a conquering power.”); *See also*, Rick Su, *supra* at 387–88 (describing New York City’s prior history of overtly using zoning laws to segregate immigrants).

¹⁶ Ibid at 6.

¹⁷ Ibid.

¹⁸ Jennifer Robinson, *Ordinary Cities*, 7, 20–21, 39 (–)

¹⁹ Ibid. at 114.

²⁰ *See, e.g.*, Joseph E. Stiglitz, *From Resource Curse to Blessing*, Project-Syndicate (Aug. 6, 2012) <http://www.project-syndicate.org/commentary/from-resource-curse-to-blessing-by-joseph-e--stiglitz>

advantages in resource extraction and agriculture, depending on its geology and climate.²¹ Generally, large foreign mining companies can invest even in conflict-ridden areas and areas with critical health and safety concerns.

Next, if this country makes dynamic use of its resource advantages by investing in its infrastructure, it can rely more heavily on another comparative advantage: its ability to supply cheap labor. It may first open itself up to large garment manufacturing operations, which often seek corners of the globe with the cheapest labor costs and low political risks. If the country again makes dynamic use of this comparative advantage by investing in its infrastructure, other forms of light industry can move in, such as electronic and toy manufacturers. These factories may then compete for the workers in the area by offering higher wages and, perhaps, better working conditions. The next step occurs when other industries open up factories and offer even higher wages. Eventually, if the surrounding political, health, infrastructural, and educational systems are favorable, a more local, diverse, and wealthy economy may emerge.

Throughout history, this trajectory has yielded tremendous upward mobility for many in the developing world. Taiwan, South Korea, Hong Kong, Singapore and other Asian economies have completed this narrative in just the last few decades. Assuming that development is not accompanied by forced displacement or environmental degradation, people's voluntary choice to migrate to areas where they can find garment or light manufacturing jobs in large factories can be seen as some level of endorsement of the opportunities those jobs provide.²² Furthermore, looking at the issue from an economic standpoint, a light-manufacturing-based industry brings two benefits: It raises the income of individuals within a poorer city and also increases global wealth by utilizing untapped labor resources and greatly increasing the amount of goods and services on the global market.

However, in the author's view an incalculably greater potential is left unrealized under this model of development. Jane Jacobs described thriving cities as generators of diversity that are by nature more so suited for small, interdependent businesses that serve narrow markets than large, monolithic, and independent companies.²³ [The very fact that cities contain large numbers of people creates the potential for varied uses that rely on each other to provide services that smaller uses cannot provide for themselves.] This focus on the small opens up new opportunities for entrepreneurship and employment on more creative and self-directed terms.

(applying dynamic comparative advantage theory to explain how poorer nations could use their natural resources to develop advanced economies)

²¹ See Ibid.

²² See Nicholas D. Kristof, *Where Sweatshops are a Dream*, THE NEW YORK TIMES (Op-Ed) (Jan. 14, 2009) http://www.nytimes.com/2009/01/15/opinion/15kristof.html?_r=0 (describing how "sweatshop" jobs are greatly desired in poorer nations because they offer a significantly better standard of living than any other alternative); Paul Krugman, *In Praise of Cheap Labor*, SLATE (Mar. 21, 1997) http://www.slate.com/articles/business/the_dismal_science/1997/03/in_praise_of_cheap_labor.2.html (describing how forcing exporters to pay higher wages and raise standards at factories will only hurt the workers there)

²³ Jane Jacobs, *THE DEATH AND LIFE OF GREAT AMERICAN CITIES*, 189–91 (1961).

Thinking of cities in this way paves the way to realizing potentials that are lost under the large-factory model of development. Inside each of the low-skilled laborers in factory assembly line positions are untapped resources of entrepreneurial energy, creativity, and tenacity. Most of these resources are lost on an assembly line, yet they could yield a tremendous amount of wealth if the institutions in a society provided greater opportunities for entrepreneurship and small interdependent businesses. Such a move would involve reconceiving of developing cities more along Jacob's conception—as generators of diversity. As long as underdevelopment is only addressed by focusing on employment in the aggregate and gradually raising the value of labor, an immeasurable potential goes unrealized. It is not that large light manufacturing export-based economies do not provide tremendous benefits to the people who choose to work there, it is that they do not provide all the benefits they could.

