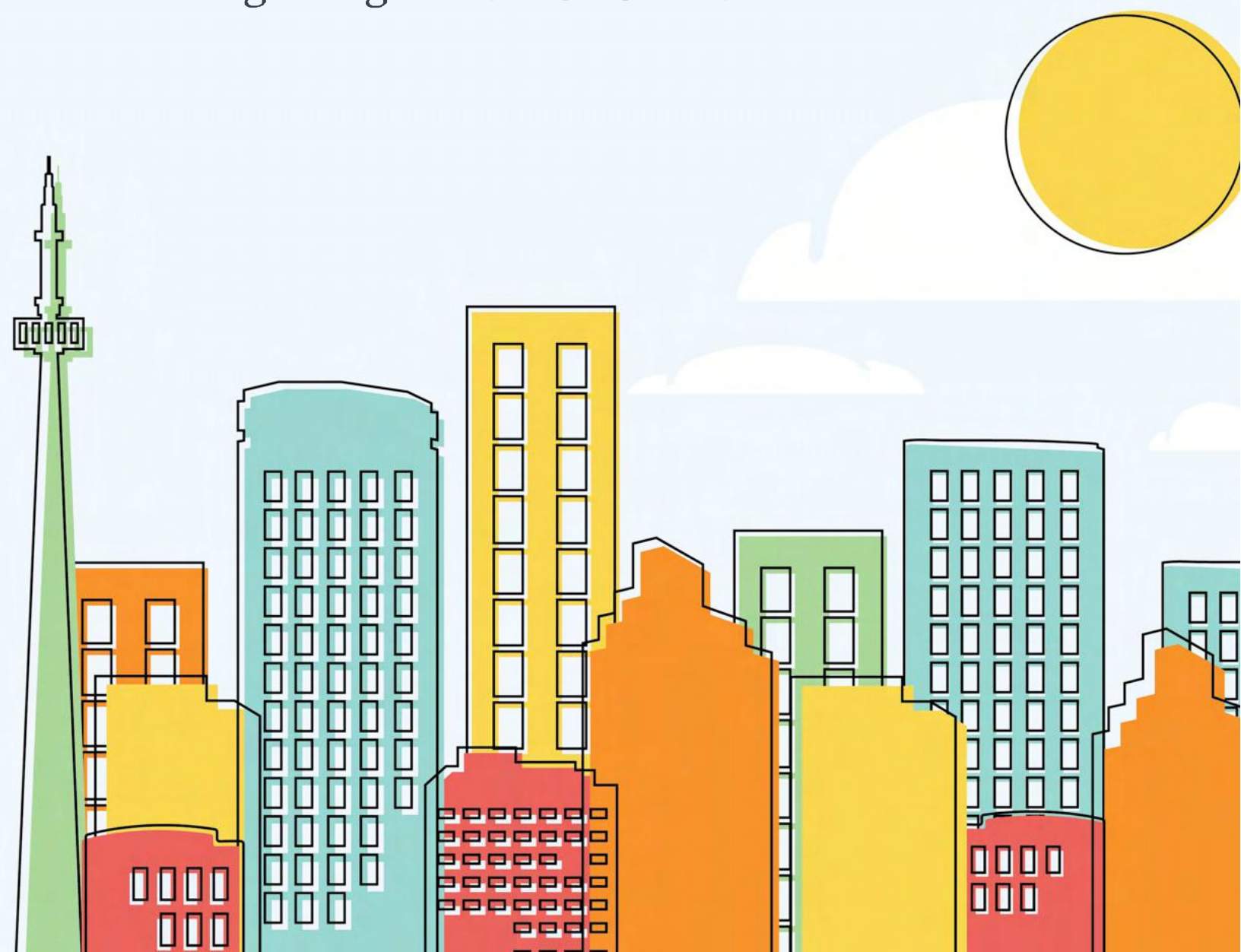


A Charter Cities Institute Flagship Report



Governance Handbook

Building a Legal Framework for Charter Cities





The Future of Development

Empowering new cities with better governance to lift tens of millions of people out of poverty.

The Charter Cities Institute is a non-profit organization dedicated to building the ecosystem for charter cities by:

- Creating legal, regulatory, and planning frameworks;
- Advising and convening key stakeholders including governments, new city developers, and multilateral institutions;
- Influencing the global agenda through research, engagement, and partnerships.



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EXECUTIVE SUMMARY

Charter cities are new cities with new rules. The *Governance Handbook* is the most comprehensive undertaking to date that lays out what these new rules should be and how they should be structured to promote inclusive economic growth.

Humans have been building new cities for millennia, and we continue to do so today. There are urban planning firms to plan cities, funds dedicated to investing in cities, and architecture and engineering firms to design and construct the built environment of cities. But currently no comprehensive framework exists to guide the development of the legal system for new cities. The Charter Cities Institute's (CCI) objective in publishing the *Governance Handbook* is to help fill this gap.

The *Governance Handbook* can be used by charter city developers, international development specialists, and policymakers as they build the cities that tomorrow's urban dwellers will live in. The handbook covers 16 chapters, each dealing with a particular regulatory domain that is essential to get right for the charter city and its inhabitants to thrive.

Each of the 16 chapters has four main components: 1) the chapter introduces the regulatory domain and explains why it's important to achieving inclusive economic growth, 2) it lists the key values that should be prioritized within each domain and gives specific goals and metrics to track progress toward these values, 3) it provides step-by-step advice for setting up the regulatory policies and agencies needed to administer each domain

effectively, and 4) it summarizes the key takeaways from each chapter. Case studies are provided throughout the chapters to further elaborate concepts and give concrete, real-world examples.

The *Governance Handbook* was put together by CCI's research team. For each chapter the team received input from several subject matter experts, including academics as well as on-the-ground practitioners (see acknowledgments). The aim was to interview both groups to see what the latest research said about each regulatory domain and then compare that to what is practically possible to arrive at pragmatic, balanced, and actionable policy recommendations. In addition to expert input, the research team conducted thorough reviews of the literature for each chapter, collecting examples of both successes and failures throughout the process and incorporating those into our case studies.

The *Governance Handbook* should be used as an adaptive reference guide, not as an immutable list of rules and steps that must be followed to the letter. To that end CCI views this handbook as a living document that will be updated periodically to reflect new knowledge and lessons. Every charter city is situated in a particular context, each different from the next. But context specificity should not be used as an excuse for inaction. A clear framework for how to approach the challenges of creating a new legal system is possible. CCI hopes the *Governance Handbook* provides such a framework for charter city builders and stakeholders.

INTRODUCTION

Rapid urbanization is the principal challenge facing the Global South in the twenty-first century. The world's urban population is expected to add 2.5 billion people by 2050, an annual increase of more than 78 million. 90% of this growth will take place in Asia and Africa, with India (416 million), China (255 million), and Nigeria (189 million) accounting for one-third of the total increase in the world's urban population.¹ The scale of the challenge facing urban governments throughout the Global South in offering adequate public services, housing, and economic opportunity to their millions of new residents is enormous. The ability of those governments to meet this challenge rests on their capacity to implement effective policy and deploy critical infrastructure.

Most governments in the Global South are unlikely to create an enabling environment

conducive to urban development and economic growth in the immediate future. Although many countries have seen their governance improve in recent decades, many have not, and there has been limited convergence between high- and low-income countries in the quality of their governance as measured through projects like the World Governance Indicators.²

Indirect measures of the quality of governance, such as the World Bank's Doing Business Index, tell a similar story to the World Governance Indicators. Although there are standout business regulatory environment performers within the Global South like Thailand, Rwanda, and Kenya, along with some countries that perform well in one or two specific regulatory areas, the business environment throughout most of the Global South remains poor.³



Urbanization on Victoria Island in Lagos, Nigeria.

While the high monetary costs and time demands associated with registering a business, paying taxes, enforcing contracts, and other key elements of the business regulatory environment all contribute to the size of the informal economy, these issues don't fully explain the predominance of informality in Global South economies. Regardless of the factors driving informality, it's well-documented that informal firms are abysmally unproductive compared to firms in the formal sector.⁴ For cities to thrive as centers of economic opportunity and increased productivity, governments must possess the capacity to provide quality public services, regulatory environments, and support for economic development. The area where governments may be facing the most pressure to support urban growth is infrastructure.

Given the millions of new residents arriving in cities throughout the Global South, governments will have to make substantial investments in road and rail networks, energy generation, water provision, sanitation systems, telecommunications, and other key pieces of infrastructure to support their growing populations. However, to date most governments have failed to match the pace of their infrastructure deployment to the pace of urbanization. For developing countries in Asia, the estimated annual infrastructure financing gap is more than US\$330 billion. In Africa the financing gap is estimated to be US\$68–US\$108 billion.⁵ With financing gaps this large—setting aside differences in technical and administrative capacity to plan, build, and maintain infrastructure across countries—it's unlikely that most cities throughout the Global South will be able to effectively accommodate their new residents.

International efforts to help create growth, deploy infrastructure, and build capacity, such as the United States' Power Africa program and China's

Belt and Road Initiative, are helping to improve governance and infrastructure deployment throughout the Global South. However, more can be done to directly support urban development, economic growth, and improved governance. Charter cities are a viable tool to help achieve these objectives. Charter cities are new cities with new rules. Developing new cities on greenfield sites with significantly devolved administrative and regulatory authority can help countries in the Global South overcome the political and technical obstacles to improving governance and fostering growth in their existing cities.

By building new cities on greenfield land with better urban planning practices, charter cities can attract a share of the population that would otherwise settle in existing primary and secondary cities, thereby lowering the infrastructure burden those cities will face in the coming decades. Building new cities from the ground up also allows for the creation of safe, affordable, and vibrant urban development based not on the car or colonial-era planning practices but on walkable and mixed-use communities. Building specifically on land with little or no existing development or population ensures that settling in a charter city is voluntary and that the rents enjoyed by local elites are not sufficiently altered to entice efforts to curtail critical reforms. What's more, these new cities are *already* being built—more than 120 new cities in more than 40 countries⁶—and will continue to be built as urbanization continues apace, so it makes clear sense for policymakers to combine these new urban agglomerations with regulatory reforms. If policymakers stick to business as usual, most new cities will be less functional than the existing cities they're already desperately trying to fix.

Creating new administrative and regulatory structures that devolve power to the city level allows for the rapid creation of a capable government, which can provide the rule of law and public goods necessary to support markets and inclusive economic growth. A blank slate approach to governance reform allows a charter city to rapidly overcome the political obstacles that limit or block reforms in existing jurisdictions.

Cities such as Singapore, Hong Kong, and Shenzhen have shown that it's possible for a city-sized jurisdiction to emerge from severe poverty and become world-class cities within two to three generations. While this is not to suggest that any given charter city is likely to perfectly replicate these successes, they can accelerate growth in countries that have remained poor much longer than the development success stories of the postwar era. Of these examples Shenzhen most closely approaches CCI's strategy for charter cities.

The Shenzhen area, home to a collection of poor fishing villages with a combined population of 300,000, was designated as one of China's first special economic zones in 1980. Shenzhen was the catalyst for reforms that led to more than 850 million Chinese rising out of extreme poverty, and today it is a modern and wealthy metropolis of 20-plus million. Shenzhen's remarkable 40-year transformation was driven by the devolution of substantial decision-making authority to the local level, manufacturing-driven industrialization, and rapid urbanization. While there are naturally unique, context-specific factors to any development success story, CCI believes this model can be implemented successfully throughout the Global South today.⁷

This handbook provides a topic-specific guide on how to implement the CCI model for charter cities. While there are many firms dedicated to planning new cities (of which there are currently



Shenzhen, the home of China's economic miracle.

several hundred in development) or redeveloping existing cities, along with development banks and other investment vehicles supporting urban development, including investment funds specifically for charter cities, there is no such infrastructure in place for creating new legal systems and administrative structures for new cities. There is a plethora of research and practical knowledge available on economic development, governance, city and urban planning, and the various policy areas detailed in the handbook, but very little of this knowledge has been compiled and presented in a charter city-specific context.

This handbook bridges the collective knowledge gap faced by all key stakeholders that must collaborate to establish a successful charter city: developers, national and local governments, multilateral institutions, investors, international development experts, urban planners, policymakers, and others. Each of these parties brings vital expertise and resources to a charter city development, and this handbook, along with other resources being developed by CCI, packages this knowledge in a charter city-specific format that is accessible by all involved parties.

CCI's model for charter cities differs from previous models, chiefly that of Paul Romer. In a 2009 TED Talk, future Nobel laureate Paul Romer first introduced the idea of charter cities—new cities with new rules. Romer argued that better governance would deliver better economic outcomes for the global poor and that new cities would be an effective mechanism for countries to experiment with new rules. More specifically, Romer proposed that high-income countries typically regarded as well-governed could administer such cities in low-income, less well-governed countries as a guarantor to ensure that the new cities were governed effectively. Romer

pursued two charter city projects in Madagascar and Honduras—both were ultimately unsuccessful—before moving on to other ideas.⁸

While CCI recognizes Paul Romer's insight about the use of new cities to improve governance, we do not propose that charter cities be governed by a high-income guarantor country. Breaking from this approach, CCI believes that charter cities are best implemented as a public-private development partnership between the host country government and a private developer.⁹ While authority over most areas of the law should be devolved to the charter city, it's not a sovereign entity and remains an inviolable part of the host country. The charter city should likewise not possess any authority over criminal law or constitutional matters. The chapters featured in this handbook are the principal areas where full administrative and regulatory authority should be devolved to the extent that it's both feasible and practical. CCI views charter cities as a cooperative development strategy between the host country government and the city developer and a component piece of a larger national economic development strategy rather than as an effort to create an isolated island of prosperity.

This approach identifies three key parties in the creation of a charter city: the host country government, the city developer, and the new city administration. The host country government, which can include both the national and state governments or other local jurisdictions, is responsible for delegating authority to the charter city. For the purposes of this handbook, we assume that this devolution of authority, either through a legislative process or a specific concession agreement, has been achieved. The private city developer bears responsibility for either purchasing the charter city's land from private

parties or acquiring the land from the government. This developer is responsible for building out the physical infrastructure of the city. The developer's incentive to invest in land acquisition and infrastructure development is that this value can be recouped through rising land values as a result of economic activity generated by the city. Finally, the city administration is responsible for administering the city. The exact structure and composition of this administration, such as the assignment of seats on a city council and the selection of a city manager, will be negotiated between the host country government and developer.

The land agreement, concession agreement, and city charter all work to align the long-term interests of the charter city developer and the host country government. As previously stated, the developer stands to benefit from investing in land and infrastructure through higher land values brought about by greater economic activity. The host government also stands to benefit from the charter city, as it can enjoy a share of the revenue stream collected by the city administration. The country as a whole can benefit from spillover effects associated with greater economic activity and investment generated by the charter city. As was the case with Shenzhen in China, the charter city can serve as an impetus for broader reforms that generate nationwide economic prosperity and social development.

This handbook stresses three critical themes for charter city developers and administrators to embrace: the need for effective administration, the importance of flexibility and local adaptation, and the need to continually revise and update policies and administrative structures over time.

More than ever the international development

community recognizes the importance of state capacity in economic development. State capacity refers to the ability of a state to execute the tasks it intends to execute, such as collect taxes and provide public goods. States that can effectively carry out these tasks are far more likely to see the rise of well-functioning markets that deliver broad-based economic prosperity, while states with little capacity are likely to remain poor or see only very limited growth. It is important to note that capacity is not a measure of the size of a state but of its effectiveness.¹⁰ A charter city that can provide quality infrastructure and reliable services at low monetary and time costs to its residents and businesses is likely to succeed, whereas a charter city whose administration grows in size or in revenues without performance improvements is likely to end up mirroring the poor state of affairs of the broader host country.

Willingness to be flexible and to experiment is a second key value for charter city administrations to embrace. This handbook is the first attempt at a generalized, comprehensive administrative and policy agenda for charter cities. It is likely that some of the recommendations made will not work perfectly in practice or in some local contexts as well as others, and charter city administrators must be willing to experiment and figure out new solutions to problems that arise. "Crossing the river by feeling the stones" is a phrase attributed to former Chinese leader Deng Xiaoping on the undergirding attitude of China's reform process. Local officials were given the authority to experiment with policy and determine what worked well and what did not. Charter city administrators will need to adopt a similar attitude to build successful charter cities. It is important to note that it is unlikely that any given charter city project will see all the authorities detailed in this handbook devolved to the local level or that

authorities will be devolved to the full extent desired. The exact powers and responsibilities bestowed on charter city administrators will be a product of any country-specific legislation or concession agreements.

Finally, it is important to recognize that the appropriate administrative structures, policies, and regulations for a charter city will vary as the city grows in both population and wealth over time. This handbook is written with the assumption that the charter city is being built in a low- or lower-middle-income country and that

lower-income people are the primary target residents. The sensible and practical services offered or regulations in place for a city of 10,000 people with an average annual income of US\$2,500 will differ from a more mature city of one million people with an average annual income of US\$10,000. However, even if some of the specific recommendations in this handbook become less relevant than others as a charter city matures or new issues not discussed in this handbook arise, administrators must continually evaluate how best to continue supporting inclusive economic growth and advancing the mission of their charter city.

¹ United Nations Department of Economic and Social Affairs. 2018. “World Urbanization Prospects 2018: Highlights.” Available at: <https://population.un.org/wup/Publications/Files/WUP2018-Highlights.pdf>.

² See the performance over time of indicators such as government effectiveness, regulatory quality, rule of law, and control of corruption in the World Bank's World Governance Indicators project. Available at: <https://info.worldbank.org/governance/wgi/Home/Reports>.

³ Doing Business. (2020a). “Ease of Doing Business rankings.” World Bank. Available at: <https://www.doingbusiness.org/en/rankings>.

⁴ La Porta, R. and Shleifer, A. (2014). “Informality and Development.” *Journal of Economic Perspectives* 28(3): pp. 109-26.

⁵ Asian Development Bank. (2017). “Meeting Asia's Infrastructure Needs.” Available at: <https://www.adb.org/sites/default/files/publication/227496/special-report-infrastructure.pdf>; African Development Bank. (2018). “Africa's Infrastructure: Great Potential but Little Impact on Inclusive Growth” in *African Economic Outlook 2018*. Available at: https://www.afdb.org/fileadmin/uploads/afdb/Documents/Publications/2018AEO/African_Economic_Outlook_2018_-_EN_Chapter3.pdf.

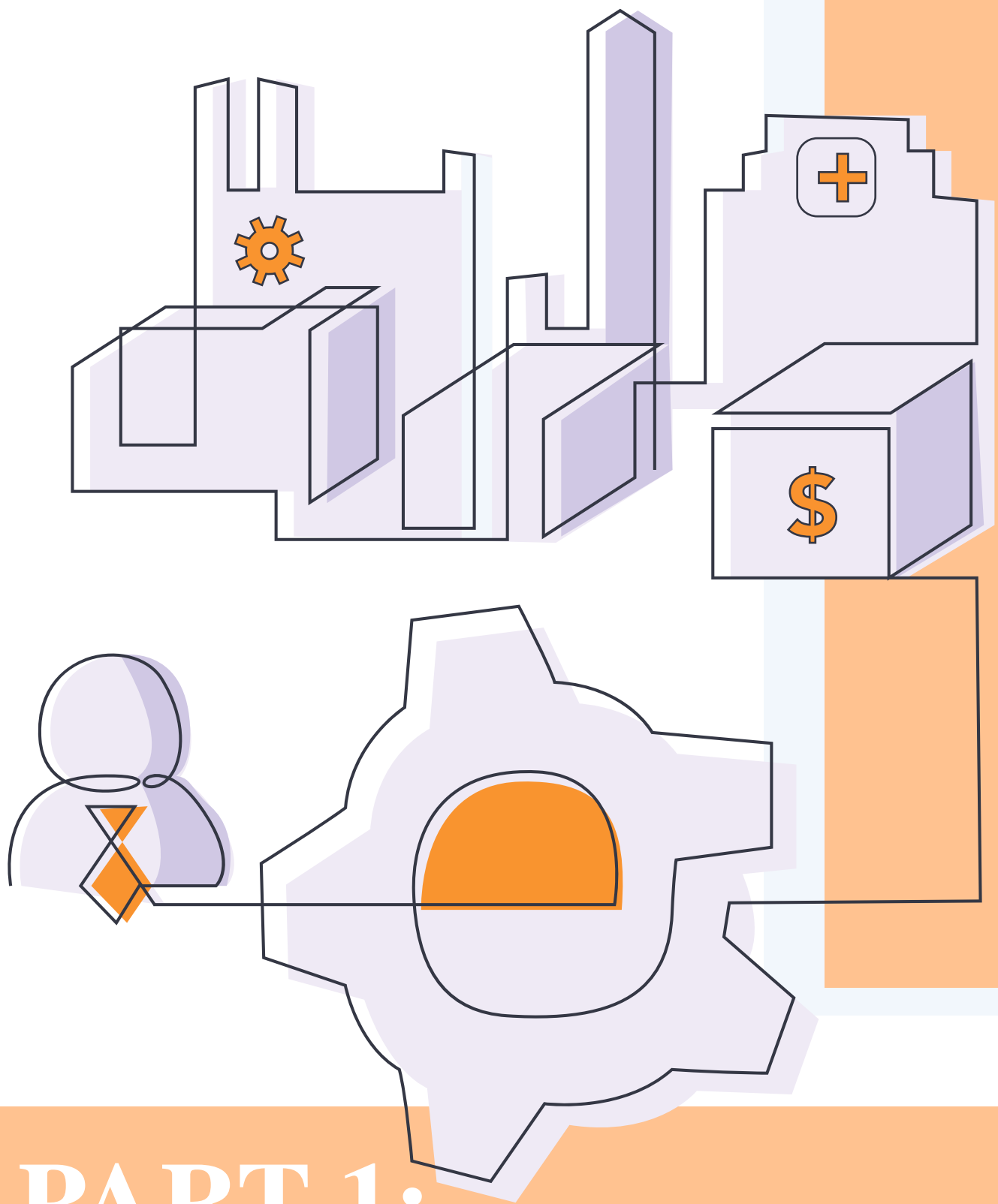
⁶ Shepard, W. (2019). “Should we build cities from scratch?” *The Guardian*, July 10th, 2019. Available at: <https://www.theguardian.com/cities/2019/jul/10/should-we-build-cities-from-scratch>.

⁷ Jeffrey Mason and Mark Lutter. 2020. “Introduction to Charter Cities.” Charter Cities Institute. Available at: <https://www.chartercitiesinstitute.org/post/introduction-to-charter-cities>.

⁸ Although no charter cities were developed in Madagascar or Honduras during Romer's period of involvement, a version of a charter city law first passed in Honduras in 2011 during Romer's involvement remains in effect. This law, which creates zones for employment and economic development (ZEDEs), is the closest statute anywhere in the world to what CCI is proposing. To date, two ZEDEs are in development.

⁹ Ideally this private developer is based in the host country or a country in the surrounding region. A local charter city developer will be best equipped to develop a new city in their country, rather than an outside developer possessing little or no knowledge of local needs, economies, culture, and other relevant considerations.

¹⁰ Johnson, N. and Koyama, M. (2017). “States and economic growth: Capacity and constraints.” *Explorations in Economic History* 64: pp. 1-20.



PART 1: ADMINISTRATION

1.1 SELECTION AND MANAGEMENT OF CITY OFFICIALS

I. KEY TAKEAWAYS

- ✓ Highly skilled and competent city personnel promote greater administrative capacity and good governance within the charter city. Good governance is essential in sustaining both well-functioning markets and economic growth in the city over the long term.
- ✓ This chapter covers two ingredients necessary to the creation of an effective city bureaucracy: selection (pre-hire) and management (post-hire) of city personnel.
- ✓ This chapter recommends the charter city administration emphasize three main values in selecting and managing city personnel: the bureaucracy should be (1) responsive and accountable, (2) impersonal and meritocratic, and (3) adaptive and efficient.
- ✓ Specifically, this chapter examines the two main decisions the charter city administration must undertake. First, implementing recruitment procedures that have demonstrated effectiveness in pinpointing talent and filtering out the rest, focusing on both formal recruitment and informal recruitment mechanisms. Second, inculcating a performance-oriented organizational culture using good management practices: focusing on pay-for-performance, easy hiring and firing, augmented autonomy for line managers, and ongoing training and skills development.

II. INTRODUCTION

The success of charter cities is premised on the fact that charter cities have good governance and high administrative capacity. This chapter covers an essential ingredient in both factors: the performance and selection of the personnel who carry out the city's administrative functions.

Broadly, governance refers to “the process through which state and non-state actors interact to design and implement policies within a given set of formal and informal rules.”¹ In short, governance provides the rules for changing rules. State capacity—or *administrative capacity* when it comes to charter cities (as charter cities are not states)—refers to the ability of governments to (1) provide public goods, (2) raise taxes, and (3) uphold the rule of law (e.g., enforce contracts and protect private property rights). A capable administration is critical to fostering the type of durable institutions that are necessary to both

support markets and spur economic growth. Research shows that the world's wealthiest countries have long histories of strong, consolidated political institutions, while the world's poorest countries lack this same history of strong statehood.² In addition, nations with weak governance show a much higher prevalence of internal conflicts and even outright civil war.³

Countries across the world differ significantly in quality of governance, but low-income countries invariably have worse governance indicators. For example, a study examined absenteeism in six nations in the Global South by randomly checking in on front-line public workers. It found that on average, 19% of primary teachers and 35% of public health workers were absent on any given visit.⁴ Despite such pervasive ineffectiveness, there are some bright spots: countries that have unexpectedly high government performance (e.g., Botswana) relative to their income levels. And even *within* low-income bureaucracies that don't

perform well overall, there are so-called pockets of effectiveness, particular agencies that, against all odds, perform much more competently and efficiently than the largely corrupt, absent, and/or low-skilled agencies that surround it.

This chapter examines how charter cities can be these pockets of effectiveness within the host countries they are located in. While administrative capacity includes several elements, surely one of the most critical elements is the quality of the personnel who are selected to perform administrative activities. Specifically, this chapter reviews two critical elements of establishing an effective charter city administration: (1) recruitment and selection of high-quality city personnel and (2) inculcating a culture of competence once such personnel are hired through the implementation of good management practices across the city

administration.

Highly skilled and competent city personnel ultimately promote greater administrative capacity and good governance within the charter city. Good governance is essential in sustaining both well-functioning markets and economic growth over the long term.

III. VALUES AND GOALS

A successful charter city administration can execute complex projects in a timely and cost-effective manner. There are several values that stem from this aim: the charter city administration should be (1) **responsive and accountable**, (2) **impersonal and meritocratic**, and (3) **adaptive and efficient**.

Table 1: Summary of Values and Goals for Selection and Management of City Officials

Value	Meaning of the Value	Measurable Goals
Responsive and Accountable	<p>—City personnel serve the needs of the charter city's residents and businesses, not the other way around.</p> <p>—For the above to happen, city agencies must be accountable to residents and businesses. That is, agency budgets (reward or sanction) must be tied in some manner to both objective and subjective measures of performance. Objective measures should stem from the service delivery targets of each city agency. Subjective measures should stem from the satisfaction of and responsiveness to residents and businesses.</p>	<p>—The charter city administration should set up service delivery targets across all city agencies, specifying expectations to city personnel when it comes to the time, quality, and quantity of service delivery.</p> <p>—Responsiveness can then be measured by the frequency that city agencies meet (or miss) these service delivery targets during a specific period (e.g., quarterly).</p> <p>—In addition to these objective measures, subjective measures can be obtained by conducting annual surveys of residents and businesses to gauge overall satisfaction across city functions.</p> <p>—Accountability can be measured via audits that are then publicly reported during, for example, an annual accountability day. Three measures can be used here: (1) the number of cases of poor performance or mismanagement across agencies uncovered by the audits over the last year (benchmarked against the previous year), (2) how quickly an underperforming</p>

		agency was able to recover, and (3) the level of engagement and public participation around annual accountability campaigns.
Impersonal and Meritocratic	—A city administration that is based solely on merit is one that by definition discounts personal connections or powerful social networks in the hiring or contracting process.	<p>—To measure if the city human resources (HR) team is successful in attracting merit, regular surveys of line managers should be done asking managers about the quality of recent hires.</p> <p>—The number or proportion of new recruits that make it through the probationary period is also a good indicator of merit hiring.</p> <p>—When the city administration succeeds in hiring a meritocratic applicant, a key goal should be to retain such quality individuals. So the turnover rate of high-quality personnel should also be tracked. Other key factors in attracting and retaining talent include relatively higher pay than typical government jobs, performance-based incentives, and at-will termination.</p>
Adaptive and Efficient	<p>—Adaptiveness ensures the city administration is both flexible and nimble enough to deal with unplanned problems as they arise.</p> <p>—Autonomy is key to allowing line managers and personnel to adapt as circumstances change.</p> <p>—Efficiency entails the ability to effectively channel given inputs into commensurate outputs.</p>	<p>—To measure adaptiveness, perceptions on autonomy from both managers and personnel should be ascertained at regular intervals—perhaps yearly—via a survey, whether digital, phone-based, or analog.</p> <p>—To measure efficiency, all charter city expenditures and projects should be justified through a cost-benefit lens, especially project completion rates, project time-to-completion, a comparison between projected and actual costs, and whether the anticipated benefits of the project/expenditures materialize as expected.</p>

First, **responsiveness and accountability** are essential values for any charter city administration because they ensure the city personnel serve the city's residents and businesses, not the other way around. A key route to ensuring the city administration is responsive is setting and disseminating widely accepted service delivery targets among the city agencies in terms of time, quality, and, if applicable, quantity. If both city personnel and city residents are aware of these targets, and if line managers in city agencies overseeing city personnel are monitoring adherence to these targets, then any deviation from the set targets should be quickly enforced and

rectified appropriately. Of course these targets would need to be updated as circumstances change to ensure adaptiveness is maintained. The obvious goal or metric that the charter city administration can use to track progress around responsiveness is the frequency that city agencies hit—or miss—these service delivery targets in a given period.

Many countries also successfully use audits and subsequent public reporting as an essential accountability mechanism across government agencies. Rwanda's success in engaging the public and civil society in holding leaders accountable is discussed below in Box 1. Some possible metrics

that the charter city administration can utilize to gauge progress around such accountability mechanisms are (1) the number of cases of poor performance or mismanagement across agencies uncovered by audits over the last year and benchmarked against the previous year, (2) how quickly an underperforming agency was able to

recover, and (3) the level of engagement and public participation around holding officials accountable and around public awareness campaigns, such as how many reports of misbehavior did the city administration receive from residents, and how many of these reported misdeeds were actually investigated and rectified.

BOX 1

Rwanda's National Dialogue: Accountability through Public Participation

Rwanda has an Office of the Auditor General (OAG) that, among several other functions, conducts performance audits on all public sector expenditures. These audits report on how effective and efficient public spending has been over the past year, with the rationale being that by examining budgetary performance, the OAG can detect poor performers or mismanagement. Poor budgetary performance is used as a mechanism to alert higher-level managers to intervene. Moreover, there is also a designated day every year in Rwanda when the OAG's audits are publicly presented to and scrutinized by the legislature and another designated day when the audits are presented to citizens and the press, referred to as National Dialogue.⁵ Citizens and the media participate in person, online, via calling in by phone, and on social media to ensure their leaders are effectively delivering promised public goods and services.

Such accountability mechanisms are one of the reasons why the Rwandan bureaucracy was recently ranked as the seventh most efficient in the world by the World Economic Forum on its Global Competitiveness Report.⁶ High citizen and civil society engagement help ensure low levels of waste in government spending.



Rwanda's National Dialogue.

Furthermore, another potential metric that can inform the charter city administration about its level of responsiveness is by conducting regular surveys of charter city residents and businesses, asking about administration performance across different city agencies and services, perhaps on an annual basis. Such surveys will ideally show whether the charter city administration is delivering on the margins that are most important to its residents and businesses.

Second, effective bureaucracies across the world exhibit the values of **impersonality and meritocracy**, which are often two sides of the same coin: a city government that is based solely on merit is one that discounts personal connections or powerful social networks in the hiring process. Goals and metrics that can be used to track progress around these values are notoriously tricky. Every organization in history has tried to solve the difficult puzzle of evaluating merit—the quality of potential hires—in advance. The best way to do so is through a rigorous recruitment process that prioritizes the selection of motivated, experienced, and talented hires, and this necessarily involves several rounds of intensive interviews and high search costs. This recruitment process is delineated in more detail in the next subsection below. Examples around the globe illustrate that there's a way to structure these recruitment processes, so the influence of patronage is minimized. Unfortunately, the best way for city administrators and human resources (HR) teams to track success at impersonally attracting merit only occurs post-hire by simply *asking line managers*, whose operational performance depends on the team of personnel that HR recruits. A survey of line managers at frequent intervals following the hiring of a new individual can help determine the merit of that hire. Moreover, these surveys can be anonymous and

can also help determine whether a recruit makes it through the probationary period. To ensure the incentives between HR and line managers are aligned, HR teams could be partially compensated based on the results of these follow-up surveys with line managers. Moreover, when the city administration succeeds in hiring a meritocratic applicant, a key goal should be to *retain* such quality individuals. Therefore, the turnover rate of high-quality personnel should be tracked.

On a broader level, while no *ex ante* metric is going to be an unfailing measure to track the quality of applicants, some indicators can be used to proxy quality. For example, average educational attainment, degree type, test scores, and the educational institution of applicants have all been used to (imperfectly) approximate quality. These proxies are also correlated with income and social connections. Therefore, in many countries the response has been to develop a civil service exam when hiring into the bureaucracy that in theory means applicants have an equal chance of excelling regardless of background. Over time the monitoring and evaluation (M&E) teams⁷ within city agencies should use the data continuously collected on high-quality hires to build up a profile of characteristics that predict success, which should then be selected for during the recruitment process.

Third, the values of **adaptivity and efficiency** within the charter city administration should be prioritized. They ensure the city administration is both flexible and nimble enough to deal with unplanned problems as they arise while also being able to effectively channel given inputs into commensurate outputs. Autonomy is key to allowing line managers and personnel to adapt as circumstances change.⁸

Therefore, perceptions on autonomy from both managers and personnel should be ascertained at regular intervals—perhaps yearly—via a survey, whether digital, phone-based, or analog. In terms of efficiency, the extent to which bureaucracies do *not* rigorously measure whether given inputs justify the projected or actual outputs of a project is striking. All charter city expenditures and projects should be justified in this way, especially project completion rates, project time-to-completion, a comparison between projected and actual costs, and whether the anticipated benefits of the project/expenditures indeed materialize as expected. Moreover, performance around these efficiency-based metrics should be rewarded or punished.⁹ For example, high-performing and competent agencies should be rewarded the following fiscal year with an augmented budget, perhaps earmarked for performance bonuses and vice versa.

By striving toward the above values—responsiveness and accountability, impersonality and meritocracy, and adaptivity and efficiency—and rigorously tracking performance around these values, the personnel within charter city agencies will see that their individual performance *matters* and that high administrative capacity is rewarded. Over time this will inculcate a bureaucratic culture of competence that becomes self-reinforcing. High administrative capacity contributes to good governance, which in turn yields long-term economic growth.

IV. IN PRACTICE

This section overviews key practical decisions involved in establishing recruitment procedures and managing the performance of charter city personnel.

This section assumes that the necessary level of

legal authority has been devolved to the charter city administration so it can establish its own city agencies and departments as it deems fit. The section also assumes that once established, these city agencies and departments are solely accountable to the charter city administration, not to host country governments. The key decisions that must be made are enumerated below.