Not only would a city that conceives of itself as a generator of diversity and of small-interdependent uses generate wealth, but it would also develop the capabilities of the people in the city and give them power on more equal terms to other larger interests. Martha Nussbaum argues in her book, *Creating Capabilities*, that poorer states should not focus exclusively on economic development but on “human development,” or developing the capabilities of their citizens.²⁴ Nussbaum embraces an outcomes-based evaluation of justice—that the level of justice in a society should be measured by what people can “do and be,” rather than evaluating the type of procedures the state follows.²⁵ Under her view, the role of governments should be to expand what each individual is capable of accomplishing, rather than focusing on one factor, such as wealth, and trying to maximize it as a sum total or average across an entire population.²⁶

Implementing these concepts within existing governments in developing nations is extremely difficult, however. For example, how can a government rid itself of corruption when its officials rely on, and feel an obligation to bestow, favors? How cities focus on the small and diverse when the large and monolithic is much simpler and helps city managers retain power? Overcoming these obstacles will require us to alter the incentives that currently operate on governments and remove barriers that prevent governance from evolving in response to demands. One method of doing this could be to create an environment wherein city governments (1) can invent, borrow, and evolve new ideas of governance, and (2) compete with each other to attract people whose value to the cities is more or less equal. Paul Romer's charter cities idea attempts to create this environment. In the last section I propose a model that could make it more effective.

²⁴ Martha Nussbaum, *CREATING CAPABILITIES*, ix–x (2011).

²⁵ Martha Nussbaum, *Foreword: Constitutions and Capabilities: “Perception Against Lofty Formalism*, 121 *Harvard L. Rev.* 4, 14, 18 (comparing her approach with utilitarianism, which also is also an outcome-oriented view of justice).

²⁶ *Id.* at 19–20. Additionally, economic development may not necessarily correspond with happiness. A recent study by Richard Easterlin indicates that, while both per capita GDP and consumption quadrupled in China between 1990 and 2009, “life-satisfaction” actually declined. Similar results were found in Eastern Europe after economic liberalization. Easterlin suggests these results may be associated with income inequality. Richard A. Easterlin, *et. al.*, *China's Life Satisfaction* (Department of Economics, University of Southern California, 2012).

II. The “Charter Cities” Concept

Paul Romer is an economist who revolutionized growth theory in the 1990s with his paper “Endogenous Technical Change.”²⁷ In the paper he introduced for the first time a model that explained the role of ideas in economic growth, paving the way for a great deal of research on the factors that generate ideas.²⁸ “Rules” are one category of ideas that concern how people should interact.²⁹ Rules determine things like whether a society will be ruled by law, how much corruption it will tolerate, and how transparent its government will be.³⁰ Romer noted that these types of ideas transferred much less easily to other parts of the world than other ideas, such as technology.³¹ The reason for this is that changing rules requires a very high degree of coordination between people who have come to rely on the system staying the way it is.³² The way out of this predicament is to create a mechanism that forces rules to change.³³ Romer decided that one step toward creating this mechanism is to introduce the public law equivalent of start up businesses, “charter cities” that implement new ideas in a region to motivate the existing governments to govern better.³⁴

Charter cities would be autonomous or semi-autonomous city-states built on uninhabited land set aside by a host nation.³⁵ The cities would be run under rules and institutions that provide a better alternative for both foreign investors and migrants than the institutions in the surrounding developing nations.³⁶ Foreign companies would be attracted by rules that make the city a more stable place for investment than politically risky developing nations.³⁷ Migrants from developing nations would be attracted by rules that make the city a safer option for finding employment than either making the perilous journey to wealthier nations (where they often will not find legal status) or staying where they are.³⁸

Each Charter City would establish a charter that would outline the basic rights of the people who settle there and the responsibilities of the city government.³⁹ Two basic guarantees must underlie every charter: (1) The city’s rules would only apply to those who choose to live under them, and (2) the rules would apply equally to all who live there.⁴⁰ The first principle ensures that people would be able to leave at any time they

²⁷ Paul M. Romer, “Endogenous Technical Change,” *The Journal of Political Economy* (1990).

²⁸ Alex Tabarrok, “Charter Cities (and Paul Romer) in 15 min.” *Urban Demographics* (Oct. 8, 2012) <http://urbandemographics.blogspot.com/2012/10/charter-cities-and-paul-romer-in-15-min.html> (visited Oct. 11, 2012).

²⁹ *Ibid.*

³⁰ *Ibid.*

³¹ *Ibid.*

³² *Ibid.*

³³ *Ibid.*

³⁴ *Ibid.*

³⁵ Charter Cities, www.chartercities.org/concept

³⁶ *Ibid.*

³⁷ *Ibid.*

³⁸ *Ibid.*

³⁹ *Ibid.*

⁴⁰ *Ibid.*

choose, making submission to the city's government entirely voluntary and offering people the freedom to choose a different option the moment the city does not provide a better alternative.⁴¹ The second principle ensures that some residents are not favored more than others.⁴²

To help get off the ground, charter cities would also rely on more developed nations to partner with them in establishing effective government services and institutions.⁴³ According to Romer, this assistance would not even need to greatly affect the partner nations' aid budgets.⁴⁴ Most, if not all, of the services could be provided by fee.⁴⁵ For example, if Canada were a partner nation, the city could pay the Royal Canadian Mounted Police to provide police training for the city's new law enforcement organs.⁴⁶

The charter cities concept also relies on incentive schemes to motivate the government to effectively promote the public welfare.⁴⁷ Under Romer's vision, the city government would own the land the city sits on, following the example of Hong Kong and Singapore.⁴⁸ The city would then lease out portions of land to private parties and collect revenue off the leases.⁴⁹ The private parties could then own the structures built on the land and rent or sell them to others.⁵⁰

Not only would this provide a revenue stream for the city (possibly even avoiding the need for taxes), but it would also create an incentive for the government to provide effective services.⁵¹ For example, if the city created a well-functioning education system that develops residents' capabilities, the residents would be able to work in higher-skilled occupations and enhance the city's culture.⁵² This, in turn, would attract new and diverse employers and raise the value of the land.⁵³ As the value of the land increases, the city government will be able to collect more revenue from its leases.⁵⁴ Well functioning law enforcement, infrastructure, parks, etc. would all have a similarly positive effect on land value.⁵⁵ Consequently, with this incentive system, the people would have something more their officials' sense of public duty or their fear of losing reputation to have their government work in their interests.

The idea has come close to being a reality on two occasions. In 2009, Marc Ravalomanana, the president of Madagascar, decided to implement a charter city in his

⁴¹ Ibid.

⁴² Ibid.

⁴³ Ibid.

⁴⁴ Brandon Fuller and Paul Romer, *Success and the City*, 15 (Macdonald-Laurier Institute, Apr. 2012)

⁴⁵ Ibid.

⁴⁶ Ibid.

⁴⁷ Charter Cities, Charter Cities: Frequently Asked Questions, <http://chartercities.org/faq/11/faq>

⁴⁸ Ibid.

⁴⁹ Ibid.

⁵⁰ Ibid.

⁵¹ Ibid.

⁵² Ibid.

⁵³ Ibid.

⁵⁴ Ibid.

⁵⁵ Ibid.

nation.⁵⁶ The project stopped shortly afterward, however, when Ravalomanana was forced to step down in a coup that arose for unrelated reasons.⁵⁷

Then, in January 2011 the government of Honduras, after discussions with Paul Romer, amended their constitution to allow for *Regiones Especial de Desarrollo* (RED), or “Special Development Regions.”⁵⁸ The next June, the parliament passed, almost unanimously, legislation outlining the REDs’ place within the larger nation.⁵⁹ Members from every political party supported the legislation, which ceded most governing authority over large-city-sized sections of land to nine-member “transparency commissions” and governors to run each RED.⁶⁰ Under the legislation, President Porifiro Lobo was to appoint the commissions and the first governors.⁶¹ Thereafter, the transparency commission of each city would appoint their governors.⁶² Once a city achieved certain institutional benchmarks, its residents would democratically elect their leaders.⁶³

All seemed to be going according to plan for the next year. Honduras chose a 1,000 square kilometer plot of lightly inhabited land on the Caribbean coast for the first city.⁶⁴ President Lobo appointed a temporary transparency commission for it, including Paul Romer and other development economists.⁶⁵ Romer then began travelling to developed nations looking for partners in the project.⁶⁶ The Supreme Court of the Republic of Mauritius, a small African island nation noted for its highly functioning legal system and economy, agreed in principal to serve as an appellate court for the REDs.⁶⁷ Cases appealed from an RED’s highest court would be heard there, and, because Mauritius is in the British Commonwealth, could be appealed still higher to the Privy Council in the

⁵⁶ Sebastian Mallaby, “The Politically Incorrect Guide to Ending Poverty,” *The Atlantic*, July/August 2010, available at <http://www.theatlantic.com/magazine/archive/2010/07/the-politically-incorrect-guide-to-ending-poverty/308134/1/>

⁵⁷ Ibid.