Key Decisions in Establishing and Managing the Charter City Administration

1. *Establishing Recruitment Procedures for Charter City Personnel*
2. *How to Inculcate a Culture of Competence Among the City Personnel: Good Management Practices*

1. *Establishing Recruitment Procedures for Charter City Personnel*

Broadly, this heading includes two main pillars: (1) implementing optimal recruitment procedures while (2) ensuring such procedures are immune to the undue influence of patronage.

The first step in cultivating a highly effective charter city administration is establishing optimal recruitment practices that select the best possible candidates. It's important to note at the outset that the selection process needed to attract rare, high-quality individuals will entail relatively high search costs, as the process is (a) intensive, (b) it involves stringent probationary periods that may not result in a job offer at the end, and (c) it often includes tapping into already high-skilled entities such as professional associations and the host country diaspora, among several other search strategies.

Pockets of bureaucratic effectiveness around the

Global South often follow common recruitment procedures when it comes to the two main methods of hiring: (1) through formal means and (2) through informal means.

1.1 Formal Recruitment¹⁰

Step 1: long list. When it comes to formal recruitment, the first step to attract and train high-quality individuals in a broader environment of government corruption, bureaucratic sclerosis, or general ineffectiveness is to formulate a long list, which is typically formed via both public job listings and referrals from trusted, high-skilled sources. For example, the director of the Monetary Policy unit within the Bank of Ghana (BoG)—the most prestigious, meritocratic public agency in Ghana—seeks recommendations from economics professors at the top-ranked university in the country, the University of Ghana, Legon. The logic behind this is to recruit top students directly following graduation *before* they're exposed to poor performing agencies that pervade the rest of the public service and then subject these talented, blank slate students to the rigorous, high-performing culture of the BoG. Simultaneously to collating these referrals, the HR team should be sorting submissions from the public job posting in terms of degree requirement match, experience, and educational credentials—typically educational institution and grades. Once this long list is formed from these two channels, it is important that *no candidates* be added after this point because candidates added to the recruitment process at later stages typically do so through patronage and connections. This must be avoided.

Step 2: interview process. The interview process below is based on McDonnell (2020), which distills the recruitment practices of high-performing pockets of effectiveness across the Global South. The particular process enumerated below especially leverages the BoG's procedure. First, long-listed candidates must pass through the first stage of interviews with HR officials. The remaining candidates then proceed to the second-stage interviews, which are typically task-based and conducted in front of senior managers at the agency. For example, the BoG requires candidates to defend their thesis in front of division managers. Each senior manager involved in this second stage interview should be given veto power, further winnowing down the applicant pool. The remaining candidates then go on to the third stage in front of the highest governing body of the agency they're applying to. At the BoG, candidates are brought in front of the board, including the governor, deputy governors, and other representatives that the Ministry of Finance nominates. Each top-level leader can question the candidate as they deem fit, and again each has veto power.

The benefits of this rigorous, formal recruitment process are threefold. First, by being forced to defend their own work product—in the case of the BoG, their thesis—to the top experts in their field, the selected candidates understand that it was the quality of their performance and work that got them the job. Second, by strictly ensuring that all hires are put through the same intensive recruitment process, a more corporatist ethos takes root, like the ethos

formed when military recruits go through a grueling mission together. Third, the process is resistant to patronage because it is a cumulative, multi-level process with numerous veto points—everyone from a lowly HR intern to the BoG governor—and these myriad veto points tend to bring about hiring decisions that are rational and meritocratic. Moreover, because the proximate manager that the hired candidate will ultimately report to will personally bear some of the costs for hiring a poor candidate, they are more likely to select for quality, talent, and ability to do the job—not nepotism. Therefore, the close involvement of these proximate managers in the selection process is another way to resist patronage. These three factors distinguish the formal recruitment process for pockets of effectiveness from more

typical, low-performing public agencies.

1.2 Informal Recruitment

Oftentimes roles in the charter city administration will require qualities or skills that are difficult to discern *ex ante* but can be more accurately assessed by directly observing the candidate. This is especially the case for more consequential or significant positions. In such a scenario more informal means of recruitment may be called for. For example, pockets of effectiveness typically use two main methods to get around this problem: (1) poaching and (2) temporary or trial employment.

First, poaching high-performing candidates from elsewhere in the city administration as well as from the private sector and from other tiers of government in the host country should not only be permitted but encouraged in the charter city.



Job candidate presenting his work during the recruitment process at the Bank of Ghana.

This increases competition between city personnel and allows the best workers to rise to the top. In pockets of effectiveness this typically entails middle and senior managers spotting talent and then informally reaching out to the high performer to gauge their willingness to be reassigned. If willing, the poaching manager should first assign additional tasks and projects for the candidate to complete while they continue to work in their current position. This not only allows the manager to assess work product and performance but also demonstrates the candidate's work ethic and motivation. In essence these tasks function as an informal probationary period. After being sufficiently satisfied, the candidate should be made a formal offer.



Lee Kuan Yew and the EDB were integral to Singapore's economic success.

Another more informal recruitment activity that could be classified as a type of poaching is targeting talented, highly skilled individuals studying or

returning from studying abroad. This is how Singapore's incredibly successful and effective Economic Development Board (EDB) recruited some of its first hires. Former Prime Minister Lee Kuan Yew, the architect of Singapore's rapid rise from the periphery to prosperity, writes that his first chairman of the EDB was "given the choice of the brightest and best of our scholars who had returned from universities in Britain, Canada, Australia, and New Zealand."¹¹ In addition to respected universities at home and abroad¹² as well as other public agencies, charter city agencies can also attempt to poach high performers from diaspora networks, professional associations, and various exchange programs, including programs involving talented foreign individuals.¹³

Second, many host countries have national service programs, internship programs, or other schemes that allow for temporary or trial employment. This is a very low-cost way to directly assess performance and candidate qualities and thereby make much more informed future hiring decisions. The human resources department in the city administration should ensure that the charter city is participating in as many of these programs as possible.

These two informal means of recruitment have the added benefit of significantly lower search costs than those involved with more formal recruitment processes.

2. How to Inculcate a Culture of Competence among the City Personnel: Good Management Practices

After the recruitment process and the hiring of the top candidates, the next question becomes how to foster a group culture of competence and effectiveness. This subsection reviews management

practices that studies show significantly improve bureaucratic performance. Four key management practices are discussed: (1) pay for performance (P4P) incentives, (2) easy hiring and firing, (3) increased autonomy, and (4) ongoing professional training and skills development.

2.1 Pay for Performance

First, several studies across different bureaucratic functions have now convincingly shown that P4P schemes result in improved bureaucratic performance and a more effective provision of public goods and services than more traditional public sector pay structures, which tend to be rigid, formulaic, and overly dependent on seniority. For example, across governmental roles as diverse as tax collectors, public prosecutors, teachers, and health workers, P4P resulted in significantly better performance either in terms of the *quality* of service provision or the *quantity* of goods/services provided—oftentimes both.¹⁴ In exchange for the higher pay, city personnel will have to contend with a much more rigorous recruitment process (see above), easier termination, longer and more stringent probation periods, and regular coaching and training (see below).

Two further points are worth emphasizing here. One is that public sector leaders have worried that an emphasis on pay and career benefits in public service jobs can lead to a lack of pro-sociality and intrinsic motivation within the applicant pool. Recent work has shown this worry to be somewhat misguided; by emphasizing pay and career trajectory, public sector agencies can find job candidates that are *both* more talented and equally pro-social.¹⁵ The second point is that P4P works best in areas where outputs are clear and therefore can be monitored and measured—like approving

permits, enforcing regulations—and less well when outputs are complex and thus less measurable.

2.2 Easy Hiring and Firing

Stringent restrictions have been placed on hiring and firing government employees around the world in order to prevent scenarios where a new politician is elected and fires many allegedly opposition-supporting bureaucrats in order to stack the bureaucracy with loyalists. While it's not impossible to fire government personnel, it's often incredibly difficult.

The US government provides a good illustration of these restrictions. In the US, any time an adverse action is taken against a government worker—a worker is fired, demoted, denied a within-grade pay raise, or suspended without pay—that worker can appeal the action, and the assigned judge must render a decision in 120 days. However, the worker can also appeal that decision to the Merit Systems Protection Board (MSPB), which must make its own decision on the case. The worker can then appeal the MSPB decision to the United States Court of Appeals.¹⁶ The substantial costs for public agency leaders in terms of both time and money lost to such an extensive appeal process often results in leaders simply deciding not to take adverse actions against their workers. Such excessive restrictions will discourage the formation of a performance-centric culture in the city administration, as under-performing personnel continue safely in their positions without punishment or sanction.

To counter this, managers should be given greater discretion to terminate poor performers and promote or reward high performers, regardless of seniority. Moreover, stringent and longer probationary periods should be the norm—such as

at least three months. After such periods managers should have free reign as to whether to keep the new hire on their team or terminate the recruit, no questions asked. This probation period and associated discretion permit the manager time to closely observe and adjudicate the new hire performing the actual role for an extended period. There is no substitute for this. Managerial discretion and autonomy are discussed in more detail below.

There will be instances where the host country is reluctant to grant charter city administrations broad authority over the city's own labor law or public service law—whichever type of law applies to the civil service. In the absence of such authority, it may remain very difficult for city administrators to terminate poor performers. In

these instances the charter city administration should exploit its ability to reassign underperformers to less desirable or lower status posts. More broadly, the above point remains that underlying host country practices or preferences may hinder the application of meritocratic standards in societies still heavily reliant on kin-based loyalty, systems of ethnic patronage, or gerontocratic norms that place high cultural respect on elders. See Box 2 below for a more detailed discussion on this point.

BOX 2

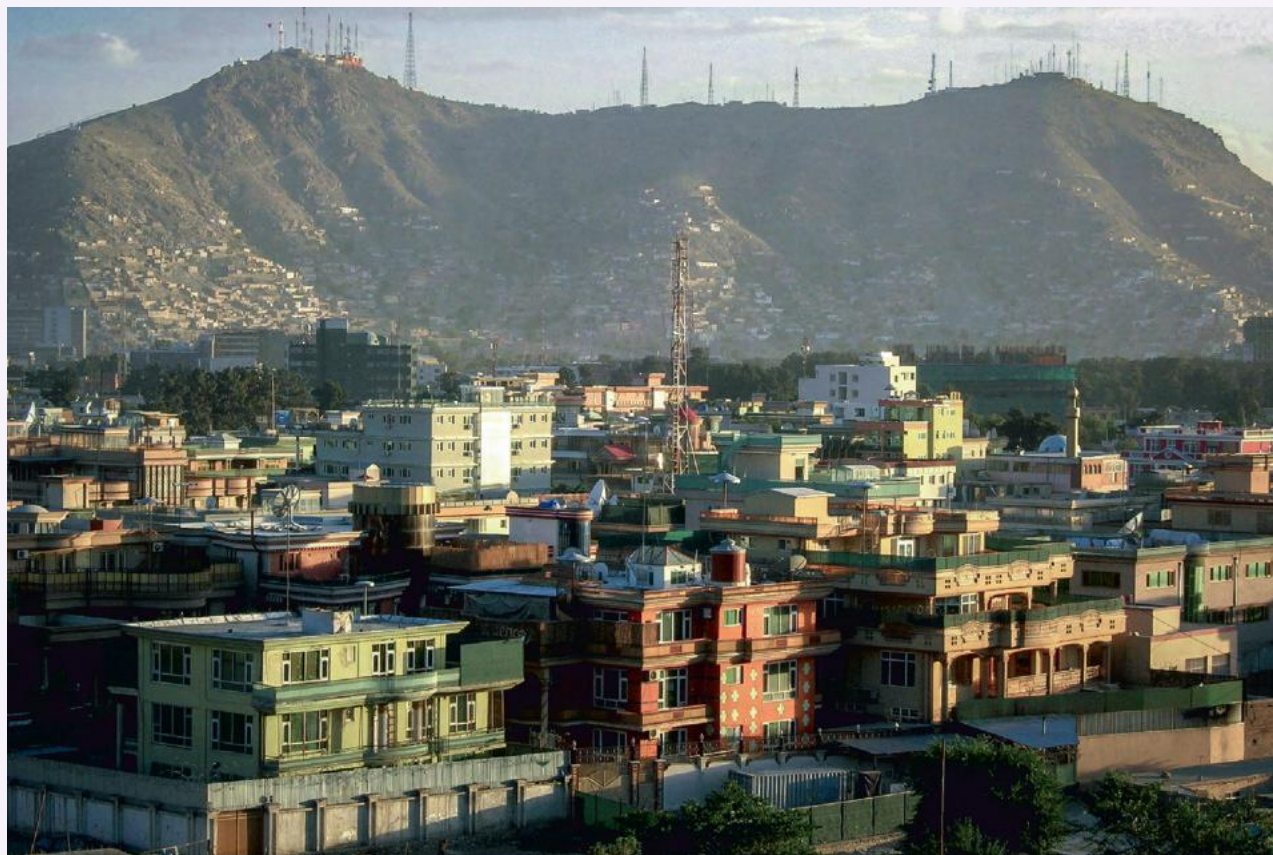
Implementing Meritocratic Practices in Afghanistan

Beginning in 2001, the war in Afghanistan saw US forces push the Taliban from power. NATO and US efforts then focused on building state institutions, establishing an effective bureaucracy that could deliver public services, and upholding the rule of law. At the time, Afghanistan's civilian government was led by President Hamid Karzai.

These public service reform efforts were varied and many, but most attempted to apply meritocratic standards to the nascent Afghan bureaucracy. Overlaying a meritocracy based on universal rules and equal access on top of a culture commonly based on clan, tribal loyalty, and underlying patronage networks were often met with significant pushback at best and outright failure at worst.

For example, Karzai and other senior government officials often engaged in nepotism with the new Lateral Entry program, appointing low-quality candidates to high-level, subnational posts like provincial governors, district governors, and police chiefs. An illustrative instance of this occurred when Karzai appointed an individual who'd previously been imprisoned in the US for heroin trafficking to the governorship of a province known for significant amounts of illicit heroin and opium trade. Moreover, millions in development assistance were frequently wasted on training and capacity-building efforts for individuals who were either so corrupt or of such low quality that no amount of training would help. Additionally, bureaucratic departments often grew significantly beyond the size planned for them under the priority reform and restructuring (PRR) process. This excessive bureaucratic bloat was the result of ongoing local pressures to hire unqualified personnel or to otherwise accommodate or compensate those candidates who failed to get selected for a public posting but were well-connected.¹⁷

Such clashes between meritocratic public service reforms on the one hand and resistant underlying social norms on the other are not uncommon. In theory it's likely that charter cities will not be *as* susceptible to these issues as national-level civil service reforms for two main reasons. First, they localize the problem to the city level and therefore are relatively easier to administer than national-level reforms.¹⁸ Second, charter cities will ideally be established on sparsely populated, greenfield land. As a result, if we follow Olson's *Logic of Collective Action*, they'll have fewer political elites to bump up against who have a vested interest in maintaining the status quo. In practice no site will ever be truly greenfield or a complete 'blank slate.' Charter city administrators will have to contend with prevailing social norms that may pushback against meritocratic standards.



Kabul, Afghanistan.

2.3 *Autonomy*

The above management practices of P4P and easy hiring and firing will not be implemented effectively if line managers are not empowered with sufficient autonomy and discretion. When it comes to public sector managers, autonomy has been drastically reduced over time. This reduction was mostly in an effort to prevent corruption or

the misuse of government funds by enacting many strict rules around what government personnel can and cannot do. However, multiple recent studies support the notion that providing line managers in public sector agencies with heightened discretion and autonomy significantly improves overall bureaucratic performance without increasing corruption or malfeasance.

Researchers in Pakistan found that procurement officers given more autonomy relative to those subjected to more strict rules and monitoring were able to reduce the average unit price of procured goods/services by 8% to 9%, resulting in considerable government savings.¹⁹ Additionally, studies of public sector bureaucracies in both Ghana and Nigeria surveyed thousands of government workers and examined the initiation and completion rates of thousands of government projects to determine how particular management practices impacted productivity. The studies found that in Ghana and Nigeria, greater autonomy increased both project initiation (a one standard deviation increase in autonomy led to a 15% boost to project initiation in Nigeria and a 20% boost in Ghana) *and* project completion (a one standard deviation increase in autonomy increased the likelihood of project completion by 16% in Nigeria, and by 27% in Ghana).²⁰

In light of these results, what practical steps can a charter city administration take to increase discretion and autonomy within its bureaucracy? To answer this question, insights from the above-cited studies are taken in addition to findings from the United States' Navy Demonstration Project,²¹ which had some naval centers give enhanced discretion to line managers over assigning, promoting, and rewarding their government employees, while managers at other naval centers were given status quo authority and served as the control group. This enhanced discretion consisted of five main elements. First, all jobs were categorized into five broad tracks—technical, specialist, professional, administrative, and clerical—and the 18 GS pay grades were lumped into just four, five, or six pay bands, contingent on the track. Second, managers had the authority to offer market-level pay to new hires. Third, within each broad pay band, managers could give high

performers pay raises without providing justification to the government personnel office or having to promote employees to managerial roles. Fourth, line managers were provided with funds to distribute performance-based pay increases and bonuses to high-performers—the level of funds provided was such that managers could *not* provide payouts to all employees; they had to select based on performance. Fifth, in the event of layoffs, managers used performance ratings as opposed to seniority to choose who stayed and who was bumped.

This more flexible personnel system was praised not just by line managers but also by government employees and by the Office of Personnel Management. Moreover, the outcomes were significantly positive across the board. The naval centers where managers were given enhanced autonomy saw the following results, relative to status quo centers: (1) they were able to attract better engineers by offering higher starting pay and more rapid promotion opportunities, (2) they saw lower rates of employee turnover, (3) the right employees turned over (higher performers were more likely to remain), and (4) managers universally attested that the augmented autonomy allowed them to better improve, or maintain, the quality of their skilled employees.

Some may remark that these recommendations around increased autonomy and flexibility to line managers stand in contrast to the type of metrics, oversight, and accountability mechanisms recommended in the Values and Goals section above—audits, service delivery targets, etc. However, this handbook views these recommendations as complementary. The city manager—in essence, the CEO of the charter city—in consultation with the heads of the various city agencies, comes up with service delivery targets for each agency. Each

respective *city agency* as a whole is then measured against these targets, but *individual* bureaucrats and line managers are left to flexibly and autonomously find innovative ways to achieve these targets.

2.4 Ongoing Training and Skills Development

This chapter has emphasized throughout that underlying organizational culture is an essential determinant of overall organizational performance. However, the question then becomes how do organizational leaders build a performance-oriented culture in practice? Recent studies have shown that an innovative training module delivered yearly and at scale to mid-level career bureaucrats results in significant

improvements in performance-oriented culture across the bureaucracy.

More specifically, mid-level bureaucrats in Ghana's civil service responsible for overseeing, administering, and managing frontline bureaucrats were assigned to a training module that had three main components: “(1) basic problem-solving skills related to identifying productivity constraints, such as fishbone diagrams, (2) a motivational video that featured real Ghanaian civil servants talking about productivity routines in their team and giving examples of how they came up with and introduced innovative ideas to improve performance, and (3) applying these skills and motivations to the development of an innovation



action plan relevant to their own work.”²² The training caused significant improvements in organizational culture for work teams that had at least one team member assigned to the training, and these improvements were sustained even six to eighteen months after the training. These improvements were greatest in the areas emphasized by the training: “(1) teamwork climate, (2) performance climate, (3) fostering new ideas, and (4) relative performance perceptions.”²³

It should be noted that the *design* of the training module mattered. The training that was focused on individual mid-level bureaucrats drove all the improvements in both the short- and long-term, whereas the training that involved groups or whole work teams saw marginal short-term improvements and no long-term benefits.

Charter city administrators and managers should incorporate similar ongoing training and skills development into their management practices to inculcate a performance-oriented organizational culture. City managers should contact Ghana's Civil Service Training Centre (CSTC), which was responsible for implementing the training module in the above study, for further details. Additionally, the World Bank's bureaucracy lab can also be contacted.²⁴ Lastly, CCI has collaborated with the International City/County Management Association (ICMA) in the past, and experienced ICMA city managers have delivered capacity-building programs and training to city officials across the Global South.²⁵

¹ World Bank (2017a). *World Development Report 2017: Governance and the Law*. World Bank Group: Washington, DC. p. 3. Available at: <https://www.worldbank.org/en/publication/wdr2017>.

² Besley, T., & Persson, T. (2009). “The Origins of State Capacity: Property Rights, Taxation, and Politics.” *American Economic Review*, 99(3): pp. 1218-44; Besley, T. & Persson, T. (2011). *Pillars of Prosperity*. Princeton University Press: Princeton, NJ; Besley, T. & Persson, T. (2013). “Taxation and Development.” CEPR Discussion Papers 9307, Center for Economic Research and Policy: Washington, DC; Herbst, J. (2000). *States and Power in Africa*. Princeton University Press: Princeton, NJ; Michalopoulos, S. & Papaioannou, E. (2013). “Pre-colonial Ethnic Institutions and Contemporary African Development.” *Econometrica*, 81(1): pp. 113-152.

³ Blattman, C. & Miguel, E. (2010). “Civil War.” *Journal of Economic Literature*, 48(1): pp. 3-57.

⁴ Chaudury, N. et al. (2006). “Missing in Action: Teacher and Health Worker Absence in Developing Countries.” *Journal of Economic Perspectives*, 20(1): pp. 91-116.

⁵ Interview with the Auditor General of Rwanda, Obadiah Biraro.

⁶ World Economic Forum (2015). “Which Countries Have the Most—and Least—Efficient Governments?” WEF: Geneva. Available at: <https://www.weforum.org/agenda/2015/07/efficient-government/>.

⁷ Monitoring and Evaluation (or M&E) teams have increasingly been embedded into public sector agencies over the last decade given the broader push toward evidence-informed policy making. M&E teams are meant to statistically track and monitor government and program effectiveness over time.

⁸ Rasul, I. & Rogger, D. (2016). “Management of Bureaucrats and Public Service Delivery: Evidence from the Nigerian Civil Service.” *Economic Journal*, 128(608): pp. 413-446; Bandiera, O. et al. (2020). “Autonomy—not rules—may be the government's best weapon in the fight against corruption.” CEPR Blog, Center for Economic Research and Policy: Washington, DC. Available at: <https://voxeu.org/article/autonomy-not-rules-may-be-government-s-best-weapon-fight-against-corruption>.

⁹ These M&E activities can be costly to set up and administer over time. The city administration can seek assistance from multiple development agencies including the newly formed Global Evaluation Initiative, the World Bank's Independent Evaluation Group, and the CLEAR initiative, among others. See here for further details: <https://ieg.worldbankgroup.org/blog/pivotal-year-monitoring-and-evaluation>.

¹⁰ Note that subsections 1.1 on Formal Recruitment and 1.2 on Informal Recruitment take from Chapter 2 of McDonnell, E. (2020). *Patchwork Leviathan: Pockets of Bureaucratic Effectiveness in Developing States*. Princeton University Press: Princeton, N.J.

¹¹ Lee, Kuan Yew (2000). *From Third World to First: The Singapore Story 1965-2000*. HarperCollins Publishers: NY: p. 59.

¹² One such well-reputed university with campuses in several African countries is the African School of Economics (ASE). Founded by Princeton professor Leonard Wantchekon in 2014, the ASE has placed African economics students in some of the best PhD

programs in the world and has had graduates serve as senior advisors to presidents and prime ministers. Professor Wantchekon also serves on CCI's Board of Advisors, and CCI is in active discussions to establish a graduate program in city management and city administration. See: <https://africanschoolofeconomics.com/>.

¹³ Note that high-skilled visas are discussed in more detail in the "Immigration" chapter of this handbook. Some external talent may include individuals with experience in relevant foreign government agencies (who are either seconded or have left their past job), technicians who have worked for private infrastructure providers, and specialists from auditing and consulting firms, among others.

¹⁴ Finan, F., et al. (2015). "The Personnel Economics of the State." NBER: Cambridge. pp. 13-17.

¹⁵ Ashraf, N. et al. (2020). "Losing Prosociality in the Quest for Talent? Sorting, Selection, and Productivity in the Delivery of Public Services." *American Economic Review* 110(5). pp. 1355-1394.

¹⁶ Wilson, J.Q. (1989). *Bureaucracy: What Government Agencies Do and Why They Do It*. Basic Books: NY. p. 145.

¹⁷ Lister, S. (2006). "Moving Forward? Assessing Public Administration Reform in Afghanistan." *AREU Briefing Paper*. Afghanistan Research and Evaluation Unit: Kabul.

¹⁸ See, for example, McDonnell (2020) on how some bureaucratic 'pockets of effectiveness' can inculcate a performance-based culture, in spite of the broader external bureaucratic apparatus being beset with corruption.

¹⁹ Bandiera, O. et al. (2020). "Autonomy—not rules—may be the government's best weapon in the fight against corruption." CEPR Blog, Center for Economic Research and Policy: Washington, DC. Available at: <https://voxeu.org/article/autonomy-not-rules-may-be-government-s-best-weapon-fight-against-corruption>.

²⁰ Rasul et al. (2017). "Management and Bureaucratic Effectiveness: A Scientific Replication in Ghana and Nigeria." International Growth Centre: Oxford.

²¹ Wilson, J.Q. (1989): pp. 146-47.

²² Azulai, M., Rasul, I., Rogger, D., & Williams, M (2020). "Can Training Improve Organizational Culture? Experimental Evidence from Ghana's Civil Service." Unpublished Working Paper: p. 2.

²³ Ibid: p. 4.

²⁴ Daniel Rogger, at the World Bank's Bureaucracy Lab, was interviewed for this chapter of the handbook.

²⁵ For an example of an ICMA program in Ethiopia, see <https://icma.org/programs-and-projects/regionalmunicipal-services-strengthening-project>.

1.2 ADMINISTRATIVE LAW

I. KEY TAKEAWAYS

- ✓ Administrative law is the layer of law below the foundational documents of a charter city and includes the actual regulations that control how a charter city is managed.
- ✓ This area of law controls how the agencies of a charter city function and how these agencies relate to and interact with one another as well as how the administrative rules themselves are altered.
- ✓ Charter city administrative law should uphold three main values: (1) efficiency, (2) transparency, and (3) uniformity.
- ✓ This chapter elucidates three key components of establishing administrative law in a charter city: (1) formulating and passing an administrative procedures act, (2) formulating and passing the individual pieces of legislation creating the various city agencies, and (3) creating and maintaining an up-to-date register for the administrative code that contains all the regulations and ordinances enacted by the city agencies.
- ✓ Technology should be leveraged where possible to streamline administrative law and procedures in a charter city.



Ministry of Finance, Malaysia

II. INTRODUCTION

Administrative law is the second layer of law dictating how a charter city will be managed. The first layer being the laws of the host country, chiefly the host country's constitution, criminal law, charter city enabling law, and the city charter. This second layer of administrative law is the legal infrastructure that governs bureaucratic administrative agencies. Furthermore, this second layer of law includes the regulations that administrative agencies will promulgate and enforce, as well as deals with the issues that will most often be encountered by city residents.

Within the administrative law layer, there are two parts: (1) administrative procedures law and (2) laws creating individual administrative agencies and delegating them powers and functions. The first part is further subdivided into four subparts: (a) the rules for changing rules of the charter city, (b) the rules for administrative enforcement or how rules are enforced, (c) the rules for an executive process for core city functions or the processes for agencies to effectively execute their core functions, and (d) the rules governing relations between different city agencies and other entities in the charter city.

Agencies in charter cities exist to enforce judicial orders and judgments, protect property, and effectively channel tax revenue into the provision of public goods, among other things. However, in

many countries the powers of these agencies are often unclear and exercised arbitrarily. Well-functioning administrative law aims to clearly enumerate the powers of bureaucratic agencies and by doing so protect against the arbitrary or extralegal use of these powers, thereby reassuring both investors and residents.

Administrative law in a charter city is subject to limitations because charter cities are not sovereign entities. For example, under CCI's Model City Charter¹ and Model Enabling Legislation,² both the constitutional and criminal law of the host country still apply within the charter city. Therefore any entity, whether it's a city agency, business, or resident that breaches the host country's constitutional and/or criminal law, will be subject to sanctions. This limitation is the clearest restriction on a charter city's administrative agencies. Other restrictions will be set forth in an administrative procedures act (APA). This act should enumerate the process for altering rules, the procedures around how agencies enforce these rules and carry out their functions, as well as how city agencies can interact with each other. Each charter city should pass such an act at the outset.

III. VALUES AND GOALS

Administrative law within a charter city should aim to uphold the values of (1) **transparency**, (2) **uniformity**, and (3) **efficiency**.

Table 2. Summary of Values and Goals for Administrative Law

Value	Meaning of the Value	Measurable Goals
Efficiency	<ul style="list-style-type: none">—The administrative system changes rules in an efficient manner that is open to public scrutiny and subject to a prescribed method.—Administrative actions are not held up by onerous or unnecessary	<ul style="list-style-type: none">—Technology is used to create greater transparency for residents who can ask questions of their city leaders and administrators and sit in on various proceedings.—A low and over time decreasing average

	<p>rules/restrictions.</p> <p>—The monetary cost of administrative actions is kept low.</p>	<p>number of calendar days from inspection to voluntary or forced compliance.</p> <p>—A low average number of calendar days from application to issuance of any permits in the city.</p> <p>—Inspections and permitting per case/permit are low in comparison to the average resident's income.</p>
Transparency	<p>—Residents understand how agencies operate.</p> <p>—Residents can provide input and comment on administrative rules and processes.</p>	<p>—The creation of a digitized administrative system that allows for resident observation, comments, and access to administrative decisions.</p> <p>—A digitized system that allows for public notice and comment on proposed rulemaking.</p> <p>—A digitized system that allows residents to respond to administrative actions, whether they are rulemakings, enforcement actions, or any other type of action that requires due process.</p>
Uniformity	<p>—Administrative rules are added, removed, or amended as prescribed by the APA.</p> <p>—Administrative rules are enforced equitably across all residents and businesses.</p> <p>—Administrative services are accessible to all residents and businesses.</p>	<p>—Random surveys of residents after an interaction with an administrative agency indicate that they perceive that the application and enforcement of rules is uniform.</p> <p>—Random surveys of residents indicate that residents perceive services are accessible to them and their fellow residents.</p>

First, **transparency** is a key underlying value for any effective administrative system. Residents and businesses within the charter city must be cognizant of how agencies operate in order to easily comply with requirements and to ensure the agencies follow their own prescribed rules. Transparency is critical to conferring legitimacy to city agencies, as opaque systems are too often clouded with arbitrary and capricious decision-making.

Second, change in administrative rules and application of administrative actions must both be done in a **uniform** manner. The adoption of an effective APA that is followed rigorously by administrative bodies and enforced by the judiciary is the critical component for ensuring

uniformity. Three other critical components include (1) standardized review and appeal processes, (2) unbiased enforcement, and (3) equal access. A standardized review process requires that a charter city's legal system adopt standards of review, which are the different amounts of deference that an appeals court will give the original court or administrative tribunal that has first heard a case. These standards can apply to either questions of fact or questions of law. A low standard of review is one that gives the reviewing court more discretion in overturning the findings of the original court, whereas a high standard of review gives substantial deference to the original court's findings. The standards of review for questions of fact are usually highly deferential to the original fact finder and typically only allow a

review of factual questions when there is a clear error on the part of the original court or unfair bias on the part of the fact-finding agency. The standards of review for questions of law can range from the reviewing court acting as if it's hearing a case for the first time to the reviewing court accepting an administrative agency's interpretation of an ambiguous regulation. Standards of review are procedural in nature, but because they often control how a case is decided, they are often a contentious subject. Ensuring that the powers of a charter city's legal and administrative branches are clearly defined in the charter will help avoid contentious fights over the interpretative powers of administrative agencies. Unbiased enforcement helps lead to city residents trusting the decisions of administrative agencies and embracing the administrative agencies as mechanisms of effective governance and not obstacles to prosperity. Finally, equal access implies that the APA is written and promulgated so that marginalized groups can both know the rules and interact with administrative agencies without needing to hire a lawyer. These three elements bolster uniformity, which in turn results in less uncertainty, heightened compliance, and lower costs when residents or businesses interact with city agencies.

Third, the charter city must prioritize **efficiency** in its administrative law system, which typically

has two main inputs: (1) time and (2) cost. To maximize efficiency both inputs should be minimized. This value is likely best measured through metrics that track the number of resources that are spent on processing, which is what the administration must do before it can reach a final resolution. Processing includes things like evaluating submitted materials, verifying those materials, requesting additional materials, investigation, peer review or review by multiple units or people, preliminary findings, and after determination, time for appeal, and appellate proceedings. It is important for residents to have a right to due process, but the risk of legal and administrative systems getting bogged down in ensuring that due process is given is real, and it's therefore imperative that a clear definition of due process is provided in a statute or regulation. This definition will help ensure that both the rights of residents are met and the dispute resolution mechanisms of the city are not bogged down in frivolous appeals or attempts to avoid the enforcement of just and properly enforced regulations. These metrics should track the average amount of time in calendar days from commencement of an enforcement action, permitting action, or application for services and seek to reduce the time spent on these actions. Additionally, these metrics should track the cost per action and seek to reduce this cost over time.

BOX 3

The Provision of Administrative Services with Technology, Estonia

The most outstanding current example of the provision of administrative and state services via the internet and digitalization is Estonia. With exceptions such as marriage and recording the transfer of real property, all bureaucratic processes in Estonia can be done online.³ A charter city should follow Estonia's example and do its best to implement the digitalization of as many administrative services and processes as is practicable. Doing so provides a high degree of transparency to the administrative systems of a charter city and serves the function of helping to create public confidence in the system of administrative law broadly.

IV. IN PRACTICE

Implementing an administrative law regime involves three main considerations: (1) formulating and passing an administrative procedures act, (2) formulating and passing the individual pieces of legislation creating the various city agencies, and (3) creating and maintaining an up-to-date register for the administrative code that contains all the regulations and ordinances enacted by the city agencies. The bulk of this section addresses the administrative procedures act and the four subparts of administrative procedures law. However, the issues of laws creating and empowering individual administrative agencies and a register for an administrative code are also discussed.

1. Administrative Procedures Law and the APA

Administrative procedures law is promulgated through a city's APA. This legislation will need to address the four areas of procedural rules: (1) altering procedure, (2) administrative enforcement, (3) executive process for core city functions, and (4) governing relations between agencies and entities. The APA should cover all these areas, but the majority of what the APA will address will be altering procedure and administrative enforcement. The other two areas of law will need to be included in the APA to the extent that there will be common executive processes for core city functions across agencies and the ability of administrative procedures to govern relationships between agencies.

1.1 The Rules for Changing the Rules of a Charter City

The rules for changing the administrative rules of a city must address five key issues: (1) notice, (2) summons, (3) minimum service standards, (4) dispute resolution, and (5) the appeals process.

1.1.1 Notice

The APA must require agencies to publish notice of the rules it intends to pass in a register to be kept by the city council. The notice should include the date and time as well as the substance and description of the rule to be passed. This notice will afford interested parties within the city the opportunity to participate in the rule-making process either by submission of written data, arguments, or oral testimony.

1.1.2 Summons

The APA should also address how an agency summons individuals and businesses. In the event an agency summons a person to give evidence, that person should be entitled to appear with a lawyer and utilize all legal protections granted by the host country's constitution and criminal law and by the city's charter.