⁵⁸ CONSTITUCIÓN POLÍTICA DE LA REPÚBLICA DE HONDURAS [CONSTITUTION OF HONDURAS], art. 329 (as amended Jan. 2011);

⁵⁹ Constitutional Statute of the Special Development Regions, Decree No. 123-2011 (Jul. 29, 2011); Charter Cities, *Update on Honduran Progress*, 1–2 (December 2011), available at <http://chartercities.org/resources>

⁶⁰ Constitutional Statute of the Special Development Regions, Decree No. 123-2011, arts. 4, 15, 26 (Jul. 29, 2011); Charter Cities, *Update on Honduran Progress*, 1–2 (December 2011), available at <http://chartercities.org/resources>

⁶¹ Ibid at art. 80.

⁶² Ibid at art. 30.

⁶³ Ibid. at art. 36.

⁶⁴ *The Economist*, “Hong Kong in Honduras,” December 10, 2011, <http://www.economist.com/node/21541392> (accessed October 10, 2012).

⁶⁵ Charter Cities, *Update on Honduran Progress*, 2 (December 2011), available at <http://chartercities.org/resources>

⁶⁶ *The Economist*, *supra* .

⁶⁷ Fuller and Romer, *supra* , at 11.

UK.⁶⁸ According to Romer, using well-respected external courts would provide an added layer of legitimacy, accountability, and impartiality to the REDs' judicial systems.⁶⁹

Then, without Romer or the rest of the transparency commission's knowledge, President Lobo signed an agreement in September 2012 with MGK, a private development company to build the first three cities.⁷⁰ Romer then resigned from the commission⁷¹ and speculations rose that the cities would be privately run.⁷² Shortly afterward, opponents of the project filed legal challenges, and the Honduran Supreme Court struck down the RED statute.⁷³

These experiences demonstrate what is perhaps the largest practical difficulty the charter cities face. While the cities are intended to be a shelter from the uncertain politics of developing nations, they must first withstand these politics to be established.⁷⁴ Nevertheless, Romer is still moving ahead with the idea,⁷⁵ which has already found new political support in other corners of the globe. The President of Georgia, Mikheil Saakashvili came across the idea on the Internet and formed plans in early 2012 to build a new charter city on the Black Sea that he calls Lazika.⁷⁶

Moreover, the idea is not entirely new. Other new "ex-nihilo" cities have similarly been forming in China under its formation of "special economic zones."⁷⁷ Hong Kong, however, bears the most striking similarity to the charter cities concept.⁷⁸ Since the British handed over control of the city in 1997, Hong Kong has retained a special autonomy from the People's Republic of China under a "One Country, Two Systems" policy.⁷⁹ Hong Kong's "charter" is the Hong Kong Basic Laws, which outlines the relationship the city has with China, the functions of the Hong Kong government, and the

⁶⁸ Owen Bowcott and Maya Wolfe-Robinson, *Honduras May Appeal to London Courts*, *The Guardian* (Jul. 22, 2012), available at <http://www.guardian.co.uk/law/2012/jul/22/honduras-london-courts>

⁶⁹ Charter Cities, *The Guardian on Potential Appeal in Honduran RED*, <http://chartercities.org/blog/230/the-guardian-on-potential-for-external-appeal-in-honduran-red>

⁷⁰ Elisabeth Malkin, *Plan for Charter City to Fight Honduras Poverty Loses Its Initiator*, *THE NEW YORK TIMES* (Sept. 30, 2012).

⁷¹ *Ibid.*

⁷² Simeon Tegel, *Can Private Cities Save a Nation with the World's Worst Murder Rate?* (Sept. 7, 2012), available at <http://www.independent.co.uk/news/world/americas/can-private-cities-save-a-nation-with-worlds-worst-murder-rate-8113966.html>

⁷³ AP, *Honduran Court: Private Cities 'Unconstitutional'* (Oct. 4, 2012), available at http://www.cbsnews.com/8301-505245_162-57525844/honduran-court-private-cities-unconstitutional/

⁷⁴ Malkin, *supra*.

⁷⁵ *Ibid.*

⁷⁶ Ellen Barry, *On Black Sea Swamp, Plans for Instant City*, *THE NEW YORK TIMES* (Apr. 21, 2012), available at http://www.nytimes.com/2012/04/22/world/europe/in-georgia-plans-for-an-instant-city.html?pagewanted=1&_r=0&ref=georgia.

⁷⁷ Sebastian Mallaby, *The Politically Incorrect Guide to Ending Poverty*, *THE ATLANTIC* (July/Aug. 2010), available at <http://www.theatlantic.com/magazine/archive/2010/07/the-politically-incorrect-guide-to-ending-poverty/308134/1/>.

⁷⁸ *Ibid.*

⁷⁹ XIANGGANG JIBEN FA [THE BASIC LAW OF THE HONG KONG SPECIAL ADMINISTRATIVE REGION OF THE PEOPLE'S REPUBLIC OF CHINA], Preamble

rights of Hong Kong residents.⁸⁰ By establishing property rights and liberal economic policies, Hong Kong's autonomy from Chinese socialism helped lead to remarkably rapid development in an otherwise impoverished region.⁸¹ The fact that the city retained independence even throughout the political turmoil of the Chinese Culture Revolution in the 1960s also speaks in favor of charter cities' chance of success.

Other historical precedents to the charter cities concept include Pennsylvania.⁸² Charles II granted Pennsylvania to William Penn by charter to experiment with the then unprecedented concept of freedom of religion.⁸³ Both Pennsylvania (and its main "charter city," Philadelphia) and Hong Kong served as a kind of laboratory for the governments neighboring them to test the efficacy of new ideas. The lessons learned from both significantly affected preexisting notions of governance.⁸⁴

The lesson learned from these antecedents is that positive change is often too difficult to come by working from within. It often comes from without. Romer draws analogies to the world of small business startups.⁸⁵ After years of serving large corporate customers, IBM developed a set of entrenched corporate rules that made it too difficult to adapt to the new market of home consumers.⁸⁶ Small startups like Dell and Apple were flexible and innovative enough to meet this demand better.⁸⁷ This lesson has been understood in business so well that some large, established businesses will purposely create startups of their own, called "skunkworks," that are given autonomy and the freedom to experiment with new business models.⁸⁸ Retailer Target is one example of a skunkworks that became tremendously successful.⁸⁹ Similarly, creating "startup" city governments could prove much more successful at responding to the world's urbanization demand than attempting to reform existing governments from within.

III. Evaluating the Effect of Charter Cities

It is now time to examine the charter cities idea in light of the observations we made about cities in the first section. How well will these cities be generators of diversity, rather than the sites of large, monolithic foreign companies? Will they seek a Western conception of "modernity" at the expense of the "traditional" by segregating the population? Will they become places where the cultures within them creatively hybridize with each other on a more or less equal footing? Lastly, will the governments have enough of an incentive to seek not just economic development in the aggregate, but also the development of each individual's range of what she can "do and become"?

⁸⁰ Ibid.

⁸¹ Mallaby, *supra*.

⁸² Ibid.

⁸³ Ibid.

⁸⁴ See Ibid (describing how the People's Republic of China attempted to replicate the success of Hong Kong by creating special economic zones, such as Shenzhen).

⁸⁵ Ibid.

⁸⁶ Ibid.

⁸⁷ Ibid.

⁸⁸ Ibid.

⁸⁹ Ibid.

The answer to these questions depends to a great extent on the incentives the city governments will have to pursue these aims. Charter cities would be particularly unique in this regard because they would not necessarily rely on democratic elections as a means of holding officials accountable. The reasons for this are predictable: if the city's leaders were democratically elected, there would not be any reason to believe that the government would end up different from other developing nations that have democratically elected leaders. The city would then lose its unique function as a chance to experiment with new policies in the developing world and to provide a meaningful alternative for migrants. Removing these cities from politics helps developing nations bypass the entrenched interests and bureaucracy that stall reforms nationwide.

The question remains, however, whether other mechanisms will keep the charter city governments accountable and working for the benefit of the people. Could these mechanisms be just as effective as, or more effective than, traditional voting democracy at producing the desired ends discussed earlier?

As noted earlier, one mechanism charter cities would rely on is having the city government retain ownership of the land. This incentivizes governance that raises the value of the land, which will, to some degree, correspond with the well-being of city residents. It may also prevent excessive boom and bust cycles in real estate.⁹⁰ Economists have debated this concept for centuries and its critics normally cite practical obstacles, such as the difficulty of determining land values without a free market⁹¹ and concerns over whether it will raise enough revenue.⁹²

However, Romer's ultimate vision relies on a much more radical and potentially more powerful mechanism to incentivize good governance: the availability of options for migrants. Just as under Jacobs view small businesses function best in cities with a diverse, interdependent network of many other small businesses, charter cities, under Romer's view, would function best if there were a diversity of other cities in the same region. If migrants have the ability to choose from among several diverse charter cities, a new, and much more powerful, type of democracy would emerge—a “vote with your feet” democracy, that incentivizes innovation in governance just as the market encourages innovation in technology.