1.1.3 Minimum Service Standards

The APA should require that agencies act in a timely manner. Residents and businesses within charter cities will lodge complaints, submit applications (permits, licenses, etc.), file service delivery requests (e.g., fill potholes), among other actions. The APA should provide limits on the maximum amount of time that an agency can take when taking administrative actions and making decisions that affect resident's rights. However, the agencies should be given sufficient leeway to make discretionary choices on how and in what timeframe an action can take place.

1.1.4 Dispute Resolution

Although businesses and residents within the charter city have a right to sue administrative

agencies and the city generally, whenever possible, agencies should use alternative dispute resolution mechanisms such as mediation when the parties agree to it; however, in instances when the matter involves a significant question of city policy or when maintaining established policies is deemed essential by the city administration, mediation should be avoided. This is because cities should want significant policy issues to be debated publicly. For further details on this, refer to the “Dispute Resolution” chapter of this handbook.

1.1.5 Review and Appeal Process

Furthermore, the APA must address how residents can challenge administrative actions, and all administrative agency decisions in a charter city must be subject to judicial review. Charter cities may establish courts to hear solely administrative matters or may permit administrative matters to be heard by the regular city judges. Additionally, being subject to public scrutiny is required to promote accountability for city agencies.

In the United States, The Administrative Procedure Act (APA), which governs the process by which federal agencies in the United States develop and issue regulations, is a good example of the sort of legislation that is required to have administrative agencies operate in a clear and non-arbitrary manner.⁵ For example, the standard for fines should be set at what is necessary to compensate for the harm caused and to disincentivize or deter similar actions in the future. Among other requirements, it mandates publishing notices of proposed and final rulemaking and opportunities for the public to comment on the administrative rules that are the subjects of the notices. In addition to setting forth rulemaking procedures, the APA addresses other agency actions such as the issuance of policy

statements, licenses, and permits. It also provides standards for judicial review if a person has been adversely affected or aggrieved by an agency's action.

2. The Rules for Administrative Enforcement

The APA should also provide what resident's rights are in an enforcement action and give guidance to agencies on how they should conduct enforcement actions. However, each ordinance that establishes an agency must also clearly list the sanctions that the agency is able to impose on residents and businesses and whether such sanctions can be imposed without judicial review.

For efficiency, charter cities should permit agencies to levy fines on businesses and residents. The ordinance should set out varying levels of these fines (depending on the transgression), including ultimate caps. Fines are important policy tools for administrative agencies to have at their disposal. While powers such as revocation of business licenses exist, they may be too harsh for minor infractions. Fines can help agencies achieve their goals by serving as a middle ground. However, it is important to note that the monetary amount of a fine that is necessary to disincentivize an action is often dependent on the wealth of the person being penalized. A set fine applied to a poor person could be devastating and excessive in terms of what is needed to deter them from taking the prohibited action in the future, whereas the same fine applied to a wealthy person could be of little deterrence. Income-based fines have been implemented in various countries, and such an approach should be strongly considered in a charter city.

However, fines cannot be seen as a substitute for judicial review. Therefore, administrative agencies

should attempt to settle all disputes with residents without fines whenever possible. In the event a resident or business is aggrieved by the imposition of a given fine, the ordinance should permit the resident to challenge the fine if it is above the relevant threshold set out in the ordinance. The APA should layout general guidelines and timelines on how and how long administrative challenges can last without substantive resolution. One of the problems that both developed and developing countries currently face is onerous procedural battles that dramatically delay projects and unnecessarily run up costs.⁶ Furthermore, the APA should direct these challenges to either the judicial system generally or to specific administrative courts specifically created for the purpose of handling challenges to administrative actions.

Conversely, if a resident or business fails to pay a fine imposed by the agency, the agency may present the details of the fine to the relevant enforcement authorities, which could be either a unit within the administration or private collections agencies contracted by the city. These authorities should be permitted to attempt to recover the fine and any reasonable costs incurred enforcing the fine, whether via property seizure, wage garnishment, or other mechanisms.

The city council should pass administrative ordinances on its first day so that city officials, under the direction of the city manager, can get to work.⁷ The administrative ordinances should establish all the agencies necessary to provide services, enforce regulations, and administer the city. The ordinances should at a minimum include (1) personnel, (2) procurement, (3) access and information, and (4) financial policies.

3.1 Personnel

One of the first ordinances passed by the city council should be a personnel policy. Necessary “provisions include a prohibition of discrimination, a definition and prohibition of nepotism, and the granting of authority to department heads to establish rules and procedures applying to their departments’ operations.”⁸ This portion of the regulations must create a system for classifying positions, compensation, a payment scheme, discipline, appeals from discipline and grievances, employee health and safety standards, hours and working conditions, authorized forms of leave, and other employment benefits, including a retirement plan, medical insurance. Furthermore, all positions in the city administration should be based on merit.⁹ The selection and recruitment of administrators and their performance management are discussed in more detail in the “Selection and Management of City Officials” chapter of this handbook.

BOX 4

Managing Personnel, Malaysia

In 2009 officials in Malaysia began discussing the Blue Ocean Strategy concept developed at INSEAD, a nonprofit private business school, as a means to promote a more creative way of delivering services and encouraging greater interagency collaboration. As the initiatives grew in number, the government decided to establish the National Strategy Unit (NSU) within the Ministry of Finance.¹⁰ The NSU was tasked with facilitating strategic collaboration between ministries, agencies, and the private sector. One of the first quick wins by the NSU involved police reform. The NSU realized they had trained policemen sitting behind desks doing administrative jobs when they could have been on the street engaged in crime prevention. All positions

in the police force were staffed by fully trained police, not administrative personnel. Immediately upon the NSU's recommendation, all police were transferred from administrative positions to crime-fighting roles. Additionally, the administrative staff was then transferred from other departments to take on the newly vacated office jobs.

3.2 Procurement

A procurement code should include at least five key elements:

1. Require that contracts be awarded to the lowest, responsible, responsive vendor.
2. Establish procedures that may become more restrictive as the anticipated cost of items to be procured increases.
3. Set a maximum amount that a purchaser can authorize above which the city manager or the council would need to approve the purchase.
4. Define and authorize emergency purchases.
5. Set forth policies and procedures for acquiring professional services, making emergency purchases, regulating and reimbursing travel that covers both employees and city officials, and authorizing the manner for disposal of surplus property.¹¹

Furthermore, it is necessary to allow city employees to have enough discretion in making procurement decisions. Increased discretion in purchasing decisions has been found to significantly reduce the amount paid for purchases of goods and services.¹²

3.3 Access to Meetings and Information

A charter city should have an ordinance that allows for access to public records, and these records should be able to be retrieved through the city's digital infrastructure. Residents and businesses must be kept informed of the charter city administration's conduct. Such a policy improves transparency and public trust.

Additionally, the general public should have the right to sit in on and observe most government meetings throughout the charter city. Public rights of access to government meetings and records are an essential ingredient to both preventing corruption and bolstering public participation.

Open meetings only work when there is sufficient notice given to the general public. Therefore, agencies hosting meetings should be required to notify the public of such a meeting within a discretionarily reasonable timeframe before it is scheduled to take place. A 2011 study “suggests that when higher-level political leadership provides sufficient or appropriate powers for citizen participation in holding within-state agencies or frontline providers accountable, there is frequently a positive impact on outcomes.”¹³ In some cases it may be necessary for public access to be limited to digital attendance if in the interest of security, health, or speedy process.

The ordinance on public meetings must also consider the privacy interests of persons and businesses in the city. The ordinance should establish particular criteria for withholding certain private information during such meetings and adhere to these criteria.

This ordinance should also give individuals and

businesses within the city the right to access information related to themselves. Although agencies should generally be permitted to charge for the cost of processing these information requests, the agency should ensure that the cost is not prohibitive and that additional barriers are not placed on individuals and businesses who have made lawful access to information requests. Nigeria is one of eleven African nations to have passed a freedom of information law in recent years,¹⁴ and its Freedom of Information Act provides a model for a charter city to emulate.¹⁵

The ordinance should also make it clear that the courts within the charter city have the right to enforce claims by individuals and businesses who are denied from lawfully accessing their information. Furthermore, in addition to the right to sue, individuals and businesses should also be afforded the opportunity to use any other dispute resolution mechanisms authorized by law, such as mediation addressed in the dispute resolution section above.

BOX 5

Public Access to Administrative Meetings, Rwanda

In Rwanda, administrative agencies that are generally regarded as competent were built from scratch following the Rwandan genocide. The country did this by utilizing some of the same mechanisms we suggest above. In 2007 a Strategy and Policy Unit (SPU) was established within the Office of the President and was given a special remit to take broad authority over government interventions in order to ensure consistency in implementation. Rwanda understood that for agencies to offer quality services to the country's residents and businesses, they needed policy analysis and oversight.¹⁶ The country understood its importance and sought a grant from the African Development Bank to create the agency and build up its ministries, departments, and agencies. Today Rwanda is generally considered to have one of the most competent civil services on the continent.¹⁷ Furthermore, Rwanda has developed administrative procedure manuals pursuant to national law and executive order.¹⁸ Such manuals aim to harmonize the way in which administrative actions are carried out.¹⁹

Additionally, Rwanda has done an outstanding job introducing technology into the functioning of its administrative agencies. The country's National Dialogue Council, or *Umushyikirano*, is an annual event where regular Rwandans get the chance to ask questions of their national leaders and sit in on various proceedings. The council's website boasts that "those unable to attend in person at Rwanda's parliament building can participate via telephone, SMS, Twitter, and Facebook as well as follow the debate live on television and radio."²⁰

3.4 Financial Policies

The financial policies of a charter city should set out methods to keep the city's finances healthy and transparent. Important elements include setting out the dates for the fiscal year, the basis of accounting, a balanced budget requirement, fiscal reporting requirements, how specific revenues are

generated, and the requirement for an annual independent city audit.²¹

4. The Rules Governing Relations

Should there be any ambiguity about the relationship between city agencies in the city charter that must be resolved, then the APA

should seek to resolve these ambiguities. Additionally, the APA can create any procedures that various city agencies may need to properly coordinate with each other should the need to do so arise.

4.1 Law Creating Administrative Agencies

There will need to be multiple acts enabling the various city agencies. Requiring that each agency has its own separate enabling act will help to ensure that later revisions to an enabling act or reforms to an agency do not bring in contentious, unnecessary, or accidental revisions to one or more non-target agencies that were lumped into a single act with the agency that is the one being reformed or altered. This legislation will define what the agency does, how it is structured, how it will operate, and how it will be regulated. Each such act will need to lay out the specifics of the agency that it creates and governs and include built-in structures that allow for compliance with the APA.

4.2 Creating a Register for the Administrative Code

An administrative code is the sum of the regulations that are created by a charter city's agencies. Administrative code differs from legislation in that it is created by administrative agencies and not by a legislature, which creates legislation. The entirety of the code should be kept in a single database known as a register. This register will allow residents to search all the regulations that a city has created. Such a system should be online and must be easy for the residents to use in a manner that allows them to comply with the regulations and use the information to defend themselves in the event that administrative action is brought against them. The register is substantially related to the issue of notice discussed

above, but whereas notice deals with the procedural requirement, the register itself is the administrative manifestation of the requirement. It is likely that a city will need to have a separate register administration—or a register unit within an administrative agency—that does the work of fulfilling the requirements for providing notice of regulations to the city residents.

4.3 Disputes with an Administrative Agency

A charter city will need to determine how it will handle disputes between administrative agencies and residents and how these disputes will be related to how the charter city and the host country negotiated the charter city's status. Legally, states have sovereign immunity, meaning that they cannot be sued except where they have made an exception through law. The charter city and host country government must come to an agreement as to whether or not the charter city will have the sovereign immunity of the country or if the charter city is a private entity disconnected from the government. If the charter city has sovereign immunity, then it will need to include provisions in its APA that waive sovereign immunity in necessary cases to allow for suits against it. Furthermore, if the charter city has sovereign immunity, then it will also need to be worked out between the host country government and the charter city whether or not the national government will be able to be held liable for the city administration's debts. These are key issues that relate to administrative law but will need to be addressed when the host country writes its charter city enabling law or when the host country and developer are negotiating the agreement for founding the charter city.

Finally, a charter city should also consider the creation of an internal strategy unit, whether for

the city government broadly or within individual agencies. Such a unit would analyze the issues relevant to the agency and help with policy formation. The unit should focus on building capacity within the agency to make prudent, evidence-informed policy decisions. This internal strategy unit should develop insights into future trends and communicate those insights across

agencies and to decision-makers. Also, like Singapore's Center for Strategic Futures,²² the agency can conduct annual conferences where it shares its thoughts with the general public and engages with a wide range of government leaders, civil servants, community members, and thought leaders both within the charter city and in the broader host country.

¹ Charter Cities Institute. (2020a, June 22). Model Charter. Retrieved April 14, 2021, from <https://www.chartercitiesinstitute.org/post/model-charter>.

² Charter Cities Institute. (2020b, June 22). Model Legislation. Retrieved April 14, 2021, from <https://www.chartercitiesinstitute.org/post/model-legislation>.

³ Heller, N. (2017). Estonia, the Digital Republic. Retrieved April 14, 2021, from <https://www.newyorker.com/magazine/2017/12/18/estonia-the-digital-republic>.

⁴ E-estonia. (2020, May 05). Solutions - e-estonia. Retrieved April 14, 2021, from <https://e-estonia.com/solutions/>.

⁵ See generally, Administrative Procedure Act, 5 U.S.C. § 551 et seq., <https://www.archives.gov/federal-register/laws/administrative-procedure>.

⁶ See, for example, Dougherty, C. (2018). *Golden Gates: Fighting for Housing in America*. Penguin Press: New York.

⁷ Mark Levin. (2020). Lessons for Charter Cities: From Decades as a City Manager. The Charter Cities Institute. Available at: <https://www.chartercitiesinstitute.org/post/lessons-for-charter-cities-from-decades-as-a-city-manager-in-the-us>.

⁸ Ibid.

⁹ Ibid.

¹⁰ World Bank (2018). "Breaking Down Silos: Malaysia's experience in strengthening inter-agency cooperation." World Bank Group: Washington, DC.

¹¹ Ibid.

¹² Coviello, D., Guglielmo, A., Spagnolo, G. (2016, August 7). Effect of discretion on procurement performance. Available at: <https://voxeu.org/article/effect-discretion-procurement-performance>.

¹³ Devarajan, S., Khemani, S., and Walton, M. (2011). Civil Society, Public Action and Accountability in Africa. HKS Faculty Research Working Paper Series RWP11-036, John F. Kennedy School of Government, Harvard University.

¹⁴ UNESCO (2021). *Freedom of Information in Africa*. Paris: United Nations Educational, Scientific, and Cultural Organization. Available at: <https://www.unesco.org/new/en/communication-and-information/freedom-of-expression/freedom-of-information/foi-in-africa/>.

¹⁵ Freedom of Information Act (2011), (Nigeria), <https://www.cbn.gov.ng/FOI/Freedompercent20Ofpercent20Informationpercent20Act.pdf>.

¹⁶ https://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/Rwanda_-_Support_for_Policy_and_Strategy_Development_-_Appraisal_Report.pdf.

¹⁷ Benjamin Chemouni, "The politics of core public sector reform in Rwanda," Effective States and Inclusive Development Working Paper No. 88, July 2017, http://www.effective-states.org/wp-content/uploads/working_papers/final-pdfs/esid_wp_88_chemouni.pdf.

¹⁸ See, for example, Republic of Rwanda. (2011). Rwanda Aid Policy Manual of Procedures. Available at: http://www.devpartners.gov.rw/fileadmin/templates/documents/Rwanda_Aid_Manual_of_Procedures.pdf.

¹⁹ Ibid.

²⁰ See <http://umushyikirano.gov.rw/about-umushyikirano/>.

²¹ Mark Levin. (2020). Lessons for Charter Cities: From Decades as a City Manager. The Charter Cities Institute.

²² See <https://www.csf.gov.sg/who-we-are/>.

1.3 TAX POLICY AND ADMINISTRATION

I. KEY TAKEAWAYS

- ✓ Efficient tax administration that effectively raises revenues that are then channeled into the provision of vital urban investments is critical to the success of a charter city.
- ✓ Charter city revenue authorities should prioritize two main values: (1) minimizing the distortion of productive activities and (2) fairness and reciprocity.
- ✓ These two values suggest that charter city administrations must balance progressivity concerns with an imperative for tax rates to be competitive.
- ✓ This chapter reviews two key decisions that charter city administrations must make when establishing their tax systems: (1) selecting the optimal taxes to enact and (2) setting up and administering the chosen tax policies.
- ✓ The three main types of tax policy that this chapter recommends are, in descending order: land value taxes/land lease payments, Pigouvian taxes, and if need be consumption taxes (e.g., value-added tax).

II. INTRODUCTION

A well-functioning tax system that collects adequate revenues is critical to the success of any charter city. City tax authorities must make it easy for businesses and residents to pay their taxes. Effective tax policies will also balance the need to be competitive with the need for revenues to deliver public services to its residents and businesses. Additionally, sufficient revenues are required to make the public investments necessary to accommodate rapid urban expansion.

Without urban investments in roads, public transit, schools, hospitals, housing, garbage collection, running water and sewage systems, and electric utilities, the charter city will not be an attractive place for individuals, families, or firms to locate. In cities across the Global South where urbanization rates have outpaced the ability of city governments to pay for these public investments, the downsides of density begin to take root: expansive slums, air pollution, traffic congestion, crime, pervasive informality, and the spread of contagious diseases.

Despite the importance of tax revenues to combat these downsides, most governments in the Global South (national, state, and local) collect significantly fewer taxes as a percentage of their GDP than compared to their rich-country counterparts. This is the result of several challenges that hamper tax administration in low-income contexts, the three most salient of which are political resistance to reform, low administrative capacity, and low rates of tax compliance.

First, political and business elites that benefit from the current state of affairs have an incentive to subvert any attempts at reform. So as a general rule, elites—including political elites—across much of the Global South succeed in evading or avoiding taxation under the current system and therefore do not want to see it altered. Both devolving tax authority to the charter city administration and locating charter cities on a greenfield site (a sparsely populated area) within a host country can help minimize this problem of reform-resistant political elites.

Second, the low administrative capacity of many revenue authorities in low-income countries naturally hinders tax collection.¹ Large upfront investments in technology and staffing capacity are often required to fix these administrative issues, as well as selecting tax policies that are relatively simpler to administer and enforce.²

Third, a lack of tax compliance among citizens of low-income nations largely stems from the perception among these citizens that they receive no public services in return for the taxes they pay.³ It follows then that such citizens have very little incentive to comply with the tax regime. Therefore, any improvements in tax administration will require a clear reciprocal connection between taxes paid by residents and the perceived benefits they receive in return.

In sum, sufficient tax revenues are a prerequisite for a charter city administration to attain a baseline level of administrative capacity, which in turn better allows the administration to effectively deliver public goods and services to the city. Without such revenues, city administrators will be unable to channel taxes into the urban investments needed for a growing city.

III. VALUES AND GOALS

The tax administration of a charter city should strive toward two key values: taxation should be (1) **minimally distortive of economic activity** and (2) **fair and reciprocal**.

Before overviewing the goals that the charter city administration should track in order to measure progress around the above two values, it is helpful to clearly lay out the components that make up total tax revenues (Formula 1.1):

Formula 1.1—*Total Tax Revenue*

$$\text{Tax revenue} = (\text{registered tax base} - \text{exemptions}) * \text{taxable value determined by valuation} * \text{legally defined tax rate} * \text{tax collection}$$

Table 3. Summary of Values and Goals for Tax Policy and Administration

Value	Meaning of the Value	Measurable Goals
Minimally Distortive	<ul style="list-style-type: none"> —Some taxes are more distortive than others. A minimally distortive tax system is one where decisions are made on their economic merits and <i>not</i> for tax reasons. —Minimizing distortions also means that <i>paying</i> taxes should be simple and easy for individuals and firms, and <i>administering</i> taxes (assess, sensitize, notify, collect, and enforce compliance) should be simple and easy for tax authorities. —Minimizing distortions entails a tax system that is competitive. That 	<ul style="list-style-type: none"> —Broadly, this chapter of the handbook follows recent tax research⁴ in concluding that land value taxation (LVT) is the least distortive tax. —A key indicator for minimizing distortions is the average amount of time/cost for an individual/firm to pay their taxes. —Another indicator for tax simplicity and ease that can be utilized is the 'Paying Taxes indicator' published annually as part of the World Bank's <i>Doing Business</i> reports.⁵ —To foster competitiveness, tax rates should be, at the very least, more lenient than in the host country as a whole. Ideally, the goal that tax authorities should prioritize here is to use

	is, while tax collection is essential to finance needed public services, ultimately charter cities must attract firms, entrepreneurs, and investment (both domestic and foreign).	countries within the regional trading bloc of the host country as benchmarks (e.g., ECOWAS, ASEAN, SADC).
Fair and Reciprocal	<p>—Fairness entails that the tax system is both impersonal and progressive.</p> <p>—An impersonal tax system means that no individual or firm should be able to shirk their prescribed taxes based on wealth or connections (<i>everybody pays taxes</i>).</p> <p>—Progressivity means that while <i>everybody pays taxes, higher earners pay higher taxes</i>.</p> <p>—Reciprocity occurs when increases in tax revenues correspond in a reciprocal way to improvements in public services for residents.</p>	<p>—The impersonal and progressive elements of tax fairness can be measured by the proportion of total revenues paid by different quintiles or deciles across the wealth distribution. Each subset of the tax base should have a predefined goal based on some benchmark jurisdictions.</p> <p>—Reciprocity can be measured by the ratio of taxes collected to public goods provided (perhaps broken down by the <i>type</i> of public good), and this data should ideally be measured at the neighborhood level so different neighborhoods across the charter city can be benchmarked against each other.</p> <p>—A fair and reciprocal tax system is not corrupt. A proven way to combat corruption is by lowering the amount of face-to-face interaction between taxpayers and tax collectors.⁶ This time should be tracked and minimized.</p>

Two further items before proceeding:

The first pertains to administrative capacity. To ensure that the city tax authorities have the administrative capacity to allow them to achieve the goals laid out in this section, the total number of staff at the revenue authority as well as the turnover rate of that staff should be tracked. Very few tax officials or a very high rate of turnover for these officials likely translates into low administrative capacity. Low administrative capacity is typically

associated with lower total tax revenues collected or lower quality staff (leading to higher tax avoidance/evasion).

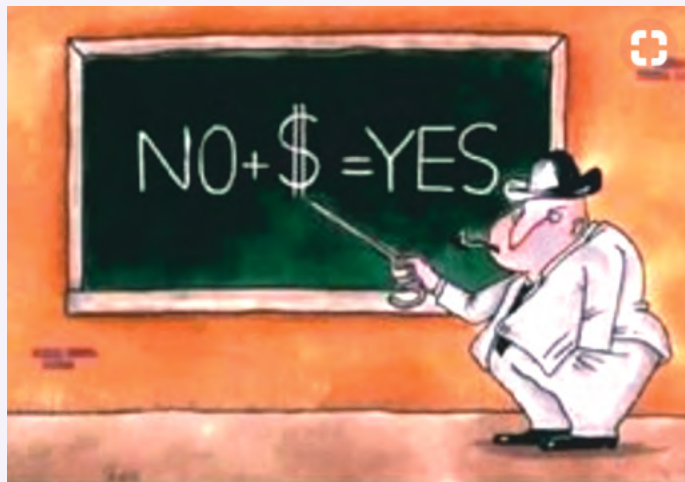
The second item pertains to economic rents. An understanding and precise definition of the concept of economic rents is important from the outset of this chapter, as the concept is alluded to throughout. For a more detailed discussion of economic rents, see Box 6 below.

BOX 6

Defining Economic Rents

Broadly, pure economic rent is any surplus that can be taxed without affecting production incentives.⁷ In particular, economic rent is any payment to a factor of production (land, labor, capital) or owner of a factor of production in excess of the costs needed to bring that factor into production. Precisely because economic rents are in excess of the costs of production, taxing them will *not* distort production decisions.

For example, because land and its natural resources are produced by nature at no cost, it follows from the above definition that to a particular owner or monopolist, any revenue streams flowing from this land, such as oil or other mineral resources underneath it, can be considered economic rent. Naturally, many individuals attempt to gain privileges through the political arena—such as lobbying for monopoly rights—that give them special access to economic rents. These individuals are called rent-seekers. Rent-seeking causes distortions because resources that would have otherwise gone to productive activities are misallocated toward rent-seeking activities to gain special privileges. For this reason, rent-seeking behavior has been shown to be inefficient.⁸ Therefore by taxing economic rents, not only are there no production distortions, but there are efficiency gains through curbing rent-seeking behavior.



Rent-seeking behavior produces economic distortions.

A general principle of the charter city revenue authorities should be to tax economic rents whenever and wherever possible and, relatedly, to *not* tax productive activities. For example, income derives from the productive activity of labor, and so the charter city should avoid taxing income to the extent possible. Following this principle will result in fewer distortions to production decisions, such as how one deploys their labor or their capital. In contrast, by the definition of economic rents (see Box 6), taxing these rents will *not* distort productive activities, thereby increasing productivity and efficiency.

IV. IN PRACTICE

This section overviews the step-by-step process of setting up a tax system and the associated city tax agency. This process can be distilled into (1) the prerequisites that need to be in place and (2) tax policy selection and tax administration set up.

1. Prerequisites

This section assumes that (1) tax authority is devolved to the city level, and (2) a concession agreement, including an agreement on revenue sharing, has been reached between the charter city and the host country.

These two prerequisites merit some elaboration. The first assumption regarding devolved tax powers effectively implies that all firms and residents *within* the charter city jurisdiction are exempt from the regular taxes that apply in the host country's territory. Instead of these regular taxes, the charter city administration is free to raise its own revenue through taxes and charges of its choosing. If these new tax policies prove effective, the host government is encouraged to adopt these policies more broadly across the country. Of course, while full autonomy for the charter city revenue authority is ideal, in practice, negotiations between the host country and the charter city will

ultimately determine which taxes the city is exempt from and which taxes the host government may still require city residents and firms to pay. Whatever taxes or tax exemptions apply within the charter city as a result of these negotiations should be clearly listed in the original concession agreement, and this information should be made publicly available. Additionally, this handbook recommends that a revenue-sharing agreement also be included in this original concession agreement, which should specify a certain percentage of the charter city's yearly revenues be channeled to the host country.

Because of the broad autonomy given to enact the charter city's own tax policies and to raise its own revenues, an important consideration is to ensure this autonomy isn't abused.⁹ In this vein all revenues raised within the charter city jurisdiction should be deposited into a charter city trust, including any and all taxes, fees, charges, and lease payments within the jurisdiction. This revenue should then be paid out to the relevant parties, including the charter city developer and the host government, based on a pre-agreed upon formula. Again, both the relevant actors and the formula will be negotiated and specified within the concession agreement.

2. Tax Policy and Administration Setup

This section overviews the key decisions that must be made by the charter city administration around taxation.

Key Taxation Decisions

2.1 Deciding the Optimal Taxes to Enact

2.2 How to Set Up and Administer the Chosen Tax Policies

2.1 Deciding the Optimal Taxes to Enact

One of the first decisions that a charter city needs to make is which taxes to impose within its jurisdiction in order to most efficiently pay for needed urban infrastructure and for the delivery of other essential public services. To best achieve the values and goals outlined in Part III of this chapter (above), this handbook recommends that the city revenue authority prioritize land value taxes (LVTs) or, relatedly, land lease rents as the main source of its revenues. Secondly, the revenue authority should levy Pigouvian taxes on pollution and congestion, among others. Thirdly, if these first two sources do not raise enough revenue, then a value-added tax (VAT) should be levied.¹⁰ The subsections below explain why LVTs/land rents, Pigouvian taxes, and VATs are the recommended sources of revenue for attaining the values and goals (above). LVTs/land rents and Pigouvian taxes are favored over VAT because they also abide by the general principle of taxing economic rents. (See Box 6 above.)

2.1.1 Land Value Taxes and Land Rents

First, it is important to precisely define what is meant by land versus what is meant by property, also referred to as *improvements* or *buildings*. Real estate is made up of both land and property/buildings. Because the underlying characteristics of land and buildings are fundamentally different, taxes on one or the other have completely different effects on incentives, distortions, and deadweight losses, and in turn on individuals, communities, overall welfare, and economic growth.

Property (aka improvements or buildings). Property or buildings are constructed by the labor of people, and producing these buildings incurs a cost.

Buildings depreciate and devalue over time and require repairs and, ultimately, replacement.

Land. Land is comprised of all ground and other natural resources freely supplied by nature, including water, minerals, forests, air, soil, etc. Unlike property, land is produced by nature without incurring a cost. Other key characteristics of land for the purposes of this chapter are its particular location, its immobility, and its fixed supply.

Land value. Land value, or land rent, is the value that a particular plot of land generates purely through that land's social and natural endowments, *not* through the activities or actions of people on that land (i.e., buildings are *not* part of land value). Because there is a fixed supply of land, demand is the only determinant of land value.

With these definitions in mind, let's consider that the chapter "Land Registration and Administration" of this handbook recommends that the charter city developer pursue a leasehold land tenure system instead of freehold tenure. The reasons are provided in that chapter and will not be rearticulated here. Given this recommendation, it should be noted how LVTs relate to land lease payments (i.e., rents).

An LVT is typically seen as a tax that is levied on land value only, not on buildings and not on a combination of buildings *and* land. Under an LVT an individual would pay a specified percentage of the total unimproved land value that they own. However, under the leasehold model, individuals do not strictly *own* land; they lease it. Therefore,

LVTs are levied on freehold land, and lease payments or rents are an equivalent concept charged on leasehold land.¹¹ The two concepts—LVTs and rents—are both analogous forms of land value capture. Thus a lease payment of 100% of the market rental value of land is effectively the same as a 100% land value tax.

While the handbook recommends the leasehold model and therefore raising revenues mainly through land rents, this chapter includes a discussion of *both* LVTs and land rents. This is for two reasons. First, the two revenue sources are extremely similar conceptually, with only some minor differences that are discussed. Second, some charter cities may opt for a freehold model over the recommended leasehold model, in which case this chapter will still be useful to them.¹² Accordingly, the terms land value tax and land rent are both used throughout this chapter.

Land value taxation/rents should be the prioritized methods by which city revenue authorities raise municipal revenues because they have several benefits over other sources:

1. LVTs/rents allow the city administration to capture the appreciation in land values that arises from forces beyond a landholder's control, namely (1) urbanization and (2) community investments such as in roads or schools nearby. Land values will rise as the city's population increases year-on-year, resulting in increased demand for land. Land values will also rise as a result of urban investments made by the city administration to accommodate urban expansion. Instead of the landholders deriving all the benefits from increased land values caused by population growth

and urban investments, which these landholders played no part in, this appreciation can be captured and channeled into the provision of more public goods and services for the broader community. That is, the community can capture economic rents. Not to mention, those whose land values suffer as a result of nearby investments or infrastructure projects—or lack thereof—will, in effect, be compensated for their losses in the form of lower taxes/rents. In this sense LVTs/land rents are **fairer than revenues raised from other sources**.

2. Annual LVTs/monthly rents permit the charter city administration to **increase its returns on investment**. Because community investments increase land values over time, the city then effectively increases its projected future streams of revenue. Moreover, applying the tax *annually* or rents *monthly* instead of after an event like a transfer or inheritance means these taxes/rents will be *regular* and *long-term*. Augmented future streams of income can then allow the city administration to be better placed to seek financing for community projects and urban infrastructure from international capital markets.
3. Because the supply of land within a charter city is fixed, taxing/leasing results in no associated distortion and in fact leads to city land being used more efficiently. For example, while taxes on work or on savings may cause individuals to work or save less because the supply of work and savings can be adjusted in response to the tax, this isn't the case for land. In addition, because

annual LVTs/monthly rents are not merely applied at the sale of the land, these charges do not hinder the transfer of these assets to their most efficient use. Therefore, raising revenue through LVTs/land rents is, in this way, **minimally distortive**. This characteristic aligns with the general principle of this chapter to raise revenues through taxing or capturing economic rents, not taxing productive outputs like income or savings.

4. Land value taxes/rents are, in essence, levies on *unearned* wealth. Land value is unearned because, with few exceptions, it is created by the community and outside forces—such as community investments and population growth—*not* by the landholder themselves. Therefore, capturing this land value created by society and channeling it back into societal investments **can promote progressivity**. In addition, **progressivity is further bolstered** because the ownership of land is highly associated with the distribution of income across the globe.¹³ However, as these levies are fundamentally applied on assets and not on income, they may be difficult to pay for individuals and households who are asset-rich but who do not earn a comparably high income (cash-poor). Some may assert that in this instance, an LVT-/land rent-based revenue system would be regressive and could result in low-income (but asset-rich) individuals being forced off their land (especially in the urban core). But this regressive critique is, for the most part, inaccurate. This is because in the charter city, land use and zoning¹⁴ would not restrict these cash-poor but asset-rich households from either (1)

selling their land or their lease to a developer or (2) building additional units onto their households that they could then rent out or sublease, which would provide the cash income they need to pay the LVT or land rent. Both of these actions—(1) and (2)—are incentivized by LVTs/rents and both result in the more productive use of scarce urban land.

5. As land taxes/public land leases around the world are overwhelmingly imposed by *local* governments in order to fund *local* public goods and services, they can, in effect, be seen as benefits taxes. By virtue of being easily connected to the provision of tangible municipal services, LVTs/land rents can **enhance reciprocity and accountability of local officials, which in turn can spur increased tax compliance by residents.**¹⁵
6. Land is a highly visible asset. This makes it

much easier and simpler for charter city revenue authorities to both identify and monitor compliance of LVTs/rental payments. As such, individuals and entities evading LVTs/rents will be more readily legible to the city revenue authorities and can be penalized accordingly (more so than, for example, when income taxes are evaded). On top of this, ordinary tax planning on, say, capital or labor can result in the removal of the taxable asset to a lower-tax jurisdiction (i.e., the money and labor can easily pick up and move). But land *cannot* be similarly moved; it is fixed and thus less susceptible to evasion or avoidance.

Given the above benefits, LVTs/land rents align with all the values enumerated in Part III (above). Therefore, this handbook sees LVTs/rents as essential ingredients to raise sufficient revenues that permit the level of community investments needed to accommodate rapid urban expansion.

BOX 7

Land Lease Financing for Infrastructure Investment in Hong Kong

Hong Kong issues land leases that grant *use rights* to private entities or individuals to develop this land, while Hong Kong retains ultimate ownership. Through the steady stream of revenues that come from appreciating lease payments, Hong Kong has been able to finance significant urban infrastructure expansion, sorely needed in one of the densest cities in the world where the growing population depends on amenities like public transportation.

Hong Kong has an estimated 11 million daily commutes on public transit (including rail, buses, ferries, taxis, and others). This means over 90% of all motorized journeys in Hong Kong are via its public transportation system, the highest rate in the world. This success is largely due to Hong Kong's Mass Transit Railway Corporation (MTRC).