Here is how it would work: each person who chooses to opt-in to a charter city does so voluntarily. If the city government does not meet expectations or turns bad, people can leave and move to another city. Each of these cities would then seek to draw residents from other cities and to retain the residents they have by offering better governance than their neighbors. Unlike current governments, these cities would have the institutional flexibility to experiment with new policies that more effectively meet citizens' demands. Cities that fail to adapt to current demands would begin losing residents to the other cities

⁹⁰ Charter Cities, Charter Cities: Frequently Asked Questions, <http://chartercities.org/faq/11/faq>

⁹¹ Murray Rothbard, “The Single Tax: Economic and Moral Implications and a Reply to Georgist Criticisms,” The Mises Institute (1997).

⁹² Richard Posner, *Economic Analysis of Law* 458–59 (3rd ed. 1986).

and be forced to change. Moreover, in the process each of these cities would begin to learn from each other's successes and failures and would replicate, avoid, or complement their policies.

Each city's charter would provide an additional layer of accountability. These documents would serve as a contract between the city governments and their residents that would be enforceable in an external court (such as Honduras's plan to use Maritius's Supreme Court for appellate jurisdiction). If a city were to go so far as to violate its charter or some other fundamental right, it could be held accountable in one of these courts.

This alternate vision of democracy may be too difficult for many citizens of western countries to embrace. This is understandable. These countries have a long history of cherishing the right to vote; some have struggled and died for it. Certainly this right was well worth the fight—for almost all of them, the only alternative to the right to vote was to live under governments that were not responsive to them.

When we look at this right from the perspective of someone in a poor nation it might take on new meaning, however. Would the opportunity to cast a single vote in an election where hundreds of thousands (or millions) of others like you will also be voting be a bigger privilege than having the opportunity to legally move with your family to a place that is safe and provides you and your children after you with the opportunity to have meaningful employment?

Even if we believe most people in the developing world would answer that question yes, the empirical data may suggest otherwise. 154 million people have migrated into nations where they are living illegally, not having (among many other things) the right to vote.⁹³ Every year 75,000 Hondurans alone attempt to travel through Central America to make it into the United States illegally, even though approximately 10,000 of them die or are abducted along the way.⁹⁴ It is difficult to say that these Hondurans cherish the right to vote in their own country more than the ability to live in a developed nation where they cannot vote. Furthermore, if 70,000 people were willing to undertake such risks and hardships to live illegally in a developed nation, how many more would make the choice if it were safe, easy to get to, legal, and a place where they could bring their families?

While this model offers exciting new possibilities it is yet unclear how effectively it will function in the interests of the poor. For example, would the city governments have so much stronger of an incentive to attract wealthy people than poorer migrants that they would skew the laws in favor of the former? Would the cities find large foreign investors so attractive that all of the available governments neglect creating a society where the poorer residents can develop their capabilities, own small businesses, and retain, share, and creatively refashion their culture on equal terms with others?

⁹³ Sebastian Mallaby, *The Politically Incorrect Guide to Ending Poverty*, THE ATLANTIC (July/Aug. 2010), available at <http://www.theatlantic.com/magazine/archive/2010/07/the-politically-incorrect-guide-to-ending-poverty/308134/1/>.

⁹⁴ Brandon Fuller and Paul Romer, *Success and the City*, 15 (Macdonald-Laurier Institute, Apr. 2012)

In the author's view, the answer to these questions depends on how the cities collect revenue. If a system were devised so that each city government's revenues were contingent on the level of justice that the city produces then this concern would be answered. We could even conceive of these city governments seeking profit, much as private companies do, and governance would evolve as rapidly as technology does in response to the large rewards that innovation brings. In such a system highly creative public policy minds could innovate and propose new methods of governance and the success or failure of those ideas would depend on the benefits they confer equally on residents. In the next section I propose one such system.

IV. A New Model for Charter Cities

In the first section I discussed how Martha Nussbaum's conception of justice was "outcome-oriented." That is, the level of justice in a society is measured by what results from that society rather than the procedures that it follows.⁹⁵ In her view, if society A has more individuals with expanded capabilities than the individuals in society B, society A is more just. Utilitarians, who also have an outcome-oriented conception of justice might measure justice instead by the total sum of "happiness" or satisfaction of desires that a society's citizens experience.⁹⁶ An outcome-oriented conception of justice that subscribed to Jacobs or Robinson's view might partially define justice in a city by whether the network of relationships in it is diverse, mixed, interdependent, and more or less egalitarian.

In the previous sections I implied that, regardless of what outcomes one uses to define an outcome-oriented conception of justice, if a system were devised to make a city government's revenue contingent on producing just outcomes, those cities could run without much oversight. Trying to reward these outcomes directly, however, is difficult because the choice of which outcomes to reward and to what degree would likely be subject to political manipulation, corruption, and mismanagement. Therefore, the system must rely on an indirect indicator that predicts with reasonable accuracy a charter city's level of justice and its rewarding of that indicator must be automatic and easily measurable.

The charter cities model contains one such system by making city revenues contingent on the value of the land. Land values, therefore, are intended to be an indirect indicator of the cities' level of justice. It remains unclear, however, whether this indicator will accurately reflect the degree to which a government produces the type of outcomes we discussed earlier, whether it be individual capabilities, happiness, or diversity.

In this section I propose a new model that relies on a different indirect indicator of justice—the number of people who desire to migrate into a society. This indirect indicator makes the liberal assumption that if more people would like to move into city

⁹⁵ Martha Nussbaum, *Foreword: Constitutions and Capabilities: "Perception Against Lofty Formalism"*, 121 *Harvard L. Rev.* 4, 18.

⁹⁶ E.g., Henry Sidgwick, *The Methods of Ethics* 411 (7th ed. 1907); Amartya Sen & Bernard Williams, *Introduction to Utilitarianism and Beyond* 1, 4–5 (Amartya Sen & Bernard Williams eds., 1982).

A, if they could, than city B, city A is probably more reliably just than city B. If this is true, then we could devise a system that ensures both easy mobility and that city revenues are contingent only on the number and quality of people who choose to migrate to them. This model would be wide enough to embrace many different conceptions of justice because it defines justice according to those social arrangements that people would like to live under if they could.

For example, we could imagine that each of the charter cities in a region would have to be associated with an intergovernmental organization. This organization would be responsible for only a few very limited functions, not rising to the level of a government of its own, and certainly not creating a full federalist system. As its primary function, the organization could hold a common fund that is acquired through taxation, leasing out jurisdiction rights to the cities, or some other mechanism.

Next, the organization would make automatic disbursements to the cities in proportion to the people that migrate there. In its simplest form, this organization could assign an equal value to each person who chooses to migrate into a city and stay there. Under this arrangement each person who moves to one of the cities could notify the organization of her residence. At regular intervals, the organization could then total up the number of people who moved in or kept residing in a city and pay the city the amount per person. For example, if the amount per person were set at \$500 per month and 1,000 people moved to the city during that month and 1,000,000 people were already living there (*i.e.* chose to stay) then the city would receive $\$500 \times (1,000,000 + 1,000)$, or \$500,500 for that month. The amount per person should be set as high as possible to maximize the incentive to innovate new and better forms of governance while staying within the limits of what the common fund can afford.

Furthermore, the organization could require that the city governments not collect revenue in any other way than from its disbursements and could enforce this rule through regular audits of the cities' finances. If the organization finds that a city did improperly collect revenue it could file an action in an external court and any judgment awarded could be withheld from that city's regular disbursements. This mechanism would help ensure that the cities have no other incentive than to create conditions that attract all people equally.

Using a simple set, per-person amount makes it easiest for the intergovernmental organization to administer the system and requires the least oversight from it. However, one might observe that setting the same amount to each person may not promote equality to the degree that we observed as desirable in the first chapter. Though the cities would receive the same amount regardless of who chooses to move within their borders, certain people will still be more desirable than others. For example, a person who is wealthy and who will use her wealth to generate economic activity in the city will ultimately draw more people besides herself into whichever city she chooses to live in. The city might then have an incentive to skew its laws in favor of her rather than other people who have less of an "attractive" quality.

If it is observed as a problem, then the organization's disbursements could vary inversely in proportion to the incentive a city would otherwise have to attract a particular person. For

example, the amount that the organization pays a city after it draws in an employer who provides 50 jobs could be less than the amount it pays after it draws in a single day laborer. The goal of such a disbursement scheme would be to promote equal treatment of each person in the cities by equalizing the desirability that each person has in the eyes of the city.