Unlike other transportation authorities across the globe, MTRC does not rely on any government subsidies or public support. Yet it's still very profitable because MTRC relies on land-based financing, leasing out the rights to construct new transit lines and stations to developers while retaining ownership over the land and coordinating the projects. In fact, only 20% of MTRC's profits derive from its transit business, with the bulk of profits stemming from real estate. It's this model that makes the MTRC simultaneously one of the most profitable *and* best served public transit systems in the world. Moreover, given the Hong Kong government has a ~75% ownership stake in MTRC, MTRC profits can contribute to government revenues, allowing for more

effective or expanded public service delivery in other domains important to its citizens.¹⁶ Ultimately, instead of lucky private individuals who happened to own a strategic patch of land getting rich off these infrastructure projects, the Hong Kong people and government were the ones who benefited. Indeed, Hong Kong has been able to recoup an estimated 80% of all infrastructure investments from 1970 to 1991 as a result of land-based financing.¹⁷



The picture depicts the Hong-Kong Metro station where 415,900 sq.m. of fully integrated offices, retail and hotel facilities were developed by MTRC using joint property development programs. This comprises notably the two International Finance Centre (IFC) towers.

2.1.2 Pigouvian Taxes

In most settings the market, left to its own devices, results in the most efficient allocation of resources such that everyone is made better off. By allowing free individuals to engage in unconstrained and voluntary mutual exchange, societal welfare is said to be maximized. However, there are instances where the interests of those directly involved in a market transaction do *not* align with the interests of society as a whole. For example, motorists may ignore the effect of their emissions on air quality, smokers may ignore the second-hand smoke they impose on passersby or the extra costs they add to

their health system, and farmers may ignore the way their pesticides impact neighboring soil quality. In these cases market prices—of gasoline, cigarettes, or pesticides—fail to reflect these broader, external costs to society, and therefore the market over-provides these goods or actions. Hence, these instances are referred to as market failures, and these external costs are called *externalities*.

Pigouvian taxes attempt to internalize such negative externalities by levying a tax on harmful goods or actions.¹⁸ This tax increases the market price so that the price now takes all costs (private

costs and external social costs) into account. By increasing the market price, fewer of the harmful goods are demanded, or fewer of the harmful actions are taken, which in theory corrects the market failure by restoring the optimal allocation of resources.¹⁹

Pigouvian taxes are often a favored way of altering behavior over other methods of more coercive regulation or outright bans because they tend to be less distortionary. That is, whereas regulation uses blanket rules that can be costly, misguided, subject to corrupt influence, and ridden with onerous red tape, Pigouvian taxes use the price mechanism to adjust behavior more efficiently. Since all individuals are subject to the same tax, those who can adjust their behavior *most easily* will do so the most, while those who find it very costly to adjust their behavior will opt to simply pay the new (taxed) market price. Thus, the 'right' people are deterred from the harmful good completely, and the others now pay for the social costs they inflict. In this way Pigouvian taxes align with the general principle of this chapter: by raising revenue they minimize the use of other distortionary taxes that adversely impact productivity and at the same time actively help bring about more efficient and less harmful outcomes.

Pigouvian taxes are recommended throughout this handbook to correct market failures while simultaneously raising revenue for the charter city. For example, a Pigouvian tax on traffic congestion is discussed in both the “Environment and Energy” chapter as well as the “Land Use Regulation and Building Regulation” chapter. Moreover, the “Environment and Energy” chapter also recommends a Pigouvian tax on carbon and other forms of polluting activities. Other examples of this tax not discussed in this handbook include luxury taxes, tobacco taxes,

alcohol taxes, and the unfortunately named fat taxes, among others. Specific Pigouvian taxes are explained in further detail below.

2.1.3 Value-Added Taxes

VAT is a form of consumption tax, also sometimes called a goods and services tax, or GST. The main features of VAT include the following:

1. VAT is a **broad-based** tax that is imposed at several stages of production/across the supply chain of goods and services. The key draw of VAT is that, in theory, it is **minimally distortive**. That is, the taxation of inputs is credited against the taxation of outputs. If taxes collected from inputs are greater than taxes collected from outputs, then this difference is refunded. For example, an exporter would pay VAT upfront on its production inputs, and then *after* it actually exports the finished product, the exporter would reclaim the amount it paid on its inputs from the taxing authority. The result is that VAT ends up being a tax on final consumption while remaining neutral on production decisions—again, in theory.
2. A common element of VAT is not to apply it to *essential* goods or services such as healthcare services, food and water, necessary pharmaceuticals, and home services like electricity. These exceptions make VAT a more **progressive tax**; without them, critics of VAT assert that it would be regressive as it'd be imposed relatively heavily on individuals that may not be able to afford these essential goods when they're taxed. This handbook will go through arguments for and against this claim in

more detail below. But broadly, VAT revenues can simply be reimbursed for low-income individuals and households if progressivity is a major concern.

3. One of the greatest advantages of VAT is that by design it generates a detailed paper or electronic data trail of business transactions. On top of this if implemented appropriately, it then incentivizes these businesses to record and submit transaction data to the revenue authorities because if they don't, they can't reclaim the VAT they've paid. In this sense, VAT makes it more **difficult to evade taxes** and is **self-enforcing**.

2.2 How to Set Up and Administer the Chosen Tax Policies

This subsection breaks down how to set up and implement the above-recommended taxes and charges in practice. It goes through each of the two main recommended tax policies—land value taxes/land rents and Pigouvian taxes—first. It then covers VAT, noting that VAT should only be implemented if additional revenue sources are required.

For each of the tax policies, this subsection overviews the main questions that need to be answered by the charter city revenue authority: (1) what to tax, (2) who to tax, (3) any exemptions, and (4) what tax rates.

2.2.1 Land Value Taxes (Freehold Tenure) and Land Rents (Leasehold Tenure)

❖ What to tax?

As noted above, the value of a given piece of real estate when it's sold on the market is a combination of the value of the land and the value of any immovable property within the parcel.

As such, charter city officials trying to raise own-source revenue from land and/or property typically have three options available to them when deciding precisely what to apply a tax or charge to:

- property** (aka improvements or buildings)
- some **combined value of land and property**
- land** (but *not* property on this land; also called *unimproved* land)

This handbook recommends that land rents be applied at 100% of the market rental value of the *land* only, under leasehold tenure. Or in the analogous concept under freehold tenure, a pure land value tax, taxing only unimproved land without taxing associated property, buildings, and/or improvements. This recommendation is explained below.

—**Property (aka improvements or buildings)**. There are two main reasons why taxing property alone is not recommended. First, the value of buildings themselves does not reflect any value addition resulting from population growth or from community investments in roads, schools, or hospitals (i.e., value that's added by society). If taxation is the price paid for public services, merely taxing

buildings alone is not a justifiable price as it does not include how public investments and urbanization have affected the broader value of land. Second, because public investments do not increase the value of buildings alone, future streams of revenue from taxes on a property cannot be used by charter city administrations to secure financing from capital markets. Such financing requires projected future streams of revenue to increase.

—**Combined value of land and property.** Combining the taxation of land value with the taxation of property can, on the surface, start to address the two main reasons outlined above for not taxing buildings alone. Not to mention, of the three options given, this combined tax on some composite of property and land is the most commonly implemented option.²⁰ Still, this handbook does not recommend this option as taxes on property (buildings and improvements) impose significant distortions that result in overall deadweight losses. To see this, recall that the definition of property (see the beginning of subsection 2.1.1 above) points out that buildings depreciate over time and therefore require investments to be spent on regular repairs and ultimately on replacements. Imposing a tax on buildings means individuals will *not* engage in the optimal level of investments in building repairs over time, which results in buildings being less safe, less beautiful, less useful, and shorter-lived (i.e., replacement comes earlier) than they otherwise would have been without being taxed. Moreover, taxing buildings also discourages vertical construction, and by doing so adversely

impacts city density. Lower densities diminish agglomeration economies—one of the main benefits to city life.²¹

—**Land.** There are two benefits to taxing land but *not* immovable property. First, because the supply of land in the charter city is fixed, a tax on land will not distort investments in urban property or building improvements like taxes on property can. This aligns with the general principle of this chapter of taxing or capturing economic rents, not distorting productive activities. Second, a tax on the value of land incentivizes efficient land use because individuals taxed on land value are discouraged from holding onto undeveloped or under-developed land. This feature has the added benefits of decreasing urban sprawl, reducing land speculation, and facilitating the transfer of land to its most productive use.

The same logic outlined above applies to the leasehold model. Land rents should therefore apply *solely* to unimproved land.²² Precisely how this land rental value should be calculated is discussed below under *What tax rates?*

❖ *Who to tax?*

Under the freehold model, the question of who to levy a land value tax on—owners or tenants/occupiers—has historically been quite dependent on the quality of land registration and land administration systems. This is because, while it's more progressive to tax the landowner, as owners are usually wealthier than tenants and can use the rents they receive from renting these assets to pay LVTs, it's typically much more administratively difficult. Such difficulty stems

from dysfunctional land administration systems that often fail to accurately track formal property rights, making it easier to both identify and impose LVTs on tenants. Tenants could then reduce their rent payments owed to the owner by the amount of the tax. However, because a charter city will have set up an efficient and accurate land administration system at its conception (see the chapter “Land Registration and Administration” in this handbook), owners should therefore pay the land value tax from the outset.

Under the leasehold model, where the charter city

is effectively the owner of all city land and is therefore *always* a party to any land transaction in the city, the above issues regarding who to tax are mostly irrelevant. In this model the charter city itself undertakes the registration, monitoring, billing, and enforcement of all leases and rent payments within the city. So it's extremely unlikely that the city revenue authorities will not know the identity of their lessees. This is in stark contrast to a freehold tenure system, which necessarily imposes the responsibility for title registration on the individual parties involved in each land transaction.



❖ *What tax rates?*

Similar to the above case of exemptions, several varying tax rates or rental values for land increases administrative complexity. Therefore, for administratively weak jurisdictions, a single rate is likely the best policy option. However, charter cities are premised on the fact that they possess high administrative capacity, especially in later phases, and three main benefits can be gained from implementing a limited number of variable rates or charges.²⁴

—**Taxing undeveloped land at higher rates.** Taxing or charging rent on undeveloped or under-developed land at *higher* rates discourages land speculation and instead encourages rapid urban development to take advantage of the lower rent or tax liability. For example, Gaborone City in Botswana taxes under-developed land at four times the tax rate of more developed parcels.²⁵

—**Varying rates/rents for different types of land.** Another reason to apply differential LVT rates or rental values for different types and/or for different land uses—residential, commercial, industrial—stems from the desire to achieve aspects of a city's master plan or industrial policy. While such a strategy can work, master plans should be thought of more as living and evolving documents that can be altered as circumstances on the ground change, not as set in stone. Therefore, if residents and businesses, as a result of their aggregated individual choices over time, do not seem to want to adhere strictly to the dictates of a master plan, the tax system should not be used to

force a master plan upon the charter city.²⁶

—**Compensate entities that increase land values.** Another option involving varying LVT rates or rental charges is one where the city revenue authorities collect the LVT or rent payments on all parcels within the city but then compensate residents and businesses in proportion to the amount these entities contribute to land values. For example, this could be done for utility companies, schools, hospitals, and any other group or individual that increases land values in the city. The city revenue authorities would calculate the proportion of land value increases resulting from the actions of these entities and then pay them accordingly using a consistent, transparent, and publicly available formula.

While the above three reasons in support of variable tax rates/rents can definitely reap benefits for charter cities, a few considerations must be taken into account. Firstly, with the increased complexity that arises from variable rates or rental charges, many residents may appeal their assessments and will be especially resistant if they're valued very close to the cut-off for a higher rate. Such appeals and resistance necessitate a lot of data to back up tax rate/land rent decisions and can result in costly and time-consuming litigation. Not to mention, it also heightens the possibility of error.

Secondly, more complex tax systems make communicating the rationale behind the tax rate/rental value choices all the more difficult. In situations where residents don't understand why they're being taxed at a particular rate or why their rent is higher than their neighbor's, compliance will decline, especially in the Global South, where

many citizens are already skeptical of complying with dysfunctional revenue authorities.

To get a sense of common tax rates applied, we can look at prevailing rates across the globe, keeping in mind that these are tax rates levied on both land *and* property combined. In the US and Europe, land/property taxes are set between 0.5% and 1% of the land/property's market value.²⁷ The Philippines and China are a little above this, with tax rates around 1% to 2% of market value.²⁸ On the other hand, sub-Saharan African countries are typically outliers, as their land/property taxes are set at *high* nominal rates, but this is because these high rates are imposed on land/property values that are decades old (and therefore vastly undervalued). For example, tax rates on land in Kenya are around 30%, but the last valuation of this land sometimes occurred in the 1980s when land values were 20 to 30 times lower.²⁹ While reliable data on land and property tax revenues in sub-Saharan Africa is scant, in those countries for which some figures are available, revenues are only 0.1-0.2% of GDP.³⁰

This handbook views these land/property tax rates as very low, sub-optimal, and a deviation from our general principle to tax or capture economic

rents, as opposed to taxing and distorting productive activities. The main reason why the above rates are so low is due to the political power of home and property owners, especially landed elites. Yet the whole *raison d'être* of charter cities is to overcome these exact political hurdles in order to implement the most effective policies aimed at spurring inclusive economic growth.

Therefore, this handbook recommends the charter city revenue authorities should aim to apply a 100% land value tax under freehold tenure; or, alternatively, to charge 100% of the annual market rental value of unimproved land under the recommended leasehold model. These numbers may seem high or even untenable at first, but once translated into a capitalized percentage, the proposal becomes much more palatable.

Let's take our recommended leasehold model. The first step in calculating the annual rental value of unimproved land is to subtract out the improvement value of buildings, structures, or any human-made alterations.³¹ This improvement value can be calculated by professional appraisers. Once the improvement value is deducted, this leaves the total *unimproved* land value. Next, Formula 1.2 shows how to arrive at the annual market rental value.

Formula 1.2—*Capturing Land Rents*

Annual market rental value of unimproved land = total unimproved land value * capitalization rate

Since we have the total unimproved land value from the first step, we just need the capitalization rate (or cap rate) for land. The cap rate will be specific to each location and even to various land uses, so some due diligence will have to be done to ascertain an appropriate cap rate for a particular charter city locale. However, a reasonable cap rate range in emerging markets is between 4% on the

lower end of normal and 8%-10% on the upper end of normal.³² The cap rate is multiplied by the total unimproved land value to get the annual market rental value of unimproved land. The charter city revenue authorities should collect 100% of this rental value each year. In other words, the rental charges will roughly work out to between 4% and 10% of the total unimproved land value per year

under the leasehold model.

There is no sound economic or public policy rationale against such a proposal, only political resistance from current landowners whose economic rents would be jeopardized. This is one of the reasons why implementation of an LVT/rental charges would be easier in a charter city: because charter cities are likely to be built on greenfield or sparsely populated land with fewer entrenched landed elites fighting to maintain their

special privilege. One of the greatest benefits of implementing this recommendation is that these rates would be projected to yield revenues sufficient to fund the majority if not all³³ of the needed public services and infrastructure investments within the charter city, *without* taxing workers, producers, merchants, investors, and buildings.³⁴ That is, LVTs or land rents have no negative or distortionary effect on the productive potential of the charter city themselves, *and* they negate the need to impose other distortionary taxes.

BOX 8

Land Value Capture in Hargeisa, Somaliland

After years of de facto civil war, conflict, and a near-complete void in governance in Somalia, land ownership and land administration remain minimal at best and non-existent at worst. However, there are bright spots. In Hargeisa, the capital of the semi-autonomous Somaliland region in the north, significant progress has been made in clarifying land rights and, in turn, in the government's ability to generate tax revenue from land value and property taxation and channel this revenue toward much needed urban services and infrastructure for the growing city.

UN-Habitat assisted Hargeisa with the training of local personnel and with broader capacity building. These initiatives allowed the municipal government to establish basic cadastres through the combined use of (1) satellite imagery and (2) survey assessments that ascertained data on both the physical characteristics of local properties as well as the identity of the occupant/owner. In just an eight-month period in 2004 and 2005, these activities expanded properties registered -- and therefore taxed -- in Hargeisa from a mere 15,850 to 59,000. Through the expansion of registered property and the automation of the property tax billing system, Hargeisa's tax revenues skyrocketed 248%.³⁵



Hargeisa, Somaliland.

2.2.2 Pigouvian Taxes

❖ *What to tax?*

As laid out in subsection 2.1.2, Pigouvian taxes can be levied on *many* different goods or activities that cause some external harm to society. Without the Pigouvian tax, this external social cost isn't incorporated into the market price, and the harmful good is over-provided. With a Pigouvian tax, this harm is incorporated, thereby correcting the market failure and restoring the efficient allocation of resources. Recent studies on these corrective taxes have shown that they work more effectively under certain conditions. The question then becomes, what harmful goods do we tax?

The conditions are worth mentioning before recommending specific items that should be subject to Pigouvian taxation. There are three main conditions.

—**No monopolies.** Corrective taxes are unlikely to correct much if levied on monopolists. This is because these entities already use their market power to restrict their supply, so an additional tax may not induce them to restrict it further. Moreover, a monopolist may simply absorb the tax rather than passing it on to end consumers, which wouldn't alter behavior at all.³⁶

—**Uniform marginal social cost or simple categorization.** If the *total* social cost of a good is the harm generated from *all* entities producing or consuming a good, then the *marginal* social cost of a good is the harm generated from each additional firm or individual that produces or consumes a good. An optimal Pigouvian tax is set equal

to this *marginal* cost because, in effect, each additional unit of harm is then paid for at its cost. However, problems arise when different firms and individuals impose very different costs. For example, a large semi-truck and a Toyota Corolla contribute to overall road congestion at very different levels. Therefore, levying the *same* tax rate across all cars on the road regardless of type will not be optimal. As such, either revenue authorities should be able to cost-effectively and easily engage in the categorization of these different types and tax them at different rates (semi-truck vs. Corolla), *or* the marginal social cost should be relatively constant across individuals and firms so that a single tax rate still approximates the social cost across all entities.³⁷

—**Location.** On top of the level of harm varying across firms, individuals, and other categories (semi-truck vs. Corolla), studies also point to the fact that social cost can vary across site location. Some locations are relatively more sensitive to harmful effluents, while others are more resilient. Therefore, they assert, the tax should adjust based on plant location.³⁸ Many categorizations and sub-categorizations obviously place an increasing amount of administrative burden on the revenue authorities and regulators and should be avoided if possible while maintaining the efficacy of the tax. Fortunately, this condition is largely met in the context of charter cities. This is because the Pigouvian tax would apply only within the charter city jurisdiction—a concentrated geographic area—thereby lessening this concern about location dependency.³⁹

On top of these three conditions, a secondary concern after internalizing the externality is how much revenue potential the tax has. When taking all these factors into consideration, there are two main types of Pigouvian taxes that meet the above conditions: (1) a carbon tax and similar taxes on polluting activities⁴⁰ and (2) a congestion tax (or congestion pricing).

Some may suggest that Pigouvian taxes could be levied on several other harmful goods or activities. And they'd likely be correct. But due to limited ex ante knowledge, this handbook recommends sticking to the two items authorities can be relatively sure will happen at a decently large scale in even a moderately successful city: (1) there will be traffic, and (2) there will be emissions from this traffic as well as from economic activity more broadly.

Avoiding the knowledge problem should be a general rule of thumb. Revenue authorities and other regulators do not possess perfect knowledge ex ante about which harmful activities are going to become most problematic for the city. Therefore, beyond those activities that one can be reasonably sure about, the preferred course of action for charter city agencies should be to *observe* a problem first and *then* work to fix it. An agency should not try to fix a problem that it doesn't know will exist.

This point leads to three key considerations that suggest charter city revenue authorities should not implement congestion pricing and carbon taxation right at the beginning of a charter city development but instead introduce them in later stages. First, and following the above rule of thumb, it will take some time for the charter city to reach a population where traffic becomes a problem.⁴¹ Therefore, congestion pricing should be introduced at this later time instead of right at the outset. Second, because firms are nascent and individuals have low incomes

at the beginning of a charter city project, even a modest tax on carbon may be unviable for them. Moreover, if we take these factors into account and set the carbon tax at a much lower, more affordable price for low-income households and SMEs, such a low tax doesn't really internalize the social cost and will therefore likely have a minimal impact on emissions, at least given these initial conditions. Third, both congestion pricing schemes and carbon taxation require administrative capacity that may be absent at the start of a new city development. Given these considerations, these two Pigouvian taxes are likely more appropriate following the initial phase of a charter city.

❖ *Who to tax? Any exemptions?*

Every individual, firm, or other entity engaged in producing (1) carbon (and other polluting activities) and (2) traffic congestion should be taxed. No exemptions.

❖ *What tax rates?*

A Pigouvian tax on a harmful good is typically set equal to that good's marginal social cost. Marginal social cost is generally calculated by estimating the total social cost of a good or activity and dividing it by the total number of units consuming or engaged in that good or activity. In practice, calculating this can often be more of an art than a science given data constraints, but technological solutions have gotten better and much cheaper in recent years, which has made effective Pigouvian taxation more feasible even in low-income contexts.

i. Congestion Pricing

In order to determine what rate to levy on congestion, it's first useful to see what rate the three major cities that have introduced city-wide congestion pricing are charging. See Table 4 below.



Singapore's Electronic Road Pricing (ERP) scheme raises revenues and reduces traffic congestion.

Table 4. Congestion Pricing in London, Stockholm, and Singapore

City	Payment	Timing	Initial Investment	Annual Operating Cost	Annual Net Revenue
London	Flat daily fee: £11.50 (US\$15.21) <i>Payments can be made by phone, text message, online, by post, or via registering for autopay.</i>	7:00 a.m. –6:00 p.m. Mon–Fri <i>No charge on weekends; bank holidays; or days between Christmas Day and New Years</i>	£161.7 million (US\$214 million)	£130 million (US\$172 million)	£137 million (US\$182 million)
Stockholm	Variable Pricing based on time of day: Highest peak period cost per trip is 35 kronor (US\$4.14) <i>The owner of the car is sent a monthly invoice for the total charge incurred. Payments can be made by mail, online, or by direct debit from a bank account.</i>	6:30 a.m. – 6:30 p.m. Mon–Fri <i>No charge on weekends; public holidays/day before public holidays; nor during the month of July</i>	2 billion kronor (US\$237 million)	100 million kronor (US\$11.8 million)	2 billion kronor (US\$155 million)

Singapore	<p>Variable pricing based on location of road, time of day, vehicle type, and local traffic levels: S\$0–\$4.00 (US \$0–\$3.00) are collected per trip within/around CBD.</p> <p><i>Cars are required to have an in-car unit on the dashboard and a smart card with fare stored on it. Electronic road pricing (ERP) automatically detects conditions and deducts the variable fee from the smart card. The in-car unit costs S\$150.</i></p>	<p>7:00 a.m. –8:00 p.m. Mon–Sat</p> <p><i>No charge on Sundays; public holidays; or after 1:00 p.m. the day before a public holiday</i></p>	<p>S\$200 million (US\$110 million)</p>	<p>S\$25 million (US\$18.5 million)</p>	<p>S\$150 million (US\$100 million)</p>
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Source: Provonsha, E. and Sifuentes, N. (2017). "Road Pricing in London, Stockholm, and Singapore: A Way Forward for New York City." Tri-State Transportation Campaign. Available at: <http://www.tstc.org/reports/A-WAY-FORWARD-FOR-NEW-YORK-CITY-2017.pdf>

From Table 4 we can see that the congestion prices set across the three cities vary quite significantly, with a high flat daily fee of US\$15.21 in London to a negligible fee in Singapore if local conditions are favorable. Singapore is most likely to approximate the true marginal social cost that an additional road user imposes on others much more closely than London simply because it uses much more relevant information in real-time via its ERP system when setting the price.

While the Singapore model of price setting should be the goal that a charter city strives toward, London's simple flat fee is likely a less administratively burdensome and fiscally expensive system to implement at the outset. Therefore, this handbook recommends a relatively easy and clear flat fee in the initial phases of the charter city, perhaps differentiated by vehicle type. Economists have devised a simple rule of thumb for setting such a fee or price on congestion. They value the time lost to congestion at half a given person's hourly wage.⁴² Such simple price-setting rules are useful in earlier stages, and then in later stages, with more resources and capacity, the congestion pricing scheme can

move toward Singapore's more sophisticated model.⁴³

Another option is to use cheaper technological alternatives that have arisen since Singapore's implementation of its ERP system. For example, car GPS devices and cell phone-enabled GPS tracking or apps are now quite affordable and ubiquitous, as are cameras that accurately read license plates. These technologies can even permit more fine-grained, Singapore-esque pricing by differentiating by road route and the time of day, so busy roads during peak hours can be charged more, and vice versa. Cities of the Global South, like Bangalore, have experimented with such alternatives, and others, like Jakarta, are implementing similar models of congestion pricing.⁴⁴

Imposing a price on parking should be part of any complete congestion pricing scheme. This is discussed more in the chapter "Land Use Regulation and Building Regulation" in this handbook.

ii. Carbon Tax

Like setting a price on traffic congestion, setting a price on carbon can also be more of an art than a science. This is evidenced by the fact that carbon pricing around the world varies significantly from less than one dollar per ton to US\$121 per ton of CO₂ emissions. It helps to be explicit about the key components of effective carbon pricing. The essential ingredients to calculating the social cost of carbon can be narrowed down to three main factors:⁴⁵

—**Discount rate.** The discount rate allows policymakers to put a number on projected future investments by discounting these investments into today's dollars. Discounting is used here because human beings typically value one dollar in the present more than a dollar ten or twenty years from now. That said, this handbook recommends a very low discount rate, as *long-term* economic growth must be the paramount priority of a charter city.⁴⁶

—**An estimate of the damage carbon imposes on the economy.** Without getting into all the assumptions and calculations made, the most well-known model to put an estimate on the costs of carbon for the broader economy is William Nordhaus's dynamic model of the climate and economy (DICE), which Nordhaus won the 2018 Nobel Prize in Economics for. All told, his model estimates damages from carbon equal to 8.5% of world income in the event of a six-degree rise in temperatures.

—**Risk of potential disasters.** This factor is simply to say that given the potential for

existential risk above a certain rise in temperature, the costs of emissions become infinite beyond this point. Again, there is a lot of uncertainty, but to take these catastrophic risks into account, Nordhaus increased the estimated costs from his DICE model by a quarter to arrive at the 8.5% figure mentioned above.

Taking these three factors—and a host of others—into consideration, Nordhaus's DICE model suggested a mean carbon tax of US\$47 per ton of CO₂ emissions for 2020 for the US. This assumed a discount rate of 3%. This number is very close to the US\$40 per ton recommended by the Climate Leadership Council's carbon tax plan for the US.⁴⁷ This plan includes an automatically increasing carbon price that's raised 5% per year (above inflation).⁴⁸ Charter cities should use the above carbon tax plans as inspiration in formulating their own carbon tax policy.

Again as mentioned above, for several reasons congestion pricing and carbon taxes are likely better suited for implementation after the initial stage of a charter city development, once a particular threshold of population, economic activity, and administrative capacity has been hit. Given this reality, charter city revenue authorities may need to raise additional revenue from sources beyond LVTs/land rents and Pigouvian taxes. The next subsection goes over value-added taxation, which can serve as a secondary revenue source that can be introduced if the need arises.

2.2.3 Value-Added Taxes

In this subsection the questions: *What to tax? Who to tax?* and *Any exemptions?* are all combined into one. Then the subsection answers: *At what tax rates?* Lastly, some further considerations are



Carbon taxes and congestion pricing can raise revenues and reduce emissions.

provided on overcoming particular administrative challenges with VAT using technology in Box 9 below. Charter city revenue authorities should only rely on VAT as a tax source if LVTs/land rents and Pigouvian taxes fail to raise the level of revenues required to fund rapid infrastructure growth and deliver effective services (both of which must accompany rapid city growth).

❖ *What to tax? Who to tax? Any exemptions?*

The above questions have been combined because the answers to them when it comes to VAT are simple:

- *What to tax?* **Everything.**
- *Who to tax?* **Everyone.**

➤ *Any exemptions?* **No.**

❖ *What tax rates?*

A single VAT rate applied uniformly to the entire tax base is recommended by this handbook, especially at the conception of the charter city. The most common criticism of VAT is that uniformly applying a single rate is regressive. This is because under VAT a babysitter and their wealthy employer pay the same, say, 5% on imported toothbrushes. Since the babysitter earns substantially less than the employer, but they pay the same VAT, opponents are quick to label this regressive. And they're right in a sense. In fact, some version of this very argument is why most countries that implement VAT, in practice tend to

not apply it to *essential* goods as discussed above, such as health care and some pharmaceuticals.

While such equity concerns are understandable, they are overly simplistic and typically incorrect. By setting a single VAT rate and applying it uniformly across the whole tax base, tax administration is greatly simplified, and compliance rates go up. (And relatedly, the cost of compliance goes down.)⁴⁹ Introducing deviations from this single and uniform rate by including various exemptions and reductions makes the VAT regime more complex, increasing both the administrative burden and the cost of compliance. What's worse, complexity is oftentimes gamed (exploited by fraudsters) to the benefit of the wealthy and well-connected. So attempts to improve the progressivity of VAT by introducing exemptions and reductions are often not only ineffective but actively tend to benefit wealthier consumers, further exacerbating VAT's regressivity.⁵⁰

For example, higher-income earners in Mexico received the most significant benefits in absolute terms, from VAT exemptions and reductions.⁵¹ Similarly, wealthier individuals in France were able to capture a greater share of the benefits stemming from exemptions than poorer households.⁵² This pattern is even more pronounced in low-income countries where revenue authorities can be more readily bribed.

Another consideration that further supports imposing a single, uniform VAT across the whole tax base is the *productivity* of the tax, also called the VAT revenue ratio, or VRR. The productivity of VAT is defined as the ratio of actual taxes collected to potential taxes collected under a single, uniform rate. A low ratio reflects low compliance as well as a lot of exemptions and reductions. For example, the productivity of VAT is lowest—by a significant

margin—in sub-Saharan Africa.⁵³ This is indicative of lobbyists, interest groups, and elites succeeding in getting their governments to grant them unnecessary loopholes and reductions.

Given the above discussion, this handbook advises charter city revenue authorities to apply a single, uniform VAT rate across the entire tax base. Yes, it is acknowledged that this may not bolster progressivity, but, as we've seen, VAT regimes that attempt to improve equity oftentimes result in greater *inequity*. Not to mention, the other benefits of VAT are that it is (1) broad-based, (2) minimally distortive, and (3) difficult to evade. *All three* of these benefits are negatively impacted by trying to make the regime more progressive through a labyrinth of exemptions. Therefore, in this instance it is concluded that progressivity can be pursued more effectively elsewhere in the tax and fiscal system of the charter city, such as through the cash transfers recommended in the “Social Protection” chapter. The evidence clearly shows that when it comes to VAT, this is a trade-off worth making.⁵⁴

BOX 9

Leveraging Technology for Value-Added Taxation Ethiopia

One of the main drawbacks of VAT regimes is that they can incur high compliance costs on both businesses—especially smaller businesses—and on revenue authorities. This is because VAT requires businesses to maintain quite a detailed paper trail of their transactions in goods and services, and it requires that revenue authorities have the data processing capacity to accommodate this paper trail, or electronic data, that businesses submit to them and also process VAT refunds. This is where effective technology systems can help.

Some countries have been much more successful than others when it comes to implementing electronic tax systems (ETS) for VAT regimes. One useful resource that charter city revenue authorities can use if they deem necessary is the IMF. The IMF championed a transition toward VAT in tax systems across the Global South since the 1980s and 1990s. As such, the IMF is invested in VAT's success and has helped many countries with implementation over the last few decades.⁵⁵

One country that epitomizes how critical an effective ETS is to a well-functioning VAT regime is Ethiopia. A recent study on Ethiopia's introduction of an ETS found that not only did this technology result in a significant increase in VAT revenues (an increase of about 20 log points) but that these increases were derived mainly from businesses that were more likely to avoid paying VAT prior to the introduction of ETS. Technology helped boost revenues *and* curtail tax evasion.



Addis Ababa, Ethiopia.

Two different investments in IT systems in Ethiopia were necessary to bring about this result. First, a company called CRC Sogema developed the Standard Integrated Government Tax Administration System (SIGTAS) and helped Ethiopian revenue authorities deploy SIGTAS across its units in 2004.⁵⁶ SIGTAS has been implemented across 24 countries since 1996 to help revenue authorities electronically manage taxpayer records and lower maintenance costs. Second, and more specific to VAT regimes, the Ethiopian revenue authorities deployed electronic sales registry machines (ESRMs) in 2008. ESRMs both record any transaction or sale digitally as well as print physical receipts. Additionally, ESRMs are linked to the Ethiopian revenue authority's database (SIGTAS) via a general packet radio service. This radio link transmits data in real-time on every sale.⁵⁷ Ultimately, ESRMs (linked with SIGTAS) have made it possible for Ethiopian revenue authorities to monitor the daily transactions and revenues that businesses report. The implementation of ESRMs has been essential to Ethiopia's success with VAT reform, and charter city revenue authorities should learn from this experience.⁵⁸

¹ Collier, P. et al. (2017). "Land and Property Taxes for Municipal Finance." Policy Paper, IGC Cities that Work: Oxford.

² Moore, M. et al. (2018). *Taxing Africa: Coercion, Reform, and Development*. Zed Books Ltd.: London. pp. 214-15.

³ Ibid.

⁴ OECD (2018a). "Tax Policies for Inclusive Growth: Prescription versus Practice." OECD: Paris. See also Collier, P. et al. (2017).

⁵ Doing Business (2019a). "Paying Taxes." World Bank Group: Washington, DC. Available at:

<https://www.doingbusiness.org/en/data/exploretopics/paying-taxes>.

⁶ Finan, F. et al., (2015). "The Personnel Economics of the State." NBER Working Paper Series, NBER: Cambridge, MA.

⁷ Samuelson, P., Hancock, K., & Wallace, R. (1975). *Economics 2nd Edition*. McGraw-Hill: Sydney: p. 623.

⁸ Krueger, A. (1974). "The Political Economy of the Rent-Seeking Society." *American Economic Review* 64(3): pp. 291-303; also see Tullock, G. (1967). "The Welfare Costs of Tariffs, Monopolies, and Theft." *Economic Inquiry* 5(3): pp. 224-232.

⁹ For a broad discussion on the costs and benefits of private versus public tax collection see Haas, A. & Manwaring, P. (2017). "Enhancing Local Tax Revenues: Private or Public Collection?" IGC Cities that Work Policy Brief. International Growth Centre: Oxford. Available at: <https://www.theigc.org/publication/private-vs-public-collection-enhancing-local-tax-revenues/>.

¹⁰ Another ancillary source of revenues discussed throughout the Handbook is user fees for particular public services.

¹¹ They are only equivalent if both LVT and lease payments are charged solely on *land value*, not on buildings/property.

¹² Some charter cities could even opt for a combination of freehold and leasehold tenure, and so have both LVTs and lease payments. For example, to attract an initial population the city developer could offer freehold title with a lower LVT for the first ~5,000 residents that move to the city. Thereafter, it could switch to leasehold/lease payments.

¹³ OECD (2018a): p. 16.

¹⁴ For more details on land use and zoning best practices, see the "Land Use Regulations and Building Regulations" chapter of this handbook.

¹⁵ OECD (2018a): p. 16.

¹⁶ Verougstraete, M. & Zeng, H. (2014). "Land Value Capture Mechanisms: The Case of the Hong Kong Mass Transit Railway." *United Nations ESCAP*. United Nations: New York. Available at: <https://www.unescap.org/sites/default/files/Case%20-%20Land%20Value%20-%20Hong-Kong%20MTR.pdf>.

¹⁷ Hong, Y. (1996). "Can Leasing Public Land Be an Alternative Source of Local Public Finance?" *Working Paper*. Lincoln Institute of Land Policy.

¹⁸ Pigouvian subsidies are an analogous policy tool meant to encourage beneficial goods or behaviors that are underprovided by the market. Subsidies for the flu vaccine are one example of Pigouvian subsidies.

¹⁹ More precisely, the market failure is completely corrected, and the efficient allocation of resources restored, when the Pigouvian tax is set equal to the marginal social cost and levied uniformly across all individuals and firms.

²⁰ Bird, R.M. et al. (2002). "Land and Property Taxation: A Review." World Bank Group: Washington, DC: p. 12.

²¹ Some support taxing a composite of property *and* land because it's administratively easier than isolating land value and taxing it on its own. They allege this is administratively less burdensome because it is this combined value (property *and* land) that is readily and costlessly observed in real estate transactions. This suggestion is largely inaccurate. In fact, isolating land value from property value is quite straightforward and common. One would only need to assess the value of the buildings or structures on the land and subtract this value from the total sale price. Professional appraisers routinely calculate both land value and building/improvement value. For example, the improvement value is needed by insurance companies to offer insurance for buildings, as it is only this improvement value that is

insured. Not to mention, this process is significantly *less* administratively burdensome than the processes involved in implementing other forms of taxes commonly used around the world like, for example, income taxes and value-added taxes (VAT).

²² Also recall from the “Land Registration and Administration” chapter: under the leasehold model there are four key rights that lessees should be granted. First, flexibility to build on or sub-lease their leased land. Second, full ownership of any buildings or improvements. Third, freedom to sell the lease (in exchange for being paid the full value of all owned buildings). Fourth, guaranteed payment for all owned buildings upon the expiration or termination of the lease.

²³ Washington, H.A. Olima (2013). “Property Tax Regimes in East Africa.” UN-HABITAT: Nairobi.

²⁴ Perhaps the best way to balance these trade-offs between a single rate and variable rates is for the charter city to initially start out with a single rate. Then as the charter city tax authorities gain administrative capacity they can transition to a slightly more complex system with variable rates/land rental values.

²⁵ Alosyus, M. (2010). *Challenges of Municipal Finance in Africa: With Special Reference to Gaborone City, Botswana*. Human Settlements Finance System Series, UN-HABITAT: Nairobi.

²⁶ CCI is publishing Planning Guidelines to provide guidance on city master plans. These will be published under the Reference Guides section of the CCI website here: <https://www.chartercitiesinstitute.org/category/reference-guides>.

²⁷ Kopanyi & Murray (2016). “An Effective Property Tax Regime for Rwanda (Draft Report).”

²⁸ Global Property Guide (2016). “South Korea Capital Gains Tax Rates, and Property Income Tax.”

²⁹ Kopanyi & Murray (2016).

³⁰ Moore, M. & Prichard, W. (2017): p. 16. The African example, again, points to the critical need for the charter city land administration to keep accurate and up-to-date land registries and land valuations.

³¹ For further details on calculating unimproved land value and other methods of assessing and taxing land rents see Gwartney, T. (2014). “Land Assessment for Socializing Land Rent While Untaxing Production.” *World Bank Conference on Land and Poverty Paper Presentation*. Available at: <https://www.oicrf.org/-/land-assessment-for-socializing-land-rent-while-untaxing-production>. Also see Bird, R. & Slack, E. (2002). “Land and Property Taxation: A Review.” *Unpublished Working Paper*. Available at: <https://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.203.2450&rep=rep1&type=pdf>.

³² For various cap rates see, for example, here: <https://ecvy.medium.com/global-cap-rates-of-real-estate-3f124bda3d14>

³³ This is why some have called an LVT a ‘single tax,’ because they assert no other taxes will be needed. Note that there is still debate about whether a 100% LVT could generate sufficient revenue to avoid all other taxes. Regardless, even if an LVT did not result in the elimination of all other taxes, it would still result in the significant reduction of these distortionary taxes, which would in turn bring about the immense efficiency and productivity gains that LVT proponents highlight. For a general review of the LVT debate see: <https://www.theatlantic.com/national/archive/2019/04/henry-georges-single-tax-could-combat-inequality/587197/>.

³⁴ If additional revenues were required, they should be ascertained by Pigouvian taxes on pollution and congestion (among others), as well as user fees.

³⁵ Walters, L. (2011). “Land and Property Tax: A Policy Guide.” UN-HABITAT: Nairobi.

³⁶ The Economist. “Pigouvian taxes.” August 19, 2017. Available at: <https://www.economist.com/schools-brief/2017/08/19/pigouvian-taxes>.

³⁷ Fleischer, V. (2015). “Curb Your Enthusiasm for Pigouvian Taxes.” *Vanderbilt Law Review* 68(6): pp. 1691-93.

³⁸ Rose-Ackerman, S. (1973). “Effluent Charges: A Critique.” *Canadian Journal of Economics* 6(4): pp. 512, 518.

³⁹ This is assuming most host countries do not have a Pigouvian tax on congestion and carbon. This assumption largely holds across the Global South.

⁴⁰ For example, many countries have introduced a gasoline tax that taxes car-emitted pollutants. This gets to the point that carbon emissions are distinct from pollution; therefore, they should be treated differently. For a more detailed discussion on this see Bertaud, A. (2018). *Order Without Design: How Markets Shape Cities*. MIT Press: Cambridge, MA: pp. 201-212.

⁴¹ Carbon emissions and pollution are much more uniform problems as any emissions flow freely across boundaries. But still, if a charter city is located on a greenfield or sparsely populated site then economic activity (and therefore emissions) will be quite low initially.

⁴² For example, if I earn US\$20 per hour and lose 15 minutes (a quarter hour) to traffic congestion, that lost time (15 min) is valued at $20 \times 0.5 \times 0.25 = \text{US\$}2.50$. See Kahn, M. (2021). *Adapting to Climate Change: Markets and the Management of an Uncertain Future*. Yale University Press: New Haven, CT: p. 198.

⁴³ Other useful considerations to incorporate in setting an efficient congestion price can be found here: <https://marketurbanismreport.com/blog/how-to-do-efficient-congestion-pricing-or-thoughts-on-william-vickrey>.

⁴⁴ Duflo, E. et al. (2018). “Benefits and Costs of Road Traffic Congestion Pricing: Evidence from Bangalore.” *Policy Brief*. International Growth Centre: Oxford. Available at: <https://www.theigc.org/project/smart-congestion-pricing-testing-travel-incentives-to-reduce-congestion-in-bangalore/>.

⁴⁵ *Scientific American*. “How to Set a Price on Carbon Pollution.” June 1, 2020. Available at:

<https://www.scientificamerican.com/article/how-to-set-a-price-on-carbon-pollution/>.

⁴⁶ Mason, J. (2020a). “What is the Appropriate Social Discount Rate for a Charter City?” Charter Cities Institute: Washington, DC. Available at: <https://www.chartercitiesinstitute.org/post/what-is-the-appropriate-social-discount-rate-for-a-charter-city>.

⁴⁷ The CLC's plan was spearheaded by a group of economists, policymakers, and business executives. The main authors are N. Gregory Mankiw, Martin Feldstein, Ted Halstead, Hank Paulson, James A. Baker, George Schultz, Rob Walton, and Thomas Stephenson.

⁴⁸ For more details on the CLC's carbon tax plan see: <https://clcouncil.org/our-plan/>.

⁴⁹ OECD (2018a): p. 21.

⁵⁰ Ibid: p. 21.

⁵¹ OECD (2011). “OECD Economic Survey of Mexico.” OECD: Paris.

⁵² Bozio, A. et al. (2012). “Fiscalité et Redistribution en France.” Institut des Politiques Publiques: Paris.

⁵³ Moore, M. et al. (2018): p. 125.

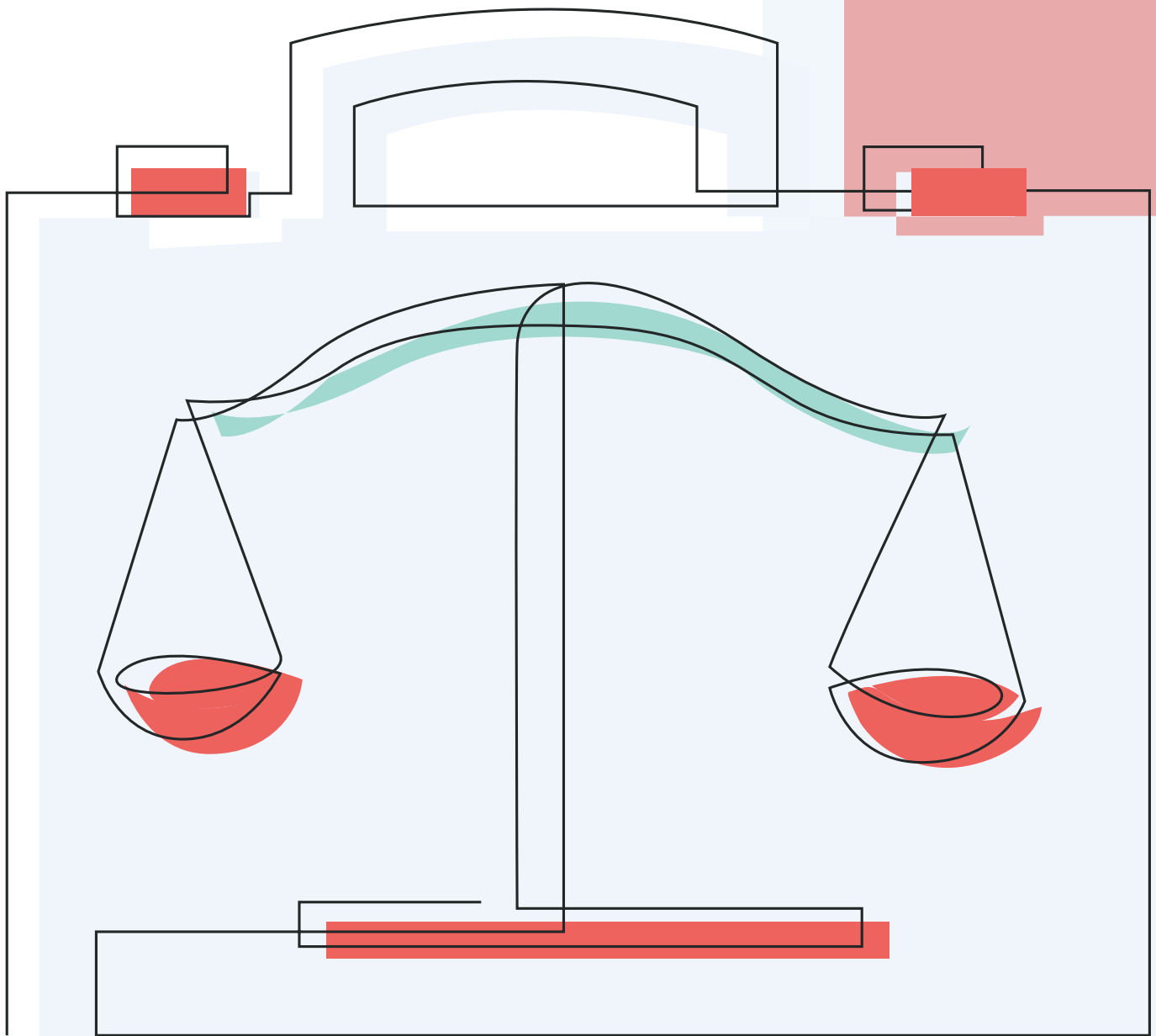
⁵⁴ In fact, many studies suggest there may not even be a trade-off between VAT's effectiveness and its alleged regressive elements. See, for example, OECD (2018): p. 25. Moreover, any regressive aspects of VAT can be redressed by a negative income tax, typically attached to a work requirement (e.g., the Earned Income Tax Credit in the US or Canada's Working Income Tax Benefit).

⁵⁵ Moore, M. et al. (2018): p. 126.

⁵⁶ See <https://sogematech.com/en/sigtas>.

⁵⁷ Indeed, many countries have begun a shift toward such real-time tax administration. See, for example, this article on Russia's implementation of a digital VAT that allows data collection in real-time: <https://kenopalo.com/2019/07/30/the-future-of-tax-administration/>.

⁵⁸ Ali, M. et al. (2015). “Information Technology and Fiscal Capacity in a Developing Country: Evidence from Ethiopia.” ICTD Working Paper 31. International Centre for Tax and Development: Brighton, UK.



PART 2: JUDICIARY AND JUDICIAL PROCEDURE

2. DISPUTE RESOLUTION

I. KEY TAKEAWAYS

- ✓ A dispute resolution system that can efficiently resolve conflicts is necessary to establish well-functioning markets, to support economic growth, and to make the regulatory reforms introduced in a charter city worthwhile.
- ✓ Additionally, the dispute resolution system must be inclusive of a charter city's low-income residents entering the formal economy for the first time who previously would have been unable to utilize the courts because of the high cost and time associated with resolving disputes.
- ✓ When establishing and administering the city's dispute resolution bodies, the charter city administration should prioritize three main values: (1) efficiency (resolving disputes fairly, at limited cost, and at rapid speed); (2) optimal structures, including a specialized commercial court, small claims court, and arbitration services; and (3) legitimacy, such that the city's rulings are upheld and respected by external jurisdictions.
- ✓ This chapter examines three significant determinations that charter city administrations must decide upon when setting up its dispute resolution system: (1) choosing the type of legal system, (2) selecting qualified court personnel to staff the system, and (3) utilizing modern information and communications technology in the daily operations of the courts to further improve their ability to resolve disputes in a timely and cost-effective manner.



The Astana International Financial Centre in Nur-Sultan, Kazakhstan, opened in 2018.

II. INTRODUCTION

Timely and low-cost dispute resolution is critical for the success of a charter city. Respect for the rule of law and secure property rights are necessary to achieve economic growth, which in turn requires a well-functioning system for resolving commercial disputes.¹ Charter cities introduce a wide variety of reforms to the law of the host country, and courts will be needed to ensure that the new laws of a charter city are enforced fairly and efficiently. Note that this chapter of the *Governance Handbook* refers only to commercial courts, leaving criminal law to the existing court structure of the host country.² Private and administrative law are both addressed in their own chapters of this handbook.

Investors and entrepreneurs need to feel confident that if they enter a commercial dispute with another individual or firm that the matter can be resolved without the case lingering in the court system for years, eating up the value of the claim they hope to recoup in legal fees. Without an effective mechanism to enforce contracts and resolve disputes between parties, the investment that would flow to a charter city may end up flowing elsewhere.

At the same time, effective dispute resolution is an important step needed to create an environment where operating in the formal sector becomes

practical for the poor. Operating in the formal economy necessitates resolving disputes through official mechanisms like arbitration or the court system. It does a low-income person little good if they can easily start and register their business but then has no practical options to address damages inflicted by someone they do business with. This effectively leaves that business owner with all the costs of operating in the formal economy, like paying taxes, without a crucial benefit: timely and low-cost access to justice.

In the countries with the best performing commercial dispute resolution systems, the process to enforce a contract can take under a year and costs under 20% of the total value of the claim made. In the worst-performing countries, the process to do so can take well over three years or more and ends up costing over half of the value of the original claim. As is the case with each subject covered in this handbook, countries in the Global North tend to outperform those in the Global South in terms of contract enforcement, with a handful of exceptions.³

III. VALUES AND GOALS

Dispute resolution in a charter city should be focused on three key values: (1) **efficiency**, (2) **optimal structure**, and (3) **legitimacy**.

Table 5. Summary of Values and Goals for Dispute Resolution

Value	Meaning of the Value	Measurable Goals
Efficiency	—The court system handles cases quickly and fairly, at a low cost.	—Measure average cost and time to resolve a dispute. —Benchmark the above measure against utilization, cost, and time of alternative dispute resolution mechanisms. —Measure the ability of low-income residents and small- and medium- enterprises (SMEs) to access the courts.

Optimal Structure	<ul style="list-style-type: none"> —How the court is structured within the existing judicial framework. —Availability of options like small claims and alternative dispute resolution. 	<ul style="list-style-type: none"> —Ease of cooperation with courts outside the charter city jurisdiction. —Utilization of alternative dispute resolution mechanisms.
Legitimacy	<ul style="list-style-type: none"> —The court system develops a reputation for effectiveness. —The court secures buy-in from domestic and international stakeholders. 	<ul style="list-style-type: none"> —Level of foreign investment. —Judgements upheld in other courts. —Host country parties express interest in opting-in to the jurisdiction.

First, an **efficient** dispute resolution system handles cases both quickly and fairly and at a limited cost, it is accessible to low-income residents, it utilizes technology to further bolster efficiency where possible, and it provides alternative dispute resolution mechanisms. A charter city court that outperforms the host country courts on these margins will be key for the growth of investment and entrepreneurship in a charter city. Regardless of the court structure or type of law adopted, the efficiency and fairness of the dispute resolution system are of utmost importance.

—**Speed and cost.** The speed and cost at which the case can be handled, from the initial court filing to the enforcement of the judgment, matters. Costs in dispute resolution arise from three places: attorney fees, court fees, and enforcement fees. The bulk of this cost typically comes from attorney fees. A charter city can help combat this by adopting a liberalized licensing regime for the legal profession, thereby increasing the supply and lowering the cost of legal services.⁴ As a share of the value of the claim, court fees vary widely from country to country. In Botswana, for example, 3.3% of the claim value is spent on court fees, and 1.5% of the claim value is

spent on enforcement fees on average.⁵ In contrast, in Nigeria these same fees consume 12% and 5% of the total claim value, respectively.⁶

—**Low-income accessibility.** Courts in a charter city must strike a balance between collecting the revenue needed to operate effectively while also not shutting out the poor in practice.

—**Technology.** Automating many of the court procedures and computerizing court functions whenever possible can improve the efficiency of the courts. Doing so can both lower the overhead costs of running the court and minimize the fees charged to system users. For example, the case of Tonga's successful transition from a manual to an electronic court filing system is elaborated on in the following subsection.

—**Alternative dispute resolution mechanisms.** Providing alternative dispute resolution mechanisms like arbitration and mediation can further ease the burden on the court system and provides individuals and businesses with alternative options that avoid the need for a

trial. That being said, if arbitration is presented as an option for parties within the charter city in dispute, there needs to be confidence that all arbitral awards can actually be enforced in order to attract users. Charter cities located in countries party to bilateral, multilateral, and international agreements concerning

arbitration and mediation, as well as those that have adopted model laws governing these areas, can use these statuses to bolster investor confidence that awards will be enforced in charter city courts or host country courts more generally.⁷

BOX 10

Building a New Court System, Dubai, United Arab Emirates

The Dubai International Financial Center (DIFC) Courts offer the best example of a recent top-down, intentional effort to create a new legal institution from scratch. To help spur investment in the newly created DIFC, the government of Dubai set up a new commercial court in 2004 to service the center. However, this new commercial court would conduct proceedings in English, according to Western common law and legal principles, and would be staffed by internationally respected judges.

As mentioned above, the first two judges hired were senior English and Singaporean judges, and the first full-time registrar was also English. The DIFC Courts aggressively built relationships with other courts in Dubai and the United Arab Emirates, as well as with international courts. It recognized foreign judgments and in turn saw its own judgments recognized abroad. Because of its initial success—originally only firms registered *within* the DIFC could use its courts—the courts' authority was expanded beyond the DIFC to the entire Emirate of Dubai, providing an alternative to the existing courts that were primarily based on Islamic law. Parties were also able to eventually opt-in to using the DIFC Courts from abroad, even if neither party had a connection to the DIFC. The DIFC Courts helped firmly establish Dubai as a leading global financial center.⁸



Former DIFC Courts Chief Justice Michael Hwang.

A variety of metrics can be used to assess the **efficiency** of the dispute resolution system. Tracking the time each case takes to complete, as

well as the associated costs, is an easy first step. These figures can be benchmarked to the host country courts as well as to strong international performers as based on the contract enforcement data shared by the World Bank.⁹ To account for the performance of alternative dispute resolution mechanisms, like arbitration, the cost, time, and utilization of these alternative options should be measured against that of the court system. If many parties continue to choose to go to court rather than arbitration, this should be taken as an indication of some flaw with the arbitration service and should therefore prompt the charter city administration into action to try and resolve this flaw.

Second, the **structure of dispute resolution** has important implications in determining judicial outcomes. This handbook recommends that charter city administrations set up a specialized commercial court, a small claims court, and arbitration services. Several questions must be considered by the city administration as they establish these dispute resolution bodies. For example, is the commercial court in a charter city independent of the courts in the host country, or is it a new branch of the existing court structure? Will there be a small claims court, and what is the threshold for 'small'? Are arbitration services or other forms of alternative dispute resolution available? These questions are discussed in further detail in the next subsection. Broadly, when in negotiation with the host country over the parameters of powers devolved to the charter city, securing the maximal authority possible over the courts is desirable.

To assess the performance of the legal system with respect to structure—similar to the metrics suggested for measuring efficiency—the utilization of the various services can be compared. For example, if the small claims court is seeing limited use, yet there is knowledge about the existence of small claims disputes, the cost may be too high or the process too ambiguous.

Third, the charter city dispute resolution system must establish **legitimacy**. The legal system requires the buy-in of both the domestic and international community. While commercial courts serve the direct function of dispute resolution, they also serve as a signaling function to potential investors and entrepreneurs.

Demonstrated efficiency in handling cases is an important consideration, but the *type* of law used and the quality of judges also matter. English

common law has increasingly been recognized as an attractive alternative to civil law for the purposes of attracting investment as it tends to afford investors stronger protections than civil law.¹⁰ Rwanda, generally a strong performer on the World Bank's Doing Business Index, has gradually been switching its legal system from a civil law system to a common law system.¹¹ The DIFC, established in 2004, effectively imported British common law courts, whose jurisdiction was later expanded to the whole of the Emirate.¹² In both cases the respective governments recognized that many investors will prefer a common law system and acted accordingly.

However, if the host country primarily uses a civil law system, it may be more sensible to keep that style of law in place in the charter city to reduce the transaction costs of doing business between the charter city and the host country. Likewise, if the expected major trading partners of the charter city use a civil law system, there are advantages to retaining that system. For example, in a charter city in Francophone Africa with strong economic ties to France, French-based civil law may prove to be a better option. In this case it is likely that the majority of foreign investors will be more familiar with French civil law than with English common law, and so adopting the former in the charter city will reduce the transaction costs of investment.

With regard to the quality of judges, in the case of the DIFC, internationally respected commercial court judges from the United Kingdom, Singapore, and elsewhere were hired to develop the legitimacy of the new legal institution with parties abroad.¹³ While Dubai is very wealthy and can afford to hire the world's best commercial court judges, a charter city can follow a similar path with a rigorous approach to hiring. For example, Ghana's Commercial Division of the High Court

(GCC) has been lauded as a highly effective body, despite limited resources (discussed further below).

The perception of legitimacy can be measured in several ways. Greater foreign investment in the charter city is a strong sign that investors are confident about the ability of the dispute resolution system to meet their needs. This is especially true if the foreign investment is tied to contract-intensive activities. If judgments from the charter city court or its arbitration services are consistently upheld by foreign courts, this is also a good sign that the jurisdiction is building legitimacy internationally. Domestically, if parties from outside the charter city—but within the host country—want to opt-in to using the city's dispute resolution mechanisms, this is a strong sign of support.

IV. IN PRACTICE

This section overviews the key processes in setting up a new court system for a charter city. This involves three main steps: (1) choosing a legal system for the charter city, (2) setting the overarching structure of the court system, (3) establishing and staffing the court system, and (4) leveraging technology where possible to save costs and speed up resolution times. For the purposes of this section, we assume that the city has been given the authority to set up its own independent court system according to the agreement signed with the host country and with any legislation passed.

1. Choosing a Legal System

Before starting operations, a decision about the type of law employed in the charter city will be needed.



The Rolls Building in London is home to the Commercial Court of England and Wales, one of the principal international dispute resolution centers in the world.

As per the earlier discussion about the tradeoffs between common law and civil law systems, for a charter city in a country where common law will yield the best results, there are several examples of courts that imported England law for their own use to follow. After the success of the Dubai International Financial Centre Courts, the Abu Dhabi Global Market (ADGM) Courts directly adopted English common law. In the authorizing legislation, the specific English statutes that would apply within the ADGM were listed, along with some necessary amendments.¹⁴ As per ADGM Courts guidelines, the entire corpus of English case law is continually held as applicable.¹⁵ For example, if English law was applied in a charter city in 2021, new English case law that arises in 2022 would be applicable.

If the charter city is located in a country that already practices common law in some capacity, as do most countries that were once colonies of the United Kingdom, then “importing” English law and court procedures may not be necessary. Instead, these jurisdictions may only require technical improvements at the margins to arrive at a sufficiently more effective legal system. However, the independence of the court from the existing judicial system is key, as judicial systems in emerging markets are often corrupt, slow, and/or expensive.¹⁶

For jurisdictions where civil law prevails, but common law could feasibly outperform it in generating investment, the charter city should follow the Abu Dhabi or Dubai models and employ English common law. In highly contract-intensive industries, like those with many linkages in a global value chain, common law jurisdictions tend to be viewed as having more favorable legal infrastructure given the increased risk of breach of contract somewhere along the value chain.¹⁷ For cases where the host country uses civil law or where most economic linkages will be with countries using French or some other form of civil law, or where the usage of contract-intensive value chains will be limited, retaining a civil law system is sensible. Whichever system is chosen, legal professionals that have experience working under that system should be prioritized to staff the courts (the selection of legal staff is elaborated on below).

It is important to note that the choice of law may have implications regarding the sovereignty of the charter city in the eyes of the host country, so the most pragmatic approach to the choice of law may be to simply apply the same type of law as the host country and strive to build a more effective court system where improvements at the margins of the law may be implemented. These considerations will vary considerably across charter city projects depending on their location and target investment industries.

BOX 11

Effective Court Modernization in a Low-Income Country, Rwanda

Rwanda is an excellent case study in how a low-income country—GDP per capita is approximately US \$825¹⁸—can nevertheless have an effective court system. An effort to reform the country's commercial justice system was launched in 2001 by President Paul Kagame, who appointed a commission to draft new laws. After spending several years drafting new commercial court laws and having those laws adopted by Parliament, Rwanda's new commercial courts became operational in 2008. The new commercial legal system is based on a mix of common and civil law adopted from the United States, Canada, Britain, Ireland, Mauritius, Kenya, Ghana, Uganda, and Tanzania.¹⁹

Although the cost to enforce contracts in Rwanda is inflated because of high fees, cases there are resolved quickly, and the quality of its judiciary is high. The average case takes 230 days to be resolved, which places Rwanda's courts among the most efficient in the world. This is almost a third of the time it takes the average sub-Saharan African country to resolve disputes. Rwanda even outperforms the average high-income country, resolving disputes over twice as quickly.

Rwanda has a specialized commercial court and a fast-track option for small claims that allows claimants to represent themselves. Claimants can secure the possibility of payment pretrial, and cases are randomly assigned. The commercial court enforces time standards for the events of a case, and adjournments are limited. This ensures that cases keep moving through the system. The courts use electronic case management tools for both judges and lawyers, including the ability to file claims and pay fees electronically. Judgments are made publicly available to the public to ensure that the court remains a transparent institution.²⁰

2. Structure of the Court System

The structure of the court system in a charter city has several practical implications. Ideally, the charter city should pursue having its own independent commercial court. If the host country is unwilling to grant such autonomy, then a specialized, fast-track commercial branch of the existing court structure that only serves the charter city jurisdiction should be pursued. Under either structure, having a specialized commercial court can greatly streamline the dispute resolution process for investors and businesses.

Another important consideration is how the charter city will address the appeals process. If the charter city courts are integrated within the existing court structure of the host country, then the country's higher court would be the final destination for an appeal. While this relieves the charter city of the need to maintain an appeals court, it can also introduce procedural concerns regarding delays and the application of the rule of law. However, if the charter city courts are fully independent of the country's court structure, then the charter city will also need its own higher appellate court.

—**Specialized commercial court.** By

having a single court that focuses solely on commercial disputes with dedicated judges, the system is less susceptible to overload, leading to fewer drawn-out suits that can go on for years.²¹ Because jurisdiction over criminal law remains with the host country, the charter city only needs a commercial court and does not need a criminal court. A higher appellate court may be needed, depending on the structure of the specialized commercial court's relationship with the national court system.

—**Small claims court.** In addition to the specialized commercial court, a small claims court with simplified procedures needs to be made available. Because a charter city will have many first-time participants in the formal economy operating small enterprises, their disputes will likely be of a limited monetary value. They also may not possess the resources to hire an attorney and pursue traditional litigation. Individuals should be able to represent themselves in small claims court to ensure that justice is accessible to everyone in a charter city. Easy-to-understand standardized forms should be

provided as a component of the small claims court, including local language variants of these forms. The court should be able to clear small claims cases quite quickly.

—**Traditional dispute resolution.** The court in a charter city not only needs to be financially accessible to low-income people, but its purpose and practices must also be legible to individuals that have no prior experience with formal court systems. Integrating the courts with local communities through the incorporation of traditional dispute resolution mechanisms into the structure of the court presents an opportunity to build trust and understanding. Popular forms of alternative dispute resolution used to resolve commercial disputes, like mediation, resemble traditional dispute resolution practices in many different cultures and provide an avenue for integration.²²

3. Court Personnel

Perhaps more important than the judges themselves is the registrar. As the individual responsible for the administration of the court, a highly experienced attorney will be needed to fill this role. Although the duties of a registrar vary by jurisdiction, this individual is typically tasked with managing the staff, processes, and records of a court.

When creating the DIFC Courts, the government of Dubai hired respected English commercial lawyer Mark Beer to be its full-time, locally based registrar. Beer was not only well-qualified for the role but also established a sense of international legitimacy for the court.²³ For a charter city,

finding an attorney from the host country that has spent time practicing abroad in commercial courts to serve as the registrar is key. This person will have knowledge of the host country's legal culture as well as foreign legal culture, both important for developing a new legal institution from scratch that will serve both domestic and international claimants. This handbook recommends identifying an expatriate that has a strong interest in returning to their home country and contributing to its development to fill this role.

The registrar will be the main person tasked with hiring the staff, implementing the technology, and enforcing court procedures. It is the registrar's responsibility to ensure that the court becomes fully functional and ready to hear cases. The registrar, along with the judges, will be the chief advocate for the court. A good registrar will work to build the reputation of the charter city court both domestically and internationally among the legal community and with other courts and arbitration centers. Building goodwill with these institutions will be important in coordinating cooperation between jurisdictions when necessary, as well as ensure that the charter city court remains abreast of novel legal issues and technologies.

In addition to the registrar, other court staff will be needed to ensure the court functions effectively. The individuals to target for staffing the court should have experience working in domestic or international commercial courts or in arbitration centers.

Lastly, on top of the registrar and the general court staff, judges will need to be recruited to operationalize the court system in the charter city. As with the registrar, hiring judges that have an established reputation is crucial to developing the legitimacy of the charter city as a desirable place to

do business. Again, using the DIFC as an example, the first two judges hired had served on the highest commercial courts in the United Kingdom and Singapore, among a litany of other reputable positions. Both were highly respected and helped firmly establish the DIFC Courts as a legitimate international arbitration center.²⁴ Hiring judges from abroad can also help ensure that they treat cases fairly, as they will have no connection to the existing court system or economy, only the body of law being used to adjudicate disputes. However, judges need not be of international origin to be effective, as the rigorous hiring for Ghana's GCC has demonstrated.

In Ghana, justices were chosen for the newly created GCC by the chief justice based on their demonstrated excellence in legal practice, as well as a strong work ethic and character. While proceedings in other divisions of Ghana's high courts were

often slow and in breach of various protocols, the GCC was able to process a larger caseload in less time than courts in other divisions. GCC justices routinely sanctioned, both verbally and formally, attorneys that were late, had incomplete or incorrect paperwork, or breached court protocol while their counterparts in other High Court divisions permitted such behavior.²⁵ Like the DIFC, the GCC is a highly successful, cost-effective, and purpose-built institution that can attribute much of its success to a deeply embedded culture of excellence in staffing.

A high-quality judge (it is unlikely that more than one or two judges will be needed initially) and other court administrator positions may be expensive first hires for a charter city getting started, but it will pay real dividends over the long run in terms of reputation effects.

BOX 12

Commercial Court Reform, Ghana

In 2005 Ghana introduced a new commercial court that has proven highly successful, the Ghana Commercial Court (GCC). The country's legal system had been a poor performer due to decades of political instability. In the early 2000s the country adopted a plan to encourage economic growth and good governance, including the creation of a new commercial court. The effort to create this new court was led by the chief justice of Ghana's Supreme Court, who secured a grant from the Danish aid agency that had previously helped establish a new commercial court in Tanzania.²⁶

The GCC introduced improved professional standards, and experienced lawyers were appointed to lead the court. For example, the woman appointed head of the court's Reform Unit had previously been a solicitor of the Supreme Court of England and Wales. The court's legal personnel were trained by various organizations supporting reforms in Ghana, including a Canadian judges' group.²⁷ As discussed in the earlier section on court personnel, the justices selected for the GCC all boasted long track records of excellence in work and in character and strictly enforced the heightened standards and attention to protocols of the GCC.²⁸

Active case management techniques were introduced to ensure that cases were resolved quickly and included items like pretrial conferences and mediation with trained judges. Mandatory mediation has kept the caseload low, as many cases can be resolved without going to trial. As a result of the establishment of the new commercial court and its improved practices, the average time to resolve a dispute in Ghana, as measured by the World Bank, fell from 552 days to 487 days within a single year.²⁹



The Ghanaian Supreme Court, which oversees all courts in Ghana, including the Commercial Court.

4. Technology

A technology-driven court system can deliver improved system performance, as well as make the court system less susceptible to corruption. Combined with experienced management, the use of information and communication technology can provide a charter city with a vastly superior commercial court to the host country.

The court will need a case management system. Public sector software companies around the world have developed expertise in creating court management software. The charter city administration should review what court management products are available, taking into account the ability of that firm to provide the necessary technical support within the country in question and contract with a firm to provide this service. Effective case management will allow the court to hear more

cases, resolve cases more quickly, and ultimately be more cost-effective.³⁰ Such processes that improve the functioning of the court further increase access for lower-income users.

The court should automate as many procedures as possible. Claimants must be able to file and submit documents, pay court fees, and conduct other court business electronically. This will reduce the need for in-person meetings, reducing both the time needed to complete a lawsuit as well as the opportunities to engage in corruption. The two countries that have fully automated their court processes, Singapore and South Korea, have some of the shortest resolution times in the world.³¹ Electronically storing records can further improve the efficiency of the court and make the work of court personnel easier and less error prone. Electronic storage, when possible, also reduces the need for physical storage and archiving.



The Dubai International Financial Centre.

In addition to technologically driven improvements to court system performance, online dispute resolution (ODR) is an emerging alternative to in-person, courtroom-based dispute resolution. With the global expansion of e-commerce and internet access, less costly yet more widely accessible dispute resolution systems are needed now more than ever before. Encouraging the use of ODR platforms by businesses operating in a charter city can help limit the extent to which small-value disputes must be resolved in court, reducing both the administrative burden faced by the courts and the cost of accessing justice for disputing parties.³² Charter city courts can establish a clear precedent that it will recognize and enforce decisions made by reputable ODR platforms to give both businesses and consumers confidence that even small-value claims can be addressed quickly and equitably.