To make this disbursement scheme perfect would make it unmanageable. However, the organization could follow a few rough guidelines. The disbursements could vary inversely in proportion to the wealth of the people who move into the city (the organization would pay proportionately less for wealthier people than poorer people), for example. As people become wealthier the organization could pay the city governments less for them to offset the natural increase in the city's incentive to keep them. Such a system would stimulate the incentive city governments have to better meet popular demands without treating some demands as more important than others.

As another function, the organization could oversee that freedom of movement is not impeded between the cities. Ensuring mobility between the cities could be contractually agreed to between the organization and the cities and the organization and any other governments that may have jurisdiction over the space between cities. Here again, if either the cities or any other government impose restrictions on movement they could be brought to an external court.

This system should be measured against the current incentive structures on urban governments in the developing world. Generally speaking, governments are incentivized to govern well by internal political processes (i.e. winning elections, fundraising, forming alliances between legislators, etc.) and international relations. However, these two factors are greatly subject to social manipulation. For example, politicians can market themselves in such a way as to shape voters' perceptions. Authoritarian governments can make grand statements about their respect for human rights to avoid or ease sanctions by the international community and yet secretly deny or delay rights to their citizens. Even when governments are functioning at their best, waste and inefficiency can prevent people from accessing justice and often result in tremendous budget deficits.

Furthermore, this system reverses the current dominant attitude toward immigrants. Rather than implementing policies to prevent immigration, cities would try to make themselves as attractive to migrants as possible, competing with all of the other cities that would like them.

Additionally, even if these city governments fully privatized, profit-driven enterprises, this system is designed to channel in a more positive direction an already potent force in the politics of many developing nations: governmental officials' desire to acquire personal wealth. Currently, heads of government use their position to acquire wealth in corrupt ways that disadvantage the citizenry. Under the system adopted above, governments could make it their explicit desire to generate profit, and yet the system by which they would have to acquire that profit would be structured so that they could only acquire wealth by governing better. This system might unleash in public policy the kind

of entrepreneurial energy and innovation that has propelled technology forward so rapidly over the last several decades.

With the system I have proposed, an inter-governmental organization could exercise a few basic and routine functions for the charter cities and little to no additional oversight over them. By implementing what is essentially a voucher system for governments, the system would highly incentivize each government to create the best possible society for each individual on their own, avoiding the need to regulate or manage. It would sustain maximum differentiation and decentralization among cities.⁹⁷

Essential to maintaining this system is that the organization's method of rewarding outcomes must be routine, easily calculable, and transparent. It must not be subject to value judgments that are not shared by all or by preconceptions for how a government should run. It should reward merely based on the outcomes it should produce.

I have suggested basing rewards on the indirect indicator of the number and characteristics of the people who choose to live in the cities. I might have used a combination of other indicators, such as the cities' education level, range of employment opportunities, or inclusiveness of diverse groups, yet basing payment determinations on these criteria would become more obscure. The inter-governmental organization would become intrusive, more manipulated by special interest motivations and lobbying, and more likely to impose contested values. The system would cease to allow cities to experiment with ideas about what fulfills people's desires and undermine cities' abilities to adapt in a pluralistic world with constantly changing values.

The effect this system would have on producing the outcomes identified earlier would need to be empirically tested. However, one may theorize that given sufficient options, people would choose to live under the principles I derived from Jacobs, Nussbaum, and others. They would not only choose to live in a place where they have basic freedoms, such as the ability to live in safety, acquire an education, and access health care, but also where there is a diverse interdependent network of small businesses, where their culture will not be swallowed up and devalued, and, generally, where their capabilities are more fully developed. If they would not choose this but some other set of values it probably only means there are other, more preferable means of living. It is perhaps best if we let them decide.

Conclusion

The Charter Cities model could offer tremendous opportunities for migrants from poorer nations to develop their capabilities, live in safer environments, and force city governance to evolve to cater to their demands. It moves us very far toward the goal of creating cities that will respond positively to the tremendous influx of new migrants over the next several decades. Such positive responses should be measured by their ability to expand the range of options available to the world's poor to shape what they do and will become.

⁹⁷ See Max Weber, *Methods of the Social Sciences*,

However, the charter cities idea, as it exists now, may not advance its goals as well as it could. By implementing a voucher system administered by an intergovernmental organization, the cities could become incentivized to innovate the best possible forms of government in the interests of all residents equally. I have suggested one option for how this system could look.