Tonga provides an illustrative example of how to

successfully leverage technology for a more efficient and low-cost legal system. In 2007 Tonga replaced its manual court filing system with an electronic system and saw a major improvement in court performance. Before computerization it took 510 days on average to enforce a contract. Following computerization this fell to just 350 days, which saved litigants significantly in attorneys' fees and other expenses.³³ The year after the reform, *Doing Business* ranked Tonga 58th in contract enforcement.³⁴

However, Tonga also shows the need to update technology solutions on an ongoing basis; despite its substantial performance improvement reported in 2008, Tonga failed to continue utilizing technology to further decrease the time and cost associated with enforcing contracts. More than 12 years later, it still takes approximately 350 days to resolve a case and costs over 30% of the claim value

to resolve a dispute. Little else beyond case management has been transitioned to electronic processes, and Tonga's contract enforcement ranking has fallen to 98th as other countries continue to make more substantial dispute resolution reforms.³⁵

In addition to the question of electronic technology, there is also room for experimentation with the structure of traditional legal technologies where a charter city could innovate. For example, in a charter city arbitration center, arbitrators could be assigned to cases from a revolving set of arbitrators, rather than having each party pick an arbitrator who then selects the third. Arbitrators could

further be pooled by subject matter expertise to ensure that disputing parties receive the most satisfactory judgment for all involved. Arbitration laws in force in the host country can help make charter city arbitral awards enforceable outside of the city, further boosting confidence in the legal system and its ability to facilitate cross-border trade. If the charter city's country is a signatory of the UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention), this can further boost the legitimacy of the arbitration center's awards as this will allow for their enforcement in any of the 166 signatory countries.³⁶

¹ Doing Business (2019b). "Enforcing Contracts – Why it matters?" World Bank Group: Washington, DC. Available at: <https://www.doingbusiness.org/en/data/exploretopics/enforcing-contracts/why-matters>.

² It is possible that some elements of criminal law could be moved into the domain of civil law within a charter city to shift priorities away from punitive measures or incarceration and instead toward rehabilitative and compensative measures with the aim of successful reintegration into society. However, we do not discuss matters pertaining to criminal law in any greater detail in this chapter.

³ Doing Business (2019c). "Enforcing Contracts (data)." World Bank Group: Washington, DC. Available at: <https://www.doingbusiness.org/en/data/exploretopics/enforcing-contracts>.

⁴ Winston, C. (2012). "Deregulate the Lawyers." Brookings Institution: Washington, DC. Available at: <https://www.brookings.edu/opinions/deregulate-the-lawyers/>.

⁵ Doing Business (2019d). "Botswana (Enforcing Contracts)." World Bank Group: Washington, DC. Available at: https://www.doingbusiness.org/en/data/exploreeconomies/botswana#DB_ec.

⁶ Doing Business (2019e). "Nigeria (Enforcing Contracts)." World Bank Group: Washington, DC. Available at: https://www.doingbusiness.org/en/data/exploreeconomies/nigeria#DB_ec. Lower costs do not necessarily translate into faster performance, however. Although the cost of recouping a claim in Botswana may be lower, the process required 660 days. In Nigeria, this took only 376 days.

⁷ Such agreements and model laws include the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958), the UNCITRAL Model Law on International Commercial Arbitration (1985), and the UNCITRAL Model Law on International Commercial Mediation and International Settlement Agreements Resulting from Mediation (2018).

⁸ Mason, J. (2020b). "Institution-Building Done Well: The DIFC Courts." *Exponents*. Available at: <https://www.chartercitiesinstitute.org/post/institution-building-done-well-difc-courts>.

⁹ Doing Business (2019c). "Enforcing Contracts (data)." World Bank Group: Washington, DC. Available at: <https://www.doingbusiness.org/en/data/exploretopics/enforcing-contracts>.

¹⁰ La Porta, R., Lopez-de-Silanes, F., & Shleifer, A. (2008). "The Economic Consequences of Legal Origins." *Journal of Economic Literature*, 46(2): pp. 285-332; J.I. Haidar (2009). "Investor protections and economic growth." *Economics Letters* 103: pp. 1-4.

¹¹ Astier, C. (2013). "The extraordinary case of Rwanda – or how a small country can take giant steps." Lexology, Available at: <https://www.lexology.com/library/detail.aspx?g=757eca1e-50ab-4f73-8ce9-e658c187b728>.

¹² Krishnan, J.K. (2018). *The Story of the Dubai International Financial Centre Courts: A Retrospective*. Motivate Publishing: Dubai. Available at: <https://www.repository.law.indiana.edu/facbooks/199/>.

¹³ Ibid.

¹⁴ Abu Dhabi Global Market (2015a). "Application of English Law Regulations 2015." ADGM: Abu Dhabi. Available at: <https://en.adgm.thomsonreuters.com/rulebook/application-english-law-regulations-2015-0>.

¹⁵ Abu Dhabi Global Market (2015b). "English Law in ADGM Guidance Notes." ADGM: Abu Dhabi. Available at:

<https://www.adgm.com/documents/legal-framework/guidance-and-policy/adgm-courts/adgm-guidance-application-of-english-laws.pdf?la=en&hash=8ECE0AB7086E6AF995219DB7A194A7F0>.

¹⁶ WJP Rule of Law Index (2020). "Absence of Corruption." World Justice Project. Available at: <https://www.worldjusticeproject.org/rule-of-law-index/global/2020/Absence-of-Corruption/>; Doing Business (2019c). "Enforcing Contracts (data)." World Bank Group: Washington, DC. Available at: <https://www.doingbusiness.org/en/data/exploretopics/enforcing-contracts#:~:text=Thepercent20enforcingpercent20contractspercent20indicatorpercent20measures,efficiencypercent20inpercent20thepercent20courtpercent20system>.

¹⁷ Nunn, N. (2007). "Relationship-Specificity, Incomplete Contracts, and the Pattern of Trade." *The Quarterly Journal of Economics*. 122(2): pp. 569-600.

¹⁸ IMF (2019). "Rwanda, gross domestic product per capita, current prices." International Monetary Fund: Washington, DC. Available at: <https://www.imf.org/external/pubs/ft/weo/2019/02/weodata/weorept.aspx?pr.x=57&pr.y=7&sy=2017&ey=2021&scsm=1&ssd=1&sort=country&ds=.&br=1&c=714&s=NGDPDpercent20PPPDPDpercent20CNGDPDPCpercent20PPPPCpercent20CPCPIPCH&grp=0&a=>.

¹⁹ Hertveldt, S. (2008). "Pragmatism leads the way in setting up specialized commercial courts." *Doing Business Enforcing Contracts Case Study*, World Bank Group: Washington, DC. Available at: <https://www.doingbusiness.org/content/dam/doingBusiness/media/Reforms/Case-Studies/2008/DB08-CS-Rwanda.pdf>.

²⁰ Doing Business (2019f). "Ease of Doing Business in Rwanda (Enforcing Contracts)." World Bank Group: Washington, DC. Available at: https://www.doingbusiness.org/en/data/exploreeconomies/rwanda#DB_ec.

²¹ Zimmer, M.B. (2009). "Overview of Specialized Courts." *International Journal for Court Administration*. 2(1): pp. 1-15.

²² Waindim, J.N. (2018). "Traditional methods of conflict resolution." ACCORD Conflict Trends. Available at: <https://www.accord.org.za/conflict-trends/traditional-methods-of-conflict-resolution/>; Dempsey, J. & Coburn, N. (2010). "Traditional Dispute Resolution and Stability in Afghanistan." United States Institute of Peace Peacebrief no. 10. Available at: https://www.usip.org/sites/default/files/resources/PB_10_Traditional_Dispute_Resolution_and_Stability_in_Afghanistan.pdf.

²³ Krishnan, J.K. (2018).

²⁴ Krishnan, J.K. (2018).

²⁵ McDonnell, E. (2017).

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²⁷ Ibid.

²⁸ McDonnell, E. (2017).

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³⁰ Gramckow, H.P. & Nussenblatt V. (2013). "Caseflow Management: Key Principles and the Systems to Support Them." Justice and Development Working Paper Series no. 81121, World Bank Group: Washington, DC. Available at: <http://documents.worldbank.org/curated/en/368901468325193887/pdf/811210NWP0Case0Box0379828B00PUBLIC0.pdf>.

³¹ Doing Business (2019g). "Good practices - Introducing or expanding case management systems." World Bank Group: Washington, DC. Available at: https://www.doingbusiness.org/en/data/exploretopics/enforcing-contracts/good-practices#Introducing_or.

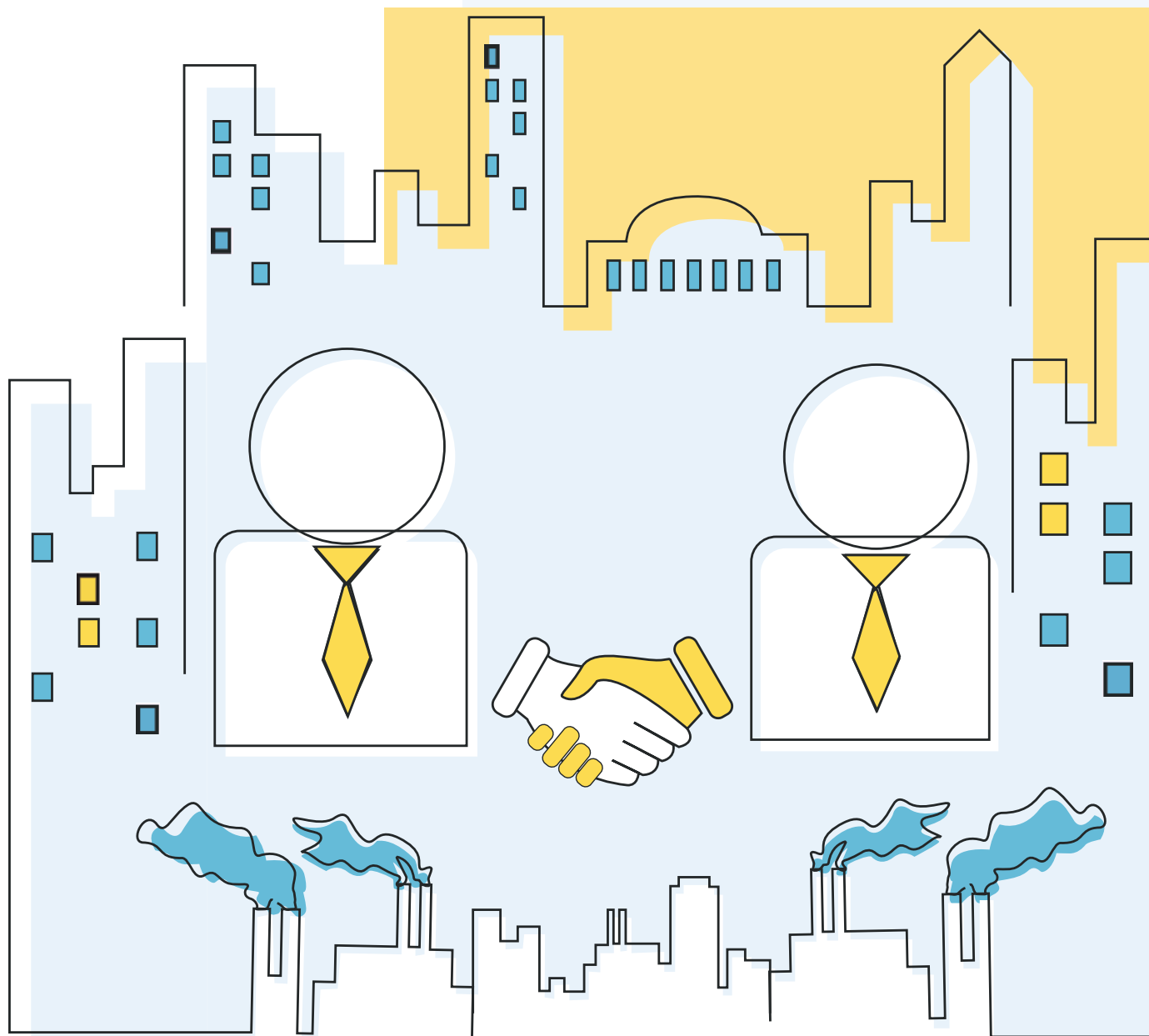
³² Schmitz, A.J. (2018). "There's an 'App' for That: Developing Online Dispute Resolution to Empower Economic Development." *Notre Dame Journal of Law, Ethics and Public Policy* (1): pp. 1-47.

³³ Ford, A. & Lorenz, O. (2008). "Enforcing contracts quickly, with help from the neighbors." World Bank Group: Washington, DC. Available at: <https://www.doingbusiness.org/content/dam/doingBusiness/media/Reforms/Case-Studies/2008/DB08-CS-Tonga.pdf>.

³⁴ Doing Business (2008). "Doing Business 2008." World Bank Group: Washington, DC. Available at: <https://www.doingbusiness.org/content/dam/doingBusiness/media/Annual-Reports/English/DB08-FullReport.pdf>.

³⁵ Doing Business (2019h). "Tonga – Enforcing Contracts." World Bank Group: Washington, DC. Available at: https://www.doingbusiness.org/en/data/exploreeconomies/tonga#DB_ec.

³⁶ United Nations Commission on International Trade Law, "Status: Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958) (the "New York Convention")." Available at: https://uncitral.un.org/en/texts/arbitration/conventions/foreign_arbitral_awards/status2.



PART 3: CIVIL SOCIETY

3.1 PRIVATE LAW

I. KEY TAKEAWAYS

- ✓ Private law governs most of the legal interactions that the residents of a charter city will enter into.
- ✓ A charter city's private legal system should strive toward two main values: (1) international recognition and acceptance and (2) local legitimacy. In addition, each subset of private law should aim to be (a) efficient, (b) transparent, and (c) easy to use.
- ✓ The recommended model for a new charter city's legal system is a mix of borrowed and local code. This approach has the advantages of encouraging economic growth and respecting indigenous legal traditions.
- ✓ The Ulex system is a well-developed approach to a mixed borrowed and local code model.

II. INTRODUCTION

One of the primary reasons for establishing a charter city is an improved business environment. This environment is brought about through the establishment and administration of an effective system of private law.

Private law has among the broadest scopes of law. So when defining private law, it often helps to delineate what it is *not*. Private law is not constitutional law, which lays out the structure and powers of government as well as defines the state's relationship with its citizens. Nor is private law criminal law, which lays out prohibited conduct and the punishments for such conduct. In this handbook private law is defined as those areas of law that wholly or primarily relate to the legal relations between private residents of a charter city rather than between the charter city administration and city residents. Private law is relevant to several key indicators that the World Bank uses in measuring the ease of doing business, like starting a business, registering property, getting credit, protecting minority investors, enforcing contracts, and resolving insolvency.¹

Broadly, the Global South lags significantly behind the Global North in all these metrics, and it is in large part due to the law governing these issues.² This section provides an overview of the most important areas of private law that a charter city must address in order to improve the business environment.

III. VALUES AND GOALS

Private law within a charter city should strive toward achieving the following key values: (1) **international recognition**, (2) **legitimacy**, (3) **efficiency**, (4) **consistency and transparency**, and (5) **ease**.

The values of a private law system are substantially similar to the values iterated elsewhere in this handbook. As several of the chapters of this handbook are expanded upon areas of private law or areas of law that have a strong relationship to private law, there is significant overlap in the values of these subsets of private law and the entirety of private law discussed here. However, the greater scope of private law as a whole dictates that it must have some additional higher values that are not as relevant to the discussion of subsets

Table 6. Summary of Values and Goals for Private Law

Value	Meaning of the Value	Measurable Goals
International recognition and acceptance	<ul style="list-style-type: none"> —Legal system should be up to widely recognized international standards. —International practitioners should want to work in the jurisdiction. 	<ul style="list-style-type: none"> —The number of countries willing to recognize judgments from the jurisdiction's courts. —Ease of recruiting respected legal practitioners to work in the legal system. —Increased domestic and international investment in the charter city.
Legitimacy	<ul style="list-style-type: none"> —Residents consent to the legal system. —Residents believe that the law is fair. 	<ul style="list-style-type: none"> —Residents willingly turn to the legal system to resolve disputes. —Residents prefer to use the legal system as opposed to comparable alternatives.
Efficiency	<ul style="list-style-type: none"> —The court system handles cases quickly and fairly, at low cost. 	<ul style="list-style-type: none"> —Average cost and time to resolve a dispute. —Utilization, cost, and time of alternative dispute resolution mechanisms.
Consistency and Transparency	<ul style="list-style-type: none"> —Residents and legal professionals are able to predict the outcome of a case by analyzing relevant legal codes and legal precedent. —Residents and investors understand the reasoning behind legal decisions made by judges and arbiters in individual cases. 	<ul style="list-style-type: none"> —A consistent set of legal rules are developed through precedent. —Legal decisions are published online with easy access for the public and practitioners.
Ease	<ul style="list-style-type: none"> —Residents and businesspeople are able to access the system without onerous procedures. 	<ul style="list-style-type: none"> —The legal system is mostly or entirely digitized, and relevant procedures can be done online.

of private law. The higher values (goals) in a charter city's private law system should be (1) international recognition and acceptance and (2) local legitimacy.

First, one of the prime motivators for the creation of a charter city as an independent jurisdiction within a greater whole is to establish a legal order that encourages business and investment from diverse international sources. By valuing a private legal system that is **recognized internationally** as one that businesspeople, investors, and legal professionals understand and can navigate effectively, a charter city shows its commitment to the creation of a business-friendly legal environment.

Second, a charter city must respect and take into account the legal traditions and values of the people who will become the residents of the city in order to **boost legitimacy**. Taking extra care to use a legal system that appropriately integrates the population-specific legal traditions around topics such as family law and wills and estates law, a charter city will likely have more leeway to introduce a legal system that may be alien in terms of issues involving property, contracts, and commercial dispute resolution. The value of a charter city is to create a legal environment that drives quality and rapid development, not drastically reshaping the traditions of its residents. One potential way of working with indigenous values and customs is to form joint bodies with

traditional leaders that work to evolve the indigenous laws so those laws fit with the needs of a modern society and with a modern understanding of human rights. Additionally, a charter city could apply the same law as the rest of the nation with regard to subjects that would not have a major impact if unchanged. It is important to understand that indigenous laws and customs will affect the Overton window of acceptable alterations or additions to the law within a charter city. It is preferable to work with these indigenous legal systems as much as it is practical, which may mean that indigenous legal traditions such as family law and wills and estates law are largely left unaltered. Ultimately, the consent of the residents to the private legal system must be valued to the highest degree.

Additionally, a charter city must have a set of overarching values of each subset of private law, which should be: (1) efficiency, (2) transparency, and (3) ease.

First, a charter city should ensure that its legal system is not, and does not become, an expensive process that creates rents for lawyers. While it is necessary that parties are given sufficient time to comply with the requirements of the dispute resolution system, such as the discovery process, excessively long judicial proceedings are not just a denial of justice but an inefficient waste of resources. The private legal system must be **cost-effective** and of sufficiently low price that low-income residents can engage in the services of legal professionals when dealing with commercial

transactions and dispute resolution mechanisms.

Second, the private legal system of a charter city should be **transparent**. In the case of a private legal system, transparency is defined by the ability of residents and legal professionals to be able to predict the outcome of a case by analyzing relevant legal codes and cases. Additionally, transparency is also defined by the public's ability to understand the reasoning behind legal decisions made by judges and arbiters in individual cases. In any legal dispute one party will almost always be unhappy with the decision, but so long as there is sound legal reasoning that can be examined by the parties and the public at large, the system will likely be considered to be transparent.

Third, the private legal system must be **easy for the average resident to access**. This is not to say that it should be a system that is easy to abuse through filing frivolous claims or false liens, but that residents who have valid claims and genuine legal needs can access and use the private legal system without onerous procedures. In ensuring that ease of use is met, it is likely that a charter city will need to turn to technology for the best results.

Ensuring that the system can easily be accessed online ensures fairness, efficiency, and independence. Specifically, the internet should be used to publish the rules that govern the residents that consent to be governed by the city law in their private disputes; the internet should also make it easy to file valid claims and select people to help settle disputes.

BOX 13

Establishing a New Legal System in Dubai, United Arab Emirates

Dubai International Financial Center

The Dubai International Financial Centre (DIFC) boasts that it has a body of law “based on international standards and principles of common law that is tailored to the region's unique needs, creating the optimal environment for financial services and related industries and services to grow.”³ While not as broad in scope as

a charter city, DIFC serves as a template for the creation of bodies of law governing a new legal jurisdiction. In the case of DIFC, Dubai Law No. 9 of 2004 established the jurisdiction and created administrative and regulatory authorities, as well as creating a court system.⁴ The DIFC Courts were established, and common law legal experts were brought in to found a common law legal system.⁵ DIFC also recruited judges from common law jurisdictions.⁶ Furthermore, DIFC's outright adoption of English common law made it a jurisdiction that was understood and trusted by business people and legal professionals alike.⁷



Dubai's International Financial Centre.

IV. IN PRACTICE

The development of a private legal system must address two broad issues: (1) how the private legal system should be modeled and (2) the substantive law that should be used.

1. Options for Modeling a Private Legal System

Private law plays a crucial role in achieving the main objectives of a charter city, including increased business formation and expansion, bolstered domestic and foreign investment, and well-functioning markets. There are three main

routes a charter city administration can take when establishing its private legal code: (1) it can borrow another sovereign's legal system wholesale, (2) it can mix borrowed and local code, or (3) it can use wholly local code.⁸

Each of these options offers a set of benefits and drawbacks that each charter city will have to weigh in order to determine which approach is best suited to its particular case.

1.1 Wholesale Adoption of an Another Sovereign's Legal System

Should a charter city choose to adopt an already established private legal system, it will be following an already well-trodden path. In part due to the legacy of colonialism, there are numerous cases of one nation adopting the law of another wholesale. Examples include the United States of America and Singapore.

The advantage of adopting an already established private legal system is that there is a depth of understanding that already exists among practitioners, officials, and scholars, and in the case of common law legal systems, there is a body of case law that is already established. The main benefit of this route is that it reduces business uncertainty, which in turn helps stimulate greater business formation and investment.

BOX 14

Adopting Laws from Other Jurisdictions, Singapore

As a city-state, Singapore provides an outstanding example of both the adoption of the laws of a different nation and the types of legislation that must be adopted in order to run a new and independent jurisdiction. First, Singapore adopted English common law “applicable to the circumstances of Singapore and its inhabitants.”¹¹ This was clarified through the 1993 Application of English Common Law Act.¹² Additionally, after independence from the United Kingdom in 1963 and the dissolution of its bonds with Malaysia in 1965, Singapore continued to use the Privy Council of the United Kingdom as a court of final appeal, though Singapore ended this practice in 1994.¹³ In terms of major legislation that Singapore has adopted, the law around the sale of goods provides an excellent example of selecting another country's law as a model for legislation. In this case, the Sale of Goods Act is based on the English Sale of Goods Act 1979.¹⁴

1.2 Using Wholly Local Code

A second option is for a charter city to use a wholly local legal system. This approach has the disadvantage of exposure to the local legal system, which may be a source of some of the governance problems in the area. However, it should be noted that often the law on the books in jurisdictions

However, when adopting the legal system of another jurisdiction wholesale, some laws or clauses may be ill-suited for a charter city's particular context. Singapore handled this problem by only adopting those parts of English common law that were “applicable to the circumstances of Singapore and its inhabitants.”⁹ A similar clause could give a charter city-wide latitude to adopt just the parts of another legal system relevant to it. Yet, this leaves open the possibility of litigation and disagreements as to which parts of a private legal system are relevant to the particular circumstances of the charter city. Additionally, because this approach ties local law to that of a foreign sovereign, locals who have a strong sense of patriotism may take offense and perceive the introduction of this type of legal system as a form of colonialism. It is likely that initial attempts at establishing charter cities in Honduras and Madagascar may have failed in part because of the perception that this type of legal system is colonial in nature.¹⁰

that are strong candidates for establishing charter cities is not nearly so bad as the administration. This means that in such a case, a charter city could rely on wholly local law while implementing the administrative reforms discussed in this handbook.

However, a key drawback of this option is that it



The Supreme Court of the Republic of Singapore.

would likely lack an element of reform that makes charter cities an appealing tool to use for development, which is the deep adoption of best practices in commercial regulation. So even if a jurisdiction's laws are generally adequate, they may not be up to date in the same way that a legal system aimed at adopting the best practices of commercial regulation would be in terms of competitiveness in the global marketplace. This option is this handbook's least preferred option. While using an existing legal system has the strong advantage of being already suited to the local needs, it lacks the key advantage that charter cities offer: a legal system that adopts best practices for commercial regulation.

1.3 Mixing Borrowed and Local Code

On a spectrum that ranges from adopting the legal system of another sovereign wholesale on one end to the complete reliance on an indigenous legal system on the other, using a system that mixes borrowed and local code is a happy medium. Additionally, scholars researching and working on charter cities and innovative governance have already done a considerable amount of quality work creating mechanisms that make it easy for charter city developers to create or adopt such a system. Additionally, this is the option that most special jurisdictions could be reasonably classified as presently using.

Currently, the best example of this approach is an innovative system called Ulex, an open-source legal system. Ulex essentially allows a new city to download a set of rules and begin using them on its first day. This is a set of rules that any legal system can operate under and is freely available online for public use, but it is not a complete legal system, only a set of rules necessary for creating a civil law legal system.¹⁵ Ulex essentially takes what a consensus of legal scholars say the law should be on a variety of topics, such as torts, contracts, secured transactions, and many others, and copies them. This has the effect of putting the common law down into statutes, and therefore technically making it a civil law jurisprudence. A charter city could pick one or a few jurisdictions' precedents to use for interpreting Ulex. Vanuatu, for instance, freely uses precedent from Australia, New Zealand, and other jurisdictions to base its Supreme Court decisions on when interpreting Vanuatu statutes that are similar in nature to those country's laws.¹⁶

Plus, all the treatises that comprise Ulex come with scholarly commentary about the main provisions that courts can look to for interpretation. Furthermore, Ulex isn't as complete as an ordinary civil law code, so there is lots of room for interpretation, which allows for courts to interpret Ulex just as when courts interpret statutes in common law countries. This means that a new common law grows on top of the foundation Ulex laid.

Ulex is not the only way that a mixed borrowed and local legal system could be created, but it is an outstanding example of what is possible and currently available. By using the best practices of commercial regulation, indigenous law where appropriate, and filling in the gaps with consensus law, the option of a mixed system is the option that

is currently this handbook's preferred choice for establishing a private legal system in a new charter city. Furthermore, this handbook recommends that a charter city developer seriously consider adopting Ulex if it feels that it is able to do so.

2. *Substantive Law*

This handbook examines substantive law by looking at potential sources for the law and by looking at key and secondary areas of law that must be implemented in a charter city. The following selection of law is drawn from prominent sources around the world and is aimed at providing a familiarization with available high-quality sources. It is important to note that Ulex uses these sources and is the model for a preferred legal system if it is not itself used.

2.1 *Sources of Substantive Law*

This handbook recommends that a charter city not seek to rewrite substantive law for the various areas of law that it needs to enact but instead look to already well-developed and established bodies of law that are respected and trusted by businesspeople, legal practitioners, and academics. There are a number of sources of law that are respected and trusted that a new charter city can choose from, including the American Law Institute's Restatements, the Uniform Law Commission's Uniform and Model Acts, the United Nations Model Laws, and the International Institute for the Unification of Private Law (UNIDROIT).

The American Law Institute (ALI) is a private, independent, nonprofit organization that helps “clarify, modernize, or otherwise improve the law to promote the better administration of justice.”¹⁷ This handbook encourages adopting a common-law model of substantive law that relies on statutes

written by legislatures that are then interpreted by the judiciary. Decisions by the judiciary create precedents that can be relied upon by legal professionals when giving advice to clients and arguing cases. ALI produces the leading set of treatises expounding upon what the common law is in the United States: *Restatements of the Law*.¹⁸ Restatements are highly regarded types of secondary authority and significantly influenced the judicial process around the globe. Many courts have adopted Restatement sections verbatim as the law of their jurisdiction. Moreover, many law professors rely on Restatements in their courses as the definitive source of *black letter law*,¹⁹ which is “basic standard rules that are generally known and free from doubt.”²⁰

Each Restatement consists of a set of volumes based on topics. These volumes contain the actual legal rules and drafters' commentary, as well as summaries of cases that have adopted or interpreted the Restatement rules. The ALI also publishes annual supplements that contain summaries of court opinions that have cited the provisions of that volume. The annual supplements also contain any corrections to the volume that the ALI feels must be made. These publications, like the actual Restatements, are available online or as hard copies. Although it is a copyrighted product, this handbook recommends that charter cities invest in purchasing or licensing the product. Cities are also free to study the Restatements in detail and, instead of adopting the work in its entirety, may draft their own substantive laws that draw on the Restatements as well as any other sources the city deems fit.

Another option for a charter city is to adopt legislation from the Uniform Law Commission (ULC), which is an American law organization that exists to provide “states with non-partisan,

well-conceived and well-drafted legislation that brings clarity and stability to critical areas of state statutory law.” The ULC has 125 Uniform Acts and 35 Model Acts available.²¹ While the uniform and model legislation created by the ULC is all oriented at the American legal system, it does provide a wealth of common law-oriented statutes that are relevant to charter cities. These include the Uniform Commercial Code, which deals with wide-ranging business transactions; the Uniform Securities Act, which aims to provide basic investor protection from securities fraud;²² and the Regulation of Virtual-Currency Businesses Act, which aims to create a regulatory framework for crypto-currencies.²³

The Uniform and Model Acts provided by the ULC serve as comprehensive, well-researched, professional, and highly reputable legislation. If a charter city should use these acts, then it will be using legislation that will be well understood by international legal practitioners.

Another option for charter cities is to look at model legislation drafted by the United Nations, such as the United Nations Commission on International Trade Law (UNCITRAL). The model laws are provided “as a suggested pattern for law-makers in national governments to consider adopting as part of their domestic legislation.”²⁴

While UNCITRAL only provides 15 legislative texts, the texts that it does provide are widely recognized and enacted internationally.²⁵

Finally, the International Institute for the Unification of Private Law (UNIDROIT) provides many such texts. UNIDROIT is an independent intergovernmental organization that was initially established in 1923 as an organ of the League of Nations, and after the League's dissolution was reestablished by treaty.²⁶

UNIDROIT provides a number of resources that are useful to charter cities establishing a private law system. These resources include treatises on the principles of commercial contracts, legislative guides for capital markets, and a model law on franchising, among many others.²⁷

This handbook recommends that if a charter city is not drawing its common law directly from a specific common law jurisdiction that it draws it from the Restatements. Furthermore, if a charter city is drawing its common law from an American jurisdiction or the Restatements, then the ULC model acts are likely a good source of statutory law, but they may be sub-optimal if the common law is being drawn from different common law jurisdiction, and that jurisdiction should be looked to for legislation. Finally, both UNCITRAL and UNIDROIT have highly regarded model legislation and legislative guides that should be used when the charter city wants to meet specific international standards in areas like money laundering and international business contracts.

2.2 Areas of Primary Concern for a Private Law System

There are three areas of private law that are of key concern for a charter city: contract law, corporate law, and property law.

First, contract law is the law that governs making and enforcing agreements. In market-oriented economies, people get the vast majority of their goods and services through interactions with private businesses.²⁸ When engaging in large international contracts between jurisdictions, it is common for parties to agree to a *choice of law* clause that selects the law of a well-regarded common law jurisdiction, such as Hong Kong, Singapore, England,²⁹ New York, or occasionally Delaware.³⁰

This is most often done because of both the favorable disposition and extensive precedent that common law jurisdictions have when it comes to contract law. This handbook recommends that a charter city looks to these well-established jurisdictions when adopting the contract law portion of its private legal system.

Corporate law is the body of law that determines how corporate entities can be organized and how corporate disputes are resolved. In the United States more than two-thirds of Fortune 500 companies are incorporated in Delaware.³¹ This is because Delaware has a well-developed corporate law system with deep precedent. The state also has the Delaware Court of Chancery, a common law court that deals with cases in equity, which effectively means that the courts are largely devoted to commercial and contractual matters. Corporate law does not only deal with the formation of business entities but also deals with the resolution of disputes among shareholders and members of corporate bodies. This handbook recommends that a charter city adopt a corporate law that makes it easy for residents to start a business and resolve disputes between shareholders and members of the corporate entities.

Property law deals with the ownership of real and personal property. A substantial portion of property law deals with the registration of real property, which is addressed in the chapter “Land Registration and Administration.” In addition to the land registration system, a charter city should develop a similar system for registering security interests in personal property. Such a system serves to facilitate secured transactions where personal property is put up as collateral for a loan. For example, in the United States all 50 states have adopted the ULC's Uniform Commercial Code (UCC) Article 9 as the law governing secured

transactions.³² The majority of enterprises do not raise capital from venture capital or private equity, but from loans usually secured by collateral, and in the case of the United States, governed by UCC Article 9.³³ This handbook recommends that a charter city adopt the ULC's UCC Article 9 to govern secured transactions or otherwise refer to the UNCITRAL Legislative Guide on Secured Transactions when drafting secured transactions law.³⁴

2.3 Areas of Secondary Concern for a Private Law System

Private law is an expansive part of the legal system and likely the largest body of law that a charter city will have to create and administer. Alongside the three areas of primary concern for a private legal system in a charter city (above), there are another five areas of secondary concern: tort law, trust law, wills and estates law, bankruptcy law, and areas of law of local concern such as family law.

First, tort law is the way that common law systems deal with civil wrongs, other than a breach of contract, that cause a claimant to suffer loss or harm. Tort law is a key element in common law, market-oriented economies that allow for persons harmed to seek redress without resorting to the state, other than to use the court system.³⁵ Tort law is common law, and a charter city should adopt a body of tort law from the Restatements or from the source which it elects to draw its common law.

Second, trust law deals with a three-party fiduciary relationship where the fiduciary manages the property of one party for the benefit of another. For many, trust law has the connotation of wealthy people using legal but unscrupulous means to protect property from taxation. However, trust law allows for many good outcomes. It provides a

mechanism where people can ensure that after their death, their property can go to the care of their loved ones while being professionally managed.³⁶ Moreover, it allows for the creation of charitable institutions and is even used for pensions.³⁷

Additionally, wills and estates law addresses how a person's property is dealt with upon their death. A will is a document that a person writes while alive that expresses how they want their property to be disposed of after they die. If a person does not have a will, their property is distributed in accordance with a state's intestacy law, first to living heirs, and in the event that there are none, then most often to the state. The ULC has created a law that addresses trusts and wills and estates called the Uniform Probate Code.³⁸ This handbook recommends that a charter city adopt the Uniform Probate Code or a similar piece of legislation in order to address issues of trusts and estates, or otherwise adopt the host country's body of law if more appropriate.

Third, bankruptcy is an important legal mechanism for ensuring an entrepreneurial economy.³⁹ When a borrower becomes insolvent and can no longer pay their debts, bankruptcy provides a mechanism for settling accounts as best as possible while allowing for entrepreneurs and residents to move on with their lives. When a charter city creates a bankruptcy code, it should ensure that it addresses both corporate reorganization and liquidation bankruptcy, as well as personal bankruptcy. This handbook recommends that a charter city refers to the UNCITRAL Legislative Guide on Insolvency Law when drafting a bankruptcy law.⁴⁰

Fourth, there are other bodies of law that a private legal system must incorporate, such as family law. However, issues such as family law are typically

unique to individual nations with their own particular customs. In the case of family law and other sensitive and particular legal issues, it is

likely best that the charter city relies heavily on the host country's laws in these domains.

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- ¹⁹ Ibid.
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- ²¹ For more details on the Uniform Law Commission's available Model Acts see: <http://uniformlaws.org/acts/overview/modelacts>.
- ²² For the Uniform Law Commission's Securities Act see: <https://www.uniformlaws.org/committees/community-home?CommunityKey=8c3c2581-0fea-4e91-8a50-27eee58da1cf>.
- ²³ For the Uniform Law Commission's Regulation of Virtual-Currency Businesses Act see: <https://www.uniformlaws.org/committees/community-home?CommunityKey=e104aaa8-c10f-45a7-a34a-0423c2106778>.
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- ²⁵ Ibid.
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³³ For UNCITRAL's Legislative Guide on Secured Transactions see: https://uncitral.un.org/en/texts/securityinterests/modellaw/secured_transactions.

³⁴ For ULC's Probate Code see: <https://www.uniformlaws.org/committees/community-home?CommunityKey=a539920d-c477-44b8-84fe-b0d7b1a4cca8>.

³⁵ Peterson, C. H., IV. (2020, September 29). "Bankruptcy in charter cities." Charter Cities Institute. Available at: <https://www.chartercitiesinstitute.org/post/bankruptcy-in-charter-cities>.

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PART 4: IMMIGRATION

4. IMMIGRATION

I. KEY TAKEAWAYS

- ✓ The immigration system in a charter city should aim for a minimally burdensome movement of people both between the city and its host country as well as between the city and external jurisdictions. This immigration system must balance relatively liberalized labor mobility with ensuring security within the city boundaries.
- ✓ To achieve the above aim, the charter city administration should have the authority to determine visa policies and should offer specialized visas for investors, entrepreneurs, foreign students, high-skill workers, and visitors and business travelers. In addition to visa-based residence and work authorization, additional workers and visitors will be able to travel to or work in the charter city under international and regional free movement agreements that the host country may be a party to.
- ✓ Charter city immigration authorities should emphasize two main values: (1) maximizing economic impact and (2) ease of access.
- ✓ This chapter breaks down the establishment of a charter city's immigration service into three key components: (1) coordination of a new immigration agency with the existing host country immigration agency, (2) the enumeration of specific visa policies, and (3) immigration enforcement.
- ✓ Ultimately, if there is to be free movement between the charter city and the host country, close cooperation with the existing host country immigration structure will likely be necessary. This handbook recommends that a charter city have its own national immigration agency to better facilitate in-migration while coordinating with the national immigration on matters of security and information sharing. The charter city administration should appoint the head of this new immigration agency.





II. INTRODUCTION

For an economy to thrive, it requires easy access to capital as well as labor at a variety of skill levels. While a charter city can attract some degree of its investment and population from the host country, creating easy channels for potential investors, entrepreneurs, and workers abroad to immigrate will help spur additional economic growth and provide opportunities to many more people.

Specific types of visas to facilitate the movement of investors, entrepreneurs, students, highly skilled workers and their families to the charter city will be needed. Creating these targeted visa categories with modest eligibility requirements will enable the immigration of key workers to the charter city. Such accommodating immigration policies are especially important when it comes to those

workers associated with the initial charter city anchor tenants, as these anchor tenants will be vital to igniting the growth of the charter city economy.

Many in the international development community have advocated for loosening migration restrictions in Global North so that citizens from low-income countries can more easily migrate in search of a better life for themselves and their families. Some studies even suggest that increasing the mobility of migrants could be the single most beneficial development intervention available to policymakers.¹

However, increasing global freedom of movement on a large scale is an infeasible policy goal in the current political climate. Although overall support for immigration across high-income countries is

decidedly mixed, anti-immigration sentiment remains high among many key EU member states and elsewhere. There are also open questions about the impact of emigration on low-income countries. Throughout the developing world, emigration to high-income countries and the associated brain-drain has been cited as a major cause for economic and social concern.² Charter cities offer domestic opportunities to would-be Global South emigrants while also generating *brain gain*, the movement of talented people and their resources into the Global South. Charter cities themselves could also facilitate brain gain in other countries if residents that develop skills in the city then migrate to other low-income countries.³

An effective immigration system will also incentivize more host country expatriates to return. Knowing that they can easily maintain business relationships abroad and recruit people they have met abroad for ventures in the charter city will help facilitate the transfer of current knowledge, skills, and technology to the host country.

At the same time, a robust immigration enforcement system will be needed to make the host country confident that it can maintain an open border with the charter city despite it having an independent immigration regime. An efficient system for verifying traveler and immigrant information, processing at ports of entry, and enforcement of immigration laws will ensure that the system functions as intended, without creating the impetus for the host country to introduce significant limits on migration from the charter city.

It is important to note that when crafting immigration policy, local context matters greatly. Because the charter city is not sovereign, depending on the terms of the concession agreement with the host country, it will likely be subject to the mobility treaties, visa reciprocity programs, and other arrangements made by the host country, as well as sanctions and other such restrictions. The opportunities and restrictions afforded and imposed by the host country to the charter city will partially determine the characteristics of the potential immigrant population, as well as the security and screening measures needed.

Geography will also play a significant role in determining the immigration policies and infrastructure needed to support the charter city. Whether or not a charter city is landlocked or shares a border with a neighboring country will impact how people can access the city, as well as the surrounding host country. Or in the case of an island charter city, extra steps may be needed to facilitate migration to the city because it cannot be accessed by foot or automobile. Modifications of the recommendations in this chapter will be necessary on a case-by-case basis according to these and other factors, as well as the political interests of the host country.

III. VALUES AND GOALS

Two central values should animate the creation of an effective immigration system: (1) **maximizing economic impact** and (2) **ease of access**.

Table 7. Summary of Values and Goals for Immigration

Value	Meaning of the Value	Measurable Goals
Maximizing economic impact	<ul style="list-style-type: none"> —Charter cities will need to attract talent from beyond the host country; this talent should support greater economic growth. 	<ul style="list-style-type: none"> —Total number of firms founded by immigrants. —Value of and employment generated by immigrant-founded firms. —Economic effects linked with particular visa categories, including students and workers.
Ease of access	<ul style="list-style-type: none"> —It should be easy for qualifying applicants to immigrate to the charter city. —Visa conditions should not block people with capital to invest or relevant work experience or education for available jobs. 	<ul style="list-style-type: none"> —Time and cost to complete the visa application procedure and receive approval or denial notice. —Share of visa applicants meeting established criteria that actually follow through on application and immigrate. —Total volume of applications received, as well as the country of origin of applications, to determine if changes to visa requirements need to be made.

First, charter cities are intended to be engines for economic growth. People with talents and people with capital are needed to **maximize the economic impact** of the charter city. While a charter city will be able to attract some level of talent and capital from the host country, it will likely need to attract much from abroad as well. The immigration system should prioritize the migration of those with the greatest potential to achieve this objective and to further economic growth at the margins. To this end, the visa categories introduced in this section of the *Governance Handbook* focus primarily on economic forms of migration.

Charter cities, as with prosperous cities of all stripes, will need residents *without* significant capital and advanced education or training. However, most of these people should be able to migrate from within the host country or potentially from the broader region, subject to the existence of international migration agreements. However, if for some reason migration from the host country is relatively difficult, additional visa categories may be needed to better facilitate the

migration of low-income people to the city.

Through a combination of domestic and foreign migration, a charter city can secure both the talent and capital needed to foster growth and create opportunities for advancement. Given that migration from the host country is likely to be relatively easy, the immigration system can devote a greater focus to a smaller number of immigrants that can be expected to have the greatest marginal impact on growth.

The immigration service can track the number and value of firms started or financed by immigrants, as well as the employment generated from these businesses to measure the economic impact of foreign migration to a charter city. Together, these measures can demonstrate the broader economic impact of specific levels of immigration and can be used to properly attribute these impacts to specific visa categories. Such information can be used to reform visa policies as needed.

BOX 15

Investor Visas, United States

The United States' EB-5 Immigrant Investor program allows investors that invest US\$1 million in an existing or new business that creates or preserves at least 10 jobs, or US\$500,000 in a targeted employment area (those with high unemployment), to become permanent residents. The program directly generated an estimated 85,000 full-time jobs and over US\$5 billion in investment between 1990 and 2014.⁴

Requirements vary widely elsewhere. Other business-focused investment models have higher thresholds than the United States, including Hong Kong (\$1.3 million), the Netherlands (\$1.7 million), and Australia (\$1.3-4.7 million). Property investment models can be found in Greece (\$32,000) and Portugal (\$634,000), among other countries. Direct donation models include Malta (\$824,000) and Dominica (\$100,000). Zero or low-interest bond models include Hungary (\$317,000) and Ireland (\$1.3 million).⁵



Second, while some requirements for the different visa types need to be maintained for each category to have meaningful value, it should be relatively **easy for qualifying immigrants to access** the charter city. The minimum requirements should not be so excessive as to block the entry of capable people that can immediately contribute to the charter city economy and community. If a potential immigrant has money to invest or relevant education or work experience for an

available job, they should easily be able to come live and work in the charter city. More talented people working in one place make the city, its residents, and the talented immigrants themselves better off. High-income countries with stringent or complex immigration systems miss the opportunity to gain millions of motivated and creative people every year with no clear, tangible benefits from increased stringency.⁶ A charter city should not make the same mistake.

There are several key metrics that the immigration service can track to gauge how effectively it enables the entry of new residents from abroad. The average time it takes for visa applicants to complete the visa application procedure and to be approved or rejected for a visa indicates how effectively the immigration office does its job relative to the host country and to other countries. The immigration service can collect information on the number of applications received, as well as the country of origin, to better gauge demand and adjust visa requirements as needed.

IV. IN PRACTICE

This section details the process of setting up an immigration system for a charter city. The establishment of the immigration service can be broken down into three components: (1) coordination with the existing host country immigration agency, (2) visa policies, and (3) immigration enforcement.

1. Coordination with the Existing Immigration Agency

The charter city immigration agency should be separate from the host country immigration agency, but close coordination between the two is necessary. By establishing an independent immigration agency that coordinates with the host country agency, the city can take advantage of a

more streamlined bureaucracy that is not plagued by the difficulties that make many Global South immigration agencies inefficient.⁷ Coordination, including information sharing and security and health enforcement, can help facilitate a seamless border between the two countries while empowering the charter city to implement its own immigration policies.

The charter city administration should be responsible for appointing the director of this agency and have the freedom to develop its own visa policies.

The visa categories created would be unique to the charter city jurisdiction, although they would still be visas recognized by the host country. A similar arrangement exists for certain British Overseas Territories, like the Falkland Islands that has its own visa policies despite not being a sovereign entity.⁸

While the charter city administration sets the visa policies, the charter city immigration agency should be responsible for verifying information, conducting security screenings, and issuing visas in coordination with the host country immigration agency as required. Access to databases and other critical infrastructure should be shared between the two entities.

2. Visa Policies

BOX 16

Entrepreneurship Visas, Canada

Canada's Start-up Visa Program provides relatively low thresholds for investment. An entrepreneur or group of up to five entrepreneurs must get a letter of support from a designated organization pledging investment, including venture capital firms (\$200,000), angel investor groups (\$75,000), or a business incubator. Applicants must prove some English or French skills and financial sustainability. Canada's provinces also offer a wide variety of their own start-up visa programs to attract investors to their region.⁹

2.1 Visa Reciprocity and Freedom of Movement

Many countries use visa reciprocity agreements, which allow for visa-free travel, to improve the freedom of movement for their citizens. Charter city visas must adhere to the reciprocity agreements of the host country to ensure that the proper security screening can be completed. When possible the charter city administration should lobby the host country government to expand the list of countries with visa reciprocity to allow for increased travel to and from the charter city.

Expanding the freedom of movement has been and continues to be a primary goal of international unions like the Economic Community of West African States (ECOWAS), the Southern Common Market (MERCOSUR), and the European Union (EU). Freedom of movement, especially when it includes the right to reside and

work in any member state of the agreement, presents excellent opportunities for growth. For example, the EU's Schengen Area, which allows for passport- and border control-free travel between member states, has delivered increased trade, lower prices, smoother value chains, more tourism, and other benefits.¹⁰ Charter cities located in host countries that are member states of international unions allowing for freedom of movement will benefit greatly.

2.2 Visa Types

There are five key visa types for a charter city to offer: (1) an investment visa, (2) an entrepreneurship visa, (3) a high-skill visa, (4) a student visa, and (5) a visitor/business visa. Note that the visa policies described below are written for the *initial* years of the charter city. As the city grows and becomes wealthier, the visa policies given here may need to



The Hudson Yards development in Manhattan, financed primarily with EB-5 Immigrant Investor Program capital.

be adapted to mirror this transformation. The visa categories recommended below should be interpreted as distinct visa categories from those of the host country and that they only apply to the charter city unless the host country grants permission to these visa holders. It is in the best interests of the charter city and the host country to grant that permission, but this is beyond the scope of powers of the charter city administration and would need to be determined in negotiation with the host country government.

2.2.1 Investor Visa

The requirements for investor visas vary by country but typically offer residency and other benefits in exchange for a minimum level of investment. Investment requirements vary by country and include donations to development funds, real estate investments, investments in businesses, and more. Minimum investment thresholds range from under US\$100,000 to well over US\$10 million, but charter cities should aim toward the lower end of this distribution. Investor visas are a low-cost mechanism for a charter city to generate investment.¹¹

There are various qualifying investments that would be sensible to adopt for a charter city investor visa program. The minimum investment thresholds should be low enough so that substantial investment is possible because the higher the threshold, the fewer investors that meet it. However, the threshold should not be so minimal that the charter city simply becomes an easily accessible tax shelter, as many immigrant investor programs in small countries have been charged.¹² Residency requirements can help ensure that this is not the case, and permanent residency can be made conditional on this consideration. It is also important to note that the kinds of tax policies

typically ascribed to tax shelters are not present in the “Tax Policy and Administration” chapter of this handbook.

Two types of qualifying investments could benefit the charter city administration directly. The first is a direct donation fund maintained by the city government that an investor can donate to as their qualifying investment. Such programs are often referred to as Citizenship-by-Investment or CBI programs. This would provide resources for immediate use by the city at virtually no cost. A second option, if the charter city administration plans to issue bonds, is to require interest-free investment in those bonds for a fixed number of years. This scheme requires the government to pay back the investment after a fixed number of years, but given the growth potential of a charter city, this should be feasible.

Other potential investment options benefit the economy of the charter city rather than the city government directly. One is to require investment in a new or existing business within the charter city, which can help generate new employment opportunities in the city. A second option is to invest in real estate within the charter city. To ensure that this option is put to productive use, the charter city administration can set parameters for approval of real estate investments. For example, the United States' EB-5 Immigrant Investor Program that offers visas to qualifying investors requires that an EB-5 investment project create at least 10 new, full-time jobs per investor.¹³

Regardless of the type of investment required, qualifying investors and their immediate families should be eligible for residency in the charter city. Five-year visas granting residency are a common standard, after which time the visa is either renewable or can be transitioned to permanent

residency. A residency requirement can be introduced as a criterion for transitioning to permanent residency, with the condition being that the visa-holder must reside in the charter city for some fixed portion of the five-year period. Residency requirements can also be modified to encourage one form of investment over another. In addition to residency, the investor and their immediate family¹⁴ should be eligible to work and attend school within the charter city and should have full access to any government services. After receiving permanent residency, the investor visa-holder should be free to do as they please,

including sell or otherwise fully divest themselves from the original investment asset.

In the early stages of the charter city, the city administration will be in need of revenues to make the necessary investments to accommodate rapid urban expansion, and so may want to incentivize direct donation investment visas or investment visas linked to municipal bonds in these initial stages. The business investment model is the most popular form of investor visa and likely produces the greatest economic returns.¹⁵ Both should be prioritized early on to attract new investment to the city.

Table 8. Investor Visa Category Recommendations

Investment Type	Minimum Investment Threshold	Residency Requirement for Permanent Residence
Direct Donation Fund	—\$200,000 —One-time investment	—40% of five years
Government Bond Investment	—\$300,000 —Bonds held for five years	—40% of five years
Business Investment	—\$100,000 —One-time investment	—30% of five years
Real Estate Investment	—\$200,000 —One-time investment	—50% of five years

2.2.2 Entrepreneurship Visa

In addition to generating investment, immigration can be an excellent source of new business activity. Entrepreneurship and startup visas are commonplace worldwide. Creating an accessible channel for individuals with business ideas will help grow the economy of a charter city. While in many countries these visas are focused on tech and other advanced industries, the types of businesses eligible for an entrepreneurship visa in a charter city should be unlimited.¹⁶ Because the charter city needs to attract thousands of new residents, all kinds of businesses, from tech firms to restaurants and retail, will be necessary.

To secure an entrepreneurship visa, an applicant should provide an overview of their business plan as well as evidence that they either currently possess the funds necessary to launch the business or have been pledged the necessary funds by a third-party individual or financial institution. Alternatively, a resident of the charter city may pledge to financially support the applicant while they secure funding for the business. Receipt of an entrepreneurship visa should be accompanied by a connection of the entrepreneur to the city's investment promotion office to help the individual secure funding.

Within two years of the visa being granted, the

business must be operational; otherwise, the visa is revoked.¹⁷ If the business remains fully operational for an additional three years, the visa holder may become eligible for permanent residency. Once granted permanent residency, the entrepreneur may do as they please, including shutting down the

business, without fear of losing permanent residency. Entrepreneurship visa holders should be able to bring their immediate family with them and will enjoy full access to the city's public services.

BOX 17

Student Visas, United States

One useful student visa program to examine is Optional Practical Training (OPT), used in the United States. OPT allows foreign students, either while at school or after they have graduated, to work in a job relevant to their field of study for up to one year. Students with degrees in science, technology, engineering, and mathematics are eligible for a two-year extension on top of the first year of OPT. The program allows students to transition to other types of work visas so that they may continue to work and live in the United States. The program has proven to be an excellent mechanism for attracting and retaining the abundance of talent possessed by foreign students that come to the United States. Recent research on OPT indicates that program participants increase US innovation and patenting, as well as earnings.¹⁸

2.2.3 Student Visa

Higher education institutions will be both an important anchor for charter cities as well as an essential source of much-needed human capital. While many of their students will likely come from the host country, some may come from abroad and will therefore require student visas.

To acquire a student visa, applicants simply need to provide proof of enrollment at an educational institution within a charter city. Student visas should be renewable every two years, so long as the student can prove they are still an enrolled student. In addition to their studies, foreign students should be eligible to work in the charter city after graduation in a field related to their academic degree for a period of two years. If the student can show proof of employment that is not temporary in nature, they should become eligible for permanent residency after the post-school two-year period. Doing so will help the charter city retain its best young talent, helping to continually

boost growth and innovation.

2.2.4 High-Skill Visa

In addition to investors, entrepreneurs, and students, many talented individuals will want to come and work in a charter city. Certain skills needed by charter city businesses or institutions may not be widely available locally, and so recruiting candidates from abroad becomes a viable option. Alternatively, foreign investors may want to have some of their own employees come to the charter city to operate the business they have invested in or to train local employees to do so. Any universities in a charter city will likely need to hire some share of their faculty from abroad. There are many reasons to hire talented individuals from around the world whose presence in the charter city will help it grow and become more productive.

Businesses in charter cities should be able to sponsor an individual for a high-skill visa.

However, to ensure that the visa holder is not wholly reliant on their employer to have residency and work eligibility in the charter city, visa sponsorship should be transferable to different employers in the event of an employment change. After three years of continuous residency, high-skill visa holders should be eligible to become permanent residents.

In addition to educational institutions, medical institutions, businesses, and other entities that would likely require skilled foreign workers, any city administration officials that are not nationals of the host country should be admitted under this visa category (assuming that any restrictions on government employment of foreigners by the host country are not applicable in the charter city). Students should also be eligible to transition to this visa if permanent residency is not offered after the visa expires.

Applicants should be required to provide evidence of a degree from an institution of higher education in a field relevant to their prospective employment to qualify for a high-skill visa. Alternatively, proof of work experience in a relevant field can replace the education requirement.

2.2.5 Visitor/Business Visa

Visitor/business visas should be made available for those temporarily seeking access to the charter city from abroad. Applicants should provide proof of financial stability sufficient for their intended duration of stay, or alternatively, a local sponsor may pledge to support the traveler for the duration

of their stay.

Visitor/business visas should be valid for six months and allow the recipient to travel in and out of the charter city as frequently or infrequently as they desire. A single three-month extension should be made available for visa holders that need to extend their stay beyond the original six months. Visitor/business visas do not provide legal work authority, nor do they authorize residency.

2.2.6 Lower Skill Workers

Because charter cities are intended to be built in lower-income countries with limited educational attainment levels, it is unlikely that a charter city would need a special class of visa for lower-skill workers. Most of these workers will migrate from the host country to the charter or from a neighboring country where they are likely already eligible to live and work in the host country under regional agreements or organizations.

2.2.7 Family Sponsorship

Under the visa categories in subsections 2.2.1 through 2.2.4, visa holders are eligible to bring their immediate families to the charter city with them. These family members enjoy the same residency, work authorization, and other benefits as the principal immigrant. Once the principal immigrant has acquired permanent residency or citizenship, as per host country law, they should also be eligible to sponsor a parent, sibling, or dependent relative on the condition that they assume financial responsibility for that individual.

BOX 18

High Skill Visas, Canada, Australia, United States

Countries have taken a variety of approaches to high-skill immigration. Canada and Australia use points-based systems that award more points to applicants with advanced degrees, language skills, work experience, age,

and other considerations. Canada and Australia both admit high numbers of immigrants as a share of their total population, and both systems are generally regarded favorably.

Canada uses a two-tiered points system. The first stage of the process requires potential immigrants to submit information about themselves to see if they qualify for any of Canada's various immigration programs. Those that meet the minimum qualification are then entered into a dynamic ranking system, under which those with the most points are invited to apply for relevant immigration programs.¹⁹

The Australian system requires applicants to apply for entry under a list of needed occupations. Points are assigned based on the applicant's human capital characteristics, employment offers, and other factors. Applicants are then ranked and selected based on their scores.²⁰

In the United States, the H-1B visa program allows US employers to file petitions for workers they would like to hire from abroad for specialty occupations that require at least a bachelor's degree. Engineering, technology, and medical jobs frequently qualify for H-1B visas. The program is currently capped at just 65,000 visas, so a lottery system is used to determine recipients. An additional 20,000 visas are made available for those with graduate degrees from a US institution. The H-1B has been a positive force for innovation and economic growth in the US.²¹

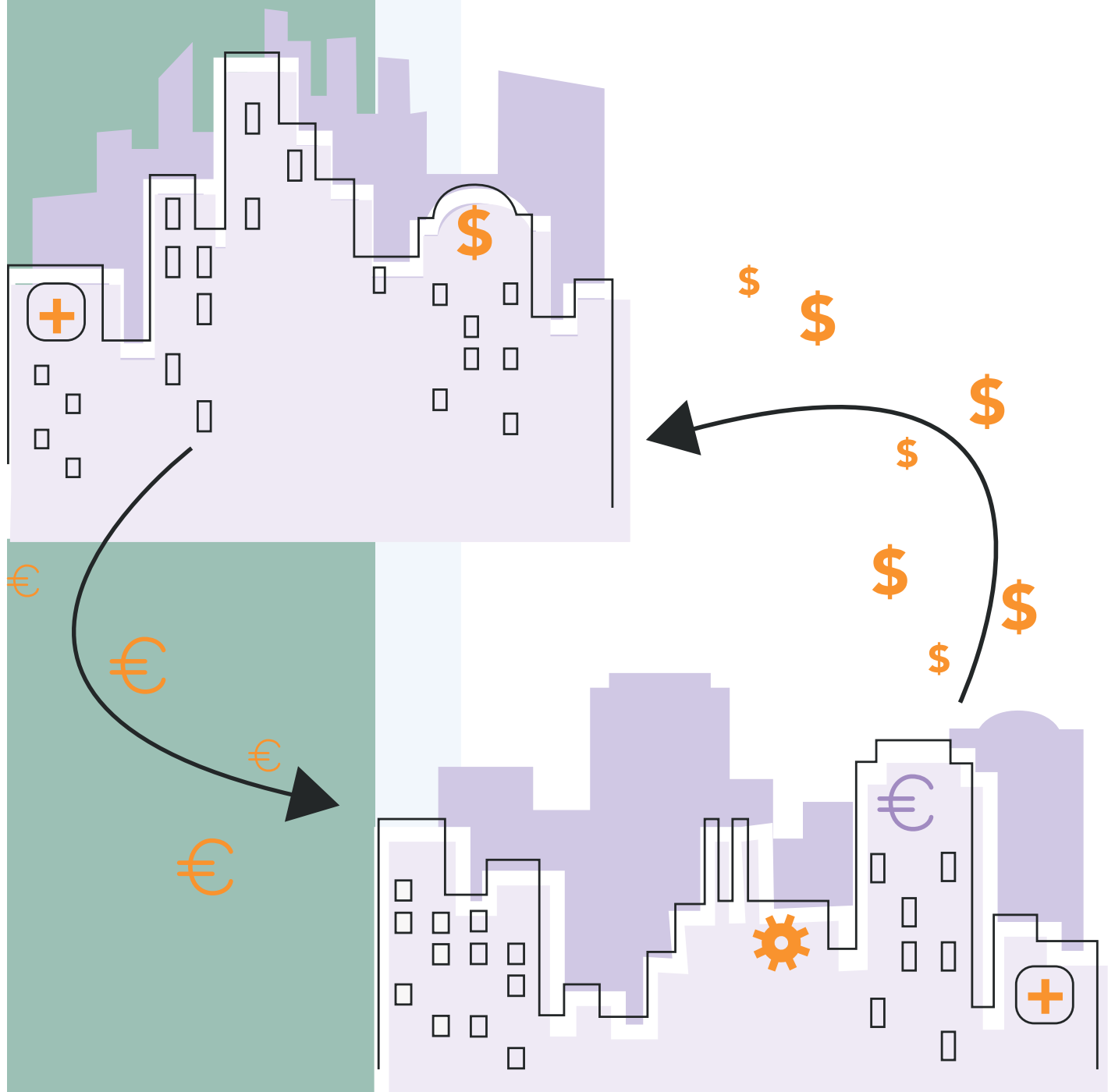
Regional political and/or economic blocs, such as the United States-Mexico-Canada Agreement (USMCA)—the successor agreement to the North American Free Trade Agreement (NAFTA)—have included high-skill labor mobility provisions. The existence of such agreements between the host country and neighboring states would be highly beneficial for a charter city. Under the USMCA, the United States offers Canadian and Mexican nationals working in one of more than sixty specified occupations, virtually all of which require at least an undergraduate degree, work authorization on a one-year renewable basis, with the ability to renew for three-year increments indefinitely after the third year.²² Such immigrants and their employers are able to bypass many of the lengthy and complicated processes required by other immigrant categories.²³ Utilizing and expanding such agreements can help a charter city, as well as the host country, participate in a much wider and richer labor market.²⁴ Although the USMCA work authorization, referred to as TN status, does not offer a direct path to permanent residence like the aforementioned Canadian and Australian systems or the H-1B program, this kind of regional arrangement could still provide greater access to talented individuals for a charter city.

3. Immigration Enforcement

Immigration enforcement in a charter city will be the responsibility of the special office of the host country immigration service. This includes the verification of identification materials at any ports of entry and the enforcement of penalties for

violation of host country immigration and criminal laws, which may include deportation. Note that these laws and their enforcement will typically fall outside the jurisdiction of the charter city administration and must therefore be enforced as per the laws of the host country.

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PART 5: COMMERCE AND TRADE

5.1 LAND REGISTRATION AND ADMINISTRATION

I. KEY TAKEAWAYS

- ✓ Land rights that are legible, secure, searchable, legally enforceable, and easily transacted on functioning land markets are all essential ingredients for a charter city. Without these attributes, scarce urban land will likely be misallocated away from its most productive uses.
- ✓ Opaque, confusing, overlapping, and/or convoluted informal systems of land rights increase transaction costs and in turn hamper needed urban investments from both the public and private sectors, constraining economic growth.
- ✓ This chapter runs through the essential steps to establish a functioning land market in a charter city, including (1) the creation of an effective land registration and administration system and (2) the setup and ongoing maintenance of a digital land information system (LIS).
- ✓ Important knock-on effects of an effective land administration system include (1) the increased ability of banks to better gauge creditworthiness and thereby improve loan quality (see the chapter “Banking and Financial Regulation” in this handbook) and (2) the enablement of charter city administrations to better implement and raise revenues from land-based taxation that can then be channeled toward needed urban investments (see the chapter “Tax Policy and Administration” in this handbook).



Kibera slum in Nairobi, Kenya.

II. INTRODUCTION

The establishment of an effective and functional land registry is an important part of a charter city. Investment and entrepreneurship are encouraged when individual property rights are clear, secure, and legally enforceable. However, in many countries in the Global South, land rights are unclear, insecure, and ineffectively enforced, which not only discourages investment and private enterprise but oftentimes leads to extra-legal expropriation, outright conflict, or broader social unrest.

On top of these considerations, a functional land registry is important because it lowers transaction costs by making land parcels easily searchable and marketable, allowing buyers and sellers of land to easily connect with each other and engage in mutual exchange. Such efficiencies when it comes to land market transactions ensure that scarce urban land is allocated toward its most productive use, maximizing the economic output of the city.¹

Moreover, as economist Hernando de Soto and others have argued, a legal land title can allow the holders to use their property as collateral to improve their creditworthiness and access loans which they otherwise would not qualify for.² This can permit these individuals to invest more in themselves, their families, their businesses, and in their wider communities, spurring increased economic growth.

Additionally, an effective land registry makes property ownership more legible to governments, which permits these governments to collect taxes on land and property more efficiently.³ Land and property taxes have been an integral part of municipal finance throughout history, as they allow city governments to capture some of the vast wealth created by urbanization and channel it toward the provision of key public goods and services needed to accommodate urban expansion.⁴

On the whole, clear land rights formally enshrined, maintained, and administered in a land registry are an essential ingredient to a well-functioning charter city. This sentiment is best summed up by a recent World Bank report: “to build cities that work, make land markets work—nothing less will do.”⁵

III. VALUES AND GOALS

A successful land registry effectively maps ownership rights to de facto use rights. A clear view of de facto use rights is crucial for city administrators because the main way the administration raises own-source revenue is through levies, lease fees, and/or taxes on land within the charter city. A charter city land registry should have three overarching values to maximize effectiveness: (1) efficiency, (2) transparency, and (3) ease.

Table 9. Summary of Values and Goals for Land Registration and Administration

Value	Meaning of the Value	Measurable Goals
Efficiency	<p>—The cost-effectiveness of the land registration process should be maximized (i.e., the output ascertained for a given input).</p> <p>—For example, in Rwanda, mapping</p>	<p>—Benchmark to lowest-cost countries for registering land as measured by the World Bank's Doing Business Index, specifically the indicator ranking registering property.</p> <p>—Measure both the <i>direct</i> benefits</p>

	and surveying a plot of land cost US\$6 on average, while in Tanzania the comparable costs were up to US\$3,000. ⁶	(government revenues from lease fees and property/land taxes applied to newly formalized land) as well as <i>indirect</i> benefits (increases in access to formal credit, such as indicated by the number of newly approved mortgages). ⁷ —The fee charged for land registration should be fine-tuned over time so that the land registration and administration system within the charter city can (at the very least) finance itself.
Transparency	—Opaque property rights systems lead to land market frictions that result in higher transaction costs, which discourages investment. This means that land oftentimes will not be allocated to its most productive use. —When transparency in land ownership is absent or unclear, the likelihood of land disputes and outright conflict increases. ⁸	—Transparency can be increased through regular (e.g., yearly) public awareness campaigns and community sensitization. A goal or metric around public awareness activities is engagement or attendance around these campaigns. —Measure the percentage of total court cases that pertain to land disputes. —As an online land information system (LIS) is one of the main factors contributing to transparency and accessibility of land registration among residents, the LIS's down-time should be tracked on an ongoing basis. This is especially true in countries that suffer from frequent power outages. —To bolster transparency a clear land administration manual should be publicly available that sets out procedures, rules, and service delivery targets for each transaction, agency, and service, and the associated costs of these services.
Ease of Use	—The process to register land should be simple for registrants to complete and for registry staff to process.	—Minimize the average time it takes to complete one land title registration or transaction. —Benchmark ease of use to the registering property indicator published in the World Bank's Doing Business Index. —Ease of use is also related to broad accessibility. The land administration system should be used by everyone, not legible only to the educated and wealthy. Therefore, the administration should precisely track <i>who</i> is using the system. If there are very few low-income users, this indicates an accessibility/ease of use problem.

IV. IN PRACTICE

city agency overseeing land administration.⁹

This section overviews the step-by-step process of setting up a land registry and the corresponding

Broadly, land administration within a new charter city occurs in three phases:

1. Prerequisites

This chapter assumes that a few key steps—the prerequisites (Phase 1)—have already been completed. First, it assumes the appropriate legal authority over land administration has been devolved to the charter city within its jurisdiction, meaning host governments cannot arbitrarily interfere. Second, it assumes that the use of city land (public use vs. private use) has already been delineated by a master plan.¹⁰ Third, it assumes that land acquisition and compensation of pre-existing community members have already taken place.¹¹

2. Land Registration and Administration Setup

Once the above prerequisites are in place, land registration and the establishment of the city's land administration agency can begin.

There is a vast literature on effective land administration systems and land registries and some professional associations that should be consulted on best practices. For example, see the European Land Registry Association (ELRA), the International Property Registries Association (IPRA-CINDER), and the Property Records Industry Association (PRIA).

In part due to the vastness of the literature, this section is by no means meant to be exhaustive. Rather, the intended goal is to highlight the most important decisions that the city developer will face in setting up and operating an effective land administration system in a new charter city. Best practices and recommendations will be suggested, and further references will be provided throughout. The main decisions around land administration that this section overviews are as follows:

Key Land Administration Decisions

2.1 Deciding the Type of Land Registration System

2.2 Deciding the Type of Land Tenure to Offer

2.3 Choosing the Best Allocation Method for the Initial Land Allocation

Before tackling these three key decisions, it's important to quickly define the different components of land policy. Broadly, land policy within a charter city can be broken down into three key functions of increasing specificity: (1) land use management, (2) land administration, and (3) a land registry.

First, land use management refers to the process of allocating scarce land to good effect. This entails the adoption of planning and management practices that aim to fulfill particular social, economic, and legal principles. Such principles are typically laid out in an underlying legal framework and associated policy documents, which animate the legal framework. In this case, we have assumed that a master plan for the charter city has already been created and that legal authority over land has been devolved to the charter city administration. As such, the principles this handbook recommends (see the Values and Goals section in this chapter) should already be given expression within this master plan and within related land regulations passed by the charter city. For further guidance on land use management, see the chapter “Land Use Regulation and Building Regulation.”

Second, land administration involves determining, recording, and disseminating accurate information about (a) ownership, (b) land use, and (c) land value, and keeping this information up-to-date and accurate over time. The benefits of an effective

land administration system are already discussed in Part II of this chapter.

Third, the land registry is, in effect, the *actual tool* utilized to record, track, and disseminate data on ownership,¹² land use, and land value.

2.1 Deciding the Type of Land Registration Systems

When establishing a land administration system and its associated land registry, at a high-level, there are two overarching types of land title systems. The first is called the Torrens system of land titling. In essence, the Torrens system has an owner of a parcel of land recorded in a land registry maintained by the government or registrar of land, and whoever is recorded as owner in the land registry has an *indefeasible* title to that land. The second is the deeds registration system, whereby all of the important legal instruments and documents related to a particular parcel of land are recorded in a government-maintained registry. In the deeds system the burden of proof is on the individual professing to hold the title to show that they have *good title*, which typically involves having to show a chain of title documents that have been executed properly. As the deeds system often creates many more frictions when transacting land, it can be much costlier and lead to more litigation when disputing parties can't come to an

agreement that good title has been demonstrated. As such, most jurisdictions around the world are either using the Torrens system or are in the process of switching over to it. This handbook recommends that the Torrens system be used.

The Torrens system has three main principles:

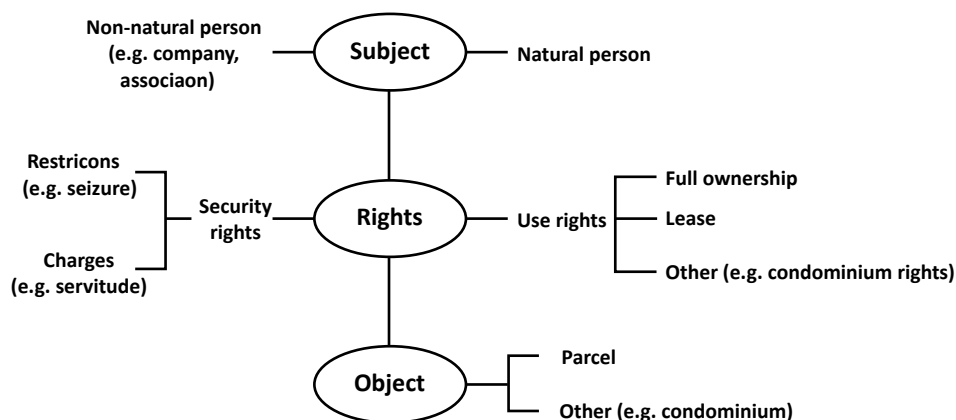
—**Mirror principle:** Affirms that the land registry is an accurate and complete picture of the current legal state of each parcel registered.

—**Curtain principle:** States that there is no need to investigate and show a *chain of title documents* (as in the deeds system), as a certificate of title contains all necessary information (and is conclusive evidence of ownership).

—**Guarantee/Indemnity principle:** Insures losses stemming from incorrect information in the land registry that contradicts the actual identity of the true, rightful claimant, such as through fraud or human error. Compensation is typically paid out of an insurance fund of the government, or in this case, of the charter city administration.

Any land registry following the Torrens system should include the three key components represented by Figure 1 below.

Figure 1. Three Components of a Land Registry Using the Torrens System¹³



In essence Figure 1 illustrates that land registration effectively records (1) which *subjects* (persons/non-persons) have (2) which tenure *rights* (freehold, leasehold, etc.) on (3) which *objects* (parcels of land).

To do this effectively in practice requires three elements:

- 1) A land registry that records this raw data on subjects, rights, and objects.
- 2) A cadastral registry—the spatial component of the system—that shows the precise location of parcels, parcel size, as
- 3) Linking the land registry and the cadastral registry is done by assigning each parcel in the master plan/charter city map a unique parcel ID number entered in both registries.

BOX 19

Torrens vs. Deeds

This chapter assumes the charter city developer has ascertained ownership over all land within the charter city jurisdiction and has devolved authority over land administration and land use from the host government. Unfortunately, in certain contexts, the pre-existing land registration system that prevails in the host country could come to adversely impact the legal security and clarity of the city developer's claims to land ownership.

In a Torrens (title) system, as long as the city developer has a properly executed title to the city land, their ownership is clear and legally secure. This is because the Torrens system's curtain principle specifies that the certificate of title is conclusive evidence of ownership. However, in a country where the prevailing land registration system is a deeds system, the city developer must be much more careful. In countries that use deed systems, it matters who owned and used the land *before* the developer acquired it—information that is often unclear and difficult to know for certain. One of the reasons the deeds system is so much more prone to corruption than the Torrens system is the requirement that the purported owner must show a chain of title documents, with each link in this chain required to be executed in accordance with the law. In countries plagued by corruption and poor governance, fake deeds are created every day, and this reality could put the developer's land ownership claims in legal jeopardy.¹⁴ In order for the city developer to ensure its investments aren't put at risk in a country with a deeds registration system, it must possess the chain of title documents on all of its acquired land and show this chain is complete and in good standing. Additionally, protective language should be included in the land agreement between the city developer and the host government that mitigates against the inherent risk of land insecurity associated with a country's deeds registration system.¹⁵



2.2 Deciding the Type of Land Tenure to Offer

There are many types of land tenure systems prevailing in the Global South. The most common tenure systems are customary (informal) tenure on one end of the spectrum and more formal freehold and leasehold tenure on the other end. In the middle there are various intermediate forms of land tenure. However, the best way to spur investment and business formation when it comes to land is to ensure property rights are secure, legally enforceable, and marketable. The only two tenure types that successfully accomplish all three of these over the long-term are freehold and leasehold tenure.¹⁶ Therefore, the difference between these two tenure systems is focused on here.

—**Freehold tenure:** gives the holder perpetual private ownership of the land in question.

—**Leasehold tenure:** entails the charter city administration merely issuing *use* rights over land to individuals/firms for a specified period of time, with the city administration still retaining ultimate ownership of the land.¹⁷

This handbook recommends leasehold tenure for a few reasons. First, even though the city developer leases out the land, it still owns the land at the end of the lease. This allows the city developer to capture the appreciation in urban land values over time. Second, because the city developer profits from the rise in land values, they are therefore incentivized to make needed investments in public services and infrastructure in order to attract as many businesses and residents to the city as possible (thereby increasing land values—and thus profits—further). Third, leasehold also permits the developer relatively more flexibility to retain particular parcels of strategic land for future urban

development, such as for transport infrastructure.¹⁸ Fourth, leasing out the land to the highest bidder ensures regular future streams of revenue (via lease payments) for the charter city developer. Indeed, if the charter city charges the full market rental value for leases, this is effectively a 100% land value tax, and these revenues can then be used to pay for public investments.¹⁹ Such predictable streams of revenue can allow the developer to access international capital markets to finance urban investments. Land value taxation/land lease-based financing is discussed more in the chapter, “Tax Policy and Administration.”

There is an additional benefit from this recommended model where the charter city developer owns all the land within the charter city jurisdiction—or leases it from the host country—and then leases or subleases land to the city residents. Namely, once both land acquisition and compensation of pre-existing community members have been completed, all future land registration—or rather *lease* registration—can be done entirely by the lessor (the city developer) without asking anything of the lessees (residents or businesses). For example, registration fees from lessees can be waived. Such a model could greatly improve both the speed, accessibility, and efficiency of formal land transactions.

This type of land lease financing for urban development projects has underpinned the ability of city governments in China to successfully accommodate rapid urban expansion.²⁰ Through leasing as well as land sales at the end of leases, Chinese cities have been able to capture land value appreciation and reinvest this appreciation in the provision of necessary public goods, services, and urban infrastructure for the city. For example, in 2013 alone Chinese municipal governments sold local land that added US\$2.4 trillion to city coffers

(35% of overall municipal revenues).²¹

There are six important pieces to this recommended leasehold model that should be incorporated by charter cities to replicate such success:

—**Flexibility to build or sub-lease.** Lessees should be given the flexibility to build whatever they want²² on the land they've leased or to sub-lease their land, very similar to the freedom that comes with freehold title.

—**Full ownership of any buildings or improvements.** While lessees should only have leasehold title over the *land* within their parcels, lessees should be granted full ownership/freehold title over any buildings, structures, and improvements they build on the parcel.

—**Freedom to sell lease in exchange for owned buildings.** Lessees should be able to sell their property (lease included) to another party. In exchange, this party should pay the former lessee for the full value of the lessee's buildings, structures, and improvements, after which this party is responsible for paying all future land lease obligations on the parcel to the charter city revenue authorities.

—**Guaranteed payment for owned buildings upon lease expiration/ termination.** When the lease expires or otherwise terminates, the lessee must be guaranteed to be paid for the value of the buildings, structures, and improvements that the lessee owns and that end up staying on the land (accounting for any depreciation in these buildings, structures, and improvements).

—**Extensive consultation with local banks/lenders.** When formulating this recommended leasehold model, charter city policymakers must engage in consultations with local banks and financial institutions to gauge their collateral comfort. A short-term lease may be judged to be too risky to serve as collateral for a loan. In such instances the charter city administration could negotiate with banks to see if it could serve as a co-mortgagee or co-signer on a loan.

—**Alignment with the charter city's industrial policy.** Strategic firms that have the most potential for job creation, investment, and value addition, or firms in industries that require more time to build their infrastructure or sustain their business can be given longer lease terms. More generally, during the initial allocation of land leases, it is advisable that the charter city administration establish some economic criteria to better ensure that scarce urban land goes to those occupants/firms in greatest alignment with the city's overall industrial policy.²³

These components to the recommended leasehold model tie into the revenue-raising methods recommended for the charter city revenue authorities in this handbook's "Tax Policy and Administration" and "Banking and Financial Regulations."

Still, there are a few potential drawbacks of leasehold tenure that any charter city developer should be aware of. First, in areas where the leaseholders feel a strong claim over the land, political problems, resistance, and outright conflict can arise when the lease ends. For example, in Sri Lanka in the 1980s, as part of a

government housing program, 20-year leases on land parcels were issued to citizens participating in the program. However, under political pressure the government extended the lease to 30 years when the initial lease was set to end and then to 50 years after that. Then finally, under further political pressure, the government replaced leasehold tenure with freehold tenure in 2006.²⁴

A second potential drawback of leasehold is that many banks and financial institutions may refuse to accept land under leasehold tenure as collateral if the lease has a particularly short duration. This could restrict access to credit for individuals and firms in the charter city. One potential solution to this was implemented in Rwanda: a *conditional freehold title*. The government of Rwanda issued 20- to 30-year leases that would transition to

freehold title at the end of the lease *conditional* on the leaseholder completing a previously agreed upon amount of construction and development work on the land. This served two purposes. Firstly, it reassured the banks that the titleholder had more secure tenure than under a typical leasehold agreement, thus making these banks more likely to accept such land as collateral. And secondly, it allowed the land to revert back to the ownership of the government at the end of the lease period if it wasn't being put to productive use.²⁵ For more on Rwandan land tenure, see Box 20.

BOX 20

Land Tenure Systems in Uganda vs. Rwanda

The East African neighbors Uganda and Rwanda are two instructive cases of divergent land tenure and administration systems. The Ugandan Constitution vests the country's land to the people and extends rights to the people to hold land under *four* separate tenure types. First, mainstream freehold and leasehold tenures are recognized. Second, mailo tenure is included and is a remnant of the colonial period, involving about 9,000 square miles land owned and administered by the Buganda Kingdom. In essence, mailo entails dual-ownership rights, whereby both the landowner *and* the owner of any permanent structures that exist on said land hold virtually the same land rights. Third, customary tenure applies to any land outside of the Buganda Kingdom that is administered by a particular tribe. Customary tenure therefore implies that *each* tribe has its own unique customary regulations over land rights and land administration.

This myriad of tenure systems means that Uganda—including its capital city, Kampala—suffers from some of the most overlapping and unclear land ownership schemes in the world. For example, estimates suggest that around 95% of landholders in Uganda lack formally registered titles (this includes Kampala). To make matters worse, Uganda lacks both a centralized and accurate database of land as well as a centralized land administration system.²⁶ Confusing and insecure land tenure systems are a common problem across cities of the Global South, and one of the main factors behind urban sprawl, disconnected and fragmented urban form, and inefficient land use (being that land cannot be easily transacted).

By contrast, Rwanda has made incredible strides since its land tenure reform and registration drive between 2009 and 2013, which transitioned the country from largely customary tenure to a private property system managed by the Rwandan government. Additionally, Rwanda's land registration system switched from a

largely deeds-based system to the more efficient Torrens system. During this period, Rwanda became the first nation on the African continent to implement an up-to-date, nation-wide, and completely digitized property registry that registered over 11 million plots in the span of just five years. Moreover, this impressive feat in land registration was administered at the cost of only US\$6 per plot (significantly lower than average costs across the globe).

The results are just as impressive. Before the reform and registration drive, Rwanda ranked 137th on the World Bank's Doing Business Index when it came to registering property. Today Rwanda is ranked fourth and is thus a significantly more attractive location for both domestic and foreign investors. Not to mention that as a direct result of the implementation of its formal property registry, land-related tax revenues increased over five-fold in just three years, from about US\$3.3 million in 2011 to over US\$15 million in 2013.²⁷



Kigali, Rwanda.

2.3 Choosing the Best Method for the Initial Land Allocation

After the compensation of pre-existing landholders, the task of the charter city administration is now to populate the city land

with the most productive firms and individuals that it can attract as quickly as possible. Ideally, the charter city administration's investment promotion team should have already been fostering relationships with potential strategic firms about relocating to the city, and its public

relations team should already have launched various campaigns aimed at inducing individuals and families (especially high-skilled individuals) to migrate to the city.

The question then becomes: when the land is ready, and when demand begins to rise for charter city land from these firms and individuals willing to migrate, how does the city best allocate the available land? The experience of Shenzhen, one of China's first special economic zones, illustrates some possible allocation strategies (see Box 21 below).

The Shenzhen experience of land reform demonstrates an initial allocation strategy of successively more liberalized land market transactions (lease issuances). This experience suggests some lessons for charter cities allocating initial land parcels. At first, Shenzhen simply selected a leaseholder without accepting other bids, then the city opened the process up slightly to allow nine total bids, and then shortly thereafter it hosted a truly public land auction at first restricted to Chinese companies and a few years later opened to foreign companies. This allocation process exhibits a relatively more closed and rigid leasing procedure at the beginning, as Shenzhen needed to be strategic about attracting the right *type* of businesses and tenants at the outset. Charter city officials should bear this in mind

when allocating early land parcels. A more active role on the part of the administration early on should be the initial aim—as the long-term success of the charter city stems from these initial choices in firms and anchor tenants.²⁸

However, this rigidity eventually gave way to a sequential easing of land market restrictions, resulting in China's first truly open and public land auctions in 1992. A similar easing of restrictions over time—after sufficient strategic firms have been attracted—is recommended.

Another lesson that can be learned from the Shenzhen example is that urban and property development does not have to come at the expense or displacement of pre-existing landholders. Indeed, indigenous groups *and* urban developers can—and should—mutually benefit from urban growth. Shenzhen's pre-existing villagers were able to retain collective title to pockets of land within the booming city, and these urban villages became experimental enclaves within Shenzhen. The original villagers were able to lease land to new rural migrants and working-class laborers at prices they could afford. Ultimately, the original villagers' retention of land ownership, and their subsequent incorporation into their own real estate development companies, allowed these pre-existing landholders to profit immensely from Shenzhen's success.²⁹

BOX 21

Shenzhen's Lessons in Land Allocation and Land Policy Experimentation

Shenzhen was proclaimed as a special economic zone (SEZ) in 1979 when the area was merely a loose network of fishing villages with roughly 300,000 people. At that time there were no private property rights in China (and therefore no land markets). However, on September 9, 1987, the first lease agreement in China was granted in Shenzhen between the city government and a state-owned enterprise (SOE) to construct residential housing (50-year term). Just 20 days after this first lease agreement was signed, the city government called for tenders to develop a commercially zoned area almost 10 times as large as the first lease agreement. Nine tender bids were allowed, and one was awarded. This commercial area was strategically located for businesses, as it was near the Shenzhen-Hong Kong border. A couple of months

after this on December 1, Shenzhen held China's very first *public land auction*: 8,588 square meters of land for residential use was leased within 17 minutes.³⁰

The above land transactions took place *despite* the fact that all land in China was still at the time *de jure* (legally) owned by the state, as the prevailing 1982 Constitution stated, “No organization or individual may appropriate, buy, sell, or lease land, or unlawfully transfer it in other ways.” Shenzhen's status as a special economic zone allowed it to get around this legal obstacle. And due to the success of these new land reforms, within a year of Shenzhen's first land transaction, the 1982 Constitution was amended to apply Shenzhen's land leasing policies across China, with the new language stating, “The right of land use can be transferred in accordance with the law.”

This opened the door for private, non-state entities to engage in land leasing and property development for the first time and ushered in an era of urban infrastructure investment across China never before seen in human history. For example, total investment inflows in capital construction in Shenzhen in 1980 were just 125 million yuan (about US\$80 million); by 1990 those inflows had increased *forty-fold* to almost 5 billion yuan (about US\$1.05 billion).³¹



Shenzhen, China.

3. Land Information System (LIS) Setup and Ongoing Maintenance

Broadly, an effective land administration system requires two key requirements:

—**Static requirement:** the initial land registration is complete and reflects reality.

—**Dynamic requirement:** an interoperable LIS links this land registry data to other essential city-wide data and is cost-effectively maintained over time.

This second objective requires setting up both the hard infrastructure (offices, IT equipment, software, survey equipment, etc.) and the soft

infrastructure (the manuals, rules and procedures; staff capacity; and overarching institutional framework governing and managing land administration services) necessary for ongoing LIS success.

The motivation for an electronic or digital LIS is clear: transferring land and property takes approximately half the time when compared to countries with paper-based registries. Not to mention, digital LIS systems take up less space—Norway required 30 kilometers of shelving to store its paper land records before digitizing—they allow for backup copies to be easily created and stored elsewhere as an extra layer of protection in the event of a natural disaster or other disruption, and digital systems on average result in fewer errors (often human-related) and fewer overlapping titles to the same parcel.³²

Electronic LISs also allow for more streamlined procedures around land administration. For example, in 2011 Costa Rica was able to allow individuals to obtain property as well as cadastral certificates online from a single website by merging several formerly independent procedures together into one website, significantly reducing time investments.³³

This subsection will focus on the sequence of activities to be undertaken to establish a functioning LIS. As mentioned above, these setup activities can broadly be split into two types: (1) hard infrastructure and (2) soft infrastructure.

3.1 Hard Infrastructure

The first step toward the establishment of a sustainable LIS is to acquire a building and/or dedicated office space. Next, procurement of the necessary equipment is required. This equipment

should include computers with the requisite specifications, printers and ancillary printing equipment, survey equipment, and, importantly, LIS software. As much as possible, it's desirable to purchase these inputs from local or regional suppliers because if there are any issues or malfunctions, dealing with local suppliers is always easier than dealing with suppliers abroad. Additionally, forming these supplier linkages regionally should always be a priority for the charter city administration. In terms of software, some vendors that have successfully implemented LIS software systems include Esri in Rwanda and ENKON in Botswana, along with GIS mapping software (ArcGIS, QGIS) linked to the LIS.

On the subject of linking the LIS, the essential feature of the selected software should be interoperability. The data within the land registry needs to be linked with several agencies across the charter city. First, the LIS needs to link with the city ID system, allowing city personnel to verify that individuals are indeed who they purport to be. Second, it should be linked with the city's mortgage registry, which speeds up verification of land ownership by banks and financial institutions.

Third, given that the chapter “Tax Policy and Administration” in this handbook recommends the implementation of land taxation or land lease payments, the LIS must be integrated into the city revenue authority's databases. For example, in 2014 the city council of Arusha, Tanzania, integrated its GIS system with the city's Revenue Collection Information System, effectively allowing tax officials to electronically view mapped properties and their associated tax liabilities. To collect these tax liabilities, Arusha also set up automated billing and digitized payment systems, and when payment is received, the digital revenue collection system automatically

updates to reflect compliance, and a receipt is generated.³⁴ This integration and digitization have resulted in a tax base about three times the size as before (104,629, up from 31,160), and within the single fiscal year 2013–2014, city tax revenues increased by 75%.³⁵ On top of increasing the tax base and revenues, digitization also reduces the need for face-to-face interactions and thus lessens opportunities for corruption.

Fourth, the LIS should be linked to the city agencies dealing with urban planning and natural resource management. The charter city planning agency can use detailed parcel mapping and cadastral data to better perform its various functions—land valuation, land surveying, and strategically planning land use as well as monitoring any land use changes. For example, as a result of Rwanda's land registration drive, landowners can now check

online for city plans that may impact their parcels. And vice versa planners can see whose land rights are impacted by different proposed urban infrastructure projects.³⁶

Fifth, the LIS should be linked to the city's investment promotion agency. Having an online portal where potential investors can get information on land available for possible investment—for example, the size of such land, whether it has any current legal disputes/encumbrances associated with it, its tenure/zoning status, the steps and paperwork necessary to acquire the land, and data on the land's soil composition, to list just a few. Studies of subnational business environments support this, finding that those subnational units that made provincial land use plans transparently and publicly accessible to firms and investors saw the largest increases in investment.³⁷



Rwanda's land registration drive created a digitized and searchable land registry of all parcels in the country.

A final consideration regarding digitizing and linking the LIS to multiple other agencies/data sources is how integrated it should be with the host country government's system. In the event the host government does *not* provide full autonomy and authority over land administration, charter cities will have no choice but to integrate at least some aspects of their LISs with the host government's. However, *fully* digitized LISs will *not* be able to be linked to analog land administration systems. Given analog systems predominate across the majority of national governments in the Global South, charter city administrations may need to consider setting up parallel LIS systems, both digitized and analog.³⁸

3.2 Soft Infrastructure

On top of the above hard infrastructure, soft infrastructure is needed in the form of rules, procedures, and a broader institutional framework that ensures the ongoing effective management and maintenance of the LIS. This soft infrastructure can be broken down into four main elements: regulations around fees charged for land administration services (cost), rules around how quickly users or registrants should be able to complete processes (time), training provided to staff to bolster capacity, and the actual legal framework/policies that land administration services are subject to.

First, a key goal of the LIS should be to become self-financing. That is, appropriate user fees for various services should be charged, such that the money raised from fees covers the operations and maintenance costs associated with providing land administration services. The key consideration here is that such user fees have a direct impact on individuals' willingness to pay to register their land. The danger is that if user fees are set too high, people will avoid using the LIS and instead revert

to informal arrangements, which in turn causes the entire system to become inaccurate and thus less useful to all, further discouraging use—a vicious cycle. Given this, cost recovery should not be the main priority in the initial stages. Therefore, financial support from donors, DFIs, other levels of government, or financial institutions may be required until the system is up and running, widely used, and has the capacity to support itself.³⁹ Alternatively, this vicious cycle can be completely avoided if the recommended leasehold model is pursued. That is, if lessees are charged 100% of the market rental value of the land they're leasing (see above), part of these lease payments will be more than sufficient to finance and maintain the land administration system and most other public services as well. This model of financing can even allow the charter city to avoid charging lessees a registration fee, avoiding the willingness-to-pay problem alluded to above.

Second, while the above *cost* considerations are important, the *time* it takes users to register, transact, or in any way alter land holdings, and have these changes reflected in the LIS, is also key. For example, under Rwandan land rules, the registrar must issue the Certificate of Registration within 30 days.⁴⁰ Additionally, other user service delivery targets around land administration are published through client charters at the district-level, and adherence to such targets is monitored and enforced by a delivery unit within the Office of the Prime Minister, ensuring that these service targets are prioritized.⁴¹ Similar service standards should be implemented by the charter city administration.

Third, the skills and capacity of land administrators, managers, and general personnel within the land administration agency are crucial. Skills in GIS, satellite imagery, land valuation, surveying,

photogrammetry, etc., are sorely lacking in a lot of places in the Global South where charter cities may choose to locate. To make this skills-vacuum worse, at times there may be no accredited training institution nearby to provide or improve upon these skills.⁴² Given this situation, it may be necessary to bring on international technical assistance to help in conjunction with local knowledge. The priority here should be to engage in skills transfer as speedily as possible to build local capacity such that when the international assistance exits, the program can be efficiently managed and administered locally.

Fourth, the charter city will need to enact policies and regulations around land registration and transaction along with corresponding manuals, standard operating procedures, and processes that reflect these land policies and regulations. Typically, the main authorizing land policy passed by the charter city council remains relatively high-level, and this policy enables more granular, secondary regulations to be passed that allow for the effective implementation of the authorizing land policy. A useful resource to guide regulation and policymaking in this realm is Rwanda's *Land*

Administration Procedure Manual (2016) published by the Office of the Registrar of Land. The manual lists all relevant laws, regulations, and ministerial orders pertaining to land (p. vii). It outlines the governance structure and institutions responsible for various aspects of land registration and administration (p. 3). The manual enumerates the step-by-step processes involved to transact and/or register land (pp. 12–13). Additionally, the manual provides procedures for all the different types of land alterations that can occur: mutation of parcels (p. 18), transfer of rights (p. 30), succession (p. 38), restriction of rights (p. 62), conversion of rights (p. 77), changes on persons (p. 85), transaction on condominiums (p. 91), and other cases (p. 98). Related to these procedures, the manual includes *sample forms* for each process/procedure it enumerates that can be used as inspirations or templates for the charter city administration.⁴³ Given the extensive consultations involved in Rwanda's land registration drive, its undeniable success, and the fact it was completed rather recently—this manual can be said to encapsulate many best practices around land registration and administration and should be leveraged accordingly.

¹ Collier, P. et al. (2017). "Secure, Legally Enforceable, and Marketable Land Rights for Urban Development." Policy Framing Paper, IGC Cities that Work: Oxford.

² It must be noted that the findings of empirical studies are mixed when it comes to the effect of land registration programs on access to formal credit (Deininger & Chamorro, 2004; Galiani & Schargrotsky, 2010; Zegarra et al., 2008; Agyei-Holmes et al., 2020). The general takeaway from these studies is that "credit markets thrive within a plethora of enabling factors, of which land titling, and thus the ability to use real estate as collateral, is an important, but not the sole driver to access to credit," (Agyei-Holmes et al., 2020: p. 3).

³ Ngoga, T.H. (2018). "Rwanda's Land Tenure Reform: Non-Existent to Best Practice." CABI: Boston, MA:.

⁴ Collier, P. et al. (2018). "Land and Property Taxes for Municipal Finance." Policy Paper, IGC Cities that Work: Oxford.

⁵ World Bank (2017b). "African Cities: Opening Doors to the World." World Bank Group: Washington, DC. p. 136.

⁶ Blake, M. (2018). "Making Land Administration Work for African Cities," IGC Blog, IGC Cities that Work: Oxford.

⁷ Ngoga, T.H. (2019). "A Quick, Cost-Effective Approach to Land Tenure Registration: The Case of Rwanda." IGC Cities that Work: Oxford. p. 14.

⁸ For example, in Rwanda in 2001 (before the land registration drive), an estimated 80% of court cases revolved around land disputes (see Ngoga, 2019: p. 4). Additionally, Dercon et al. (2019) note that "65% of social unrest in China can be attributed to land disputes stemming from issues of illegal expropriation, inadequate compensation, or forced land seizures," (p. 11).

⁹ Another resource for establishing effective land registration and administration processes is the Global Land Tool Network. The GLTN has developed several tools for items like determining the value of unregistered lands and determining ownership and land rights

between disputed claims. See here: <https://glt.net/land-tools/>.

¹⁰ For more on land use planning see the “Land Use Regulation and Building Regulation” chapter in this handbook.

¹¹ Note that CCI has forthcoming publications on land agreements, land acquisition, and planning guidelines. These will be published under the Reference Guides section of the CCI website here: <https://www.chartercitiesinstitute.org/category/reference-guides>.

¹² This handbook recommends land title based on long-term leases. See subsection 2.2 of this chapter below for a more in-depth rationale.

¹³ Government of Rwanda (2016): p. 5.

¹⁴ Interview, Thierry Hoza Ngoga.

¹⁵ Note that CCI has forthcoming publications on land agreements and land acquisition. These will be published under the Reference Guides section of the CCI website here: <https://www.chartercitiesinstitute.org/category/reference-guides>.

¹⁶ Collier, P. et al. (2017): p. 19.

¹⁷ Alternatively, the charter city developer may have only been able to secure a *lease* from the host government (or previous landowners), as opposed to full freehold. In this case where the developer is only leasing the land, it would then be *sub-leasing* land to new residents and businesses.

¹⁸ Parcels can be retained under leasehold in several ways. First, simply don't lease out the land. Second, lease out the land, but get it back at the end of the lease term. Third, lease the land, but then buy out the lessee's remaining years left in the lease term (in accordance with the provisions of the lease agreement).

¹⁹ In fact, advocates of land value taxes (LVTs) suggest that with a 100% LVT there may be no need for any additional taxes at all. See, for example, George, H. (1879). *Progress and Poverty*. Pantianos Classics.

²⁰ Dercon, S. et al. (2019). “Can Africa Learn from the Chinese Urbanization Story?” Policy Framing Paper, IGC Cities that Work: Oxford: p. 30.

²¹ Major, T. (2014). “The Role of Land Sales in Local Government Financing in China.” *CKGSB Knowledge*. Available at: <https://knowledge.ckgsb.edu.cn/2014/09/03/policy-and-law/the-role-of-land-sales-in-local-government-financing-in-china/>.

²² In accordance with the “Land Use Regulations and Building Regulations” chapter of this handbook.

²³ See CCI's publication on anchor tenant selection and industrial policy on the Reference Guides section of our website here: <https://www.chartercitiesinstitute.org/category/reference-guides>.

²⁴ Collier, P. et al. (2017): p. 15.

²⁵ Ibid: p. 15.

²⁶ Mabikke, S.B. (2016). “Historical Continuum of Land Rights in Uganda: A Review of Land Tenure Systems and Approaches for Improving Tenure Security.” *Journal of Land and Rural Studies* 4(2). pp. 153-171.

²⁷ Ngoga (2018).

²⁸ See CCI's publication on anchor tenant selection and industrial policy on the Reference Guides section of our website here: <https://www.chartercitiesinstitute.org/category/reference-guides>.

²⁹ Castle-Miller, M (2014). “Unexpected Laboratories within the State-Sanctioned Laboratory: Shenzhen's Urban Villages.” *SSRN*. Available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2459173.

³⁰ Du, J. (2020). *The Shenzhen Experiment: The Story of China's Instant City*. Harvard University Press: Cambridge, MA. p. 188.

³¹ Zhu, J. (1996). “Denationalization of Urban Physical Development: The Experiment in the Shenzhen Special Economic Zone, China.” *Cities* 12(3): pp. 193.

³² Doing Business (2020b). “Registering Property.” World Bank Group: Washington, DC. Available at: <https://www.doingbusiness.org/en/data/exploretopics/registering-property/good-practices>.

³³ Ibid.

³⁴ Collier et al. (2018): p. 35.

³⁵ World Bank (2015a). “The Tanzanian Strategic Cities Project. Improving Local Governments' Own Source Revenues: The Arusha Experience.” World Bank Group: Washington, DC.

³⁶ Ngoga (2019): p. 14.

³⁷ Malesky, E. (2019). “Decentralization and Business Performance,” in Rodden, J. & Wibbels, E. (eds.) *Decentralized Governance and Accountability: Academic Research and The Future of Donor Programming*. USAID: Washington, DC: p. 196.

³⁸ Interview, Thierry Hoza Ngoga.

³⁹ Ngoga (2018): p. 80-81.

⁴⁰ Government of Rwanda (2016). “Land Administration Procedure Manual.” Office of the Registrar of Land Titles: Kigali: p. 17.

⁴¹ Ngoga (2018): p. 84.

⁴² Ngoga (2018): p. 87.

⁴³ Government of Rwanda (2016).

5.2 LAND USE REGULATION AND BUILDING REGULATION

I. KEY TAKEAWAYS

- ✓ A liberal approach to land use regulation, including zoning, urban development, transit, and housing policies promotes economic growth. Overly restrictive land use and building regulations prevent essential housing and infrastructure from being built and thereby stifle both the city's physical growth and its rate of economic growth.
- ✓ Charter city land use and building regulations should align with four main values: (1) regulations should be unapologetically pro-growth, (2) they should result in housing, public transit, and overall urban development that is affordable and functional, (3) they should promote safety, and (4) they should be supported by efficient and time-sensitive permitting and regulatory services.
- ✓ This chapter reviews four main components of land use and building regime for a charter city: (1) liberalized land use regulations, (2) an effective public transportation system, (3) affordable and accessible housing, and (4) building codes that are permissive and safe.
- ✓ For additional information on this topic, please consult the CCI urban planning guidelines.¹

II. INTRODUCTION

The regulation governing the built environment in a charter city will shape the development of a charter city, both physically and in terms of productivity and economic outcomes. Land use regulation should support, not hinder, the economic development of the city. Yet many countries across the world, in both the Global North and the Global South, violate this maxim. In both regions of the world, the regulatory structure in place is not aligned with the needs and interests of relevant stakeholders—while much of the Global South often lacks an effective land use regulatory system (or features a system so ungovernable or burdensome that noncompliance is standard), many countries in the Global North have been stifled socially and economically by theirs. Charter cities will need to strike a balance between the complete absence of land use regulation that leads to poorly managed cities and slums on the one hand and overbearing land use regulations that inhibit much-needed development on the other.

In general, land use regulations in charter cities should strive to align with the values of “market urbanism.” Market urbanism refers to how market forces and respect for property rights enable complex, vibrant, and economically robust communities and regions to emerge spontaneously.² Charter cities should be free to grow organically, with only very limited top-down intervention in the creation of the built environment by the city government. The central focus of urban planning in a charter city should be to ensure the efficient delivery of public services, especially transportation and utilities, and facilitate economic and social activity.

While there are many geographic, social, cultural, and other factors that shape the development of cities, they can ultimately be conceived of through the lens of labor markets. Larger cities, and therefore larger labor markets, are more productive and more innovative because they feature more people exchanging goods, services, and ideas in a single location. However, a larger labor market

requires the ability to travel within that labor market efficiently. A city that emerges organically to pull oneself out of poverty through greater will effectively allocate jobs and housing near each access to economic opportunity and mobility.

other, more so than a city planned in detail from

the top-down would. At the same time, an effective While a charter city must be free to grow, the built city government must use its land use policies and environment must also be made safe. A robust transit system to expand access to that labor building regulation and inspection system can help market. This creates a virtuous cycle where the ensure that as the city grows, the homes and city becomes more productive as more people can workplaces of its residents are well-built, and risks access their desired employment in a timely and are minimal. Deadly building collapses, fires, and low-cost fashion, and as more firms can select from a environmental hazards are common throughout more diverse set of workers. This virtuous cycle the Global South. Charter cities can provide a goes beyond matching employers and employees— higher quality-built environment alongside the it establishes the conditions for learning and the promise of economic opportunity through a generation of new knowledge.³ sensible risk-based and performance-based approach to building regulation.

A city whose residents can easily and safely travel from point A to point B, whether the destination is home, work, school, or play, is a functional city. Charter cities offer the promise of a functional, pleasant, and safe alternative to the increasingly congested and polluted urban environments of the

III. VALUES AND GOALS

Land use regulations in a charter city should uphold two key values: (1) **encourage growth and development** and (2) **create an affordable and functional built environment**.

Table 10. Summary of Values and Goals for Land Use Regulation

Value	Meaning of the Value	Measurable Goals
Encourage growth and development	<ul style="list-style-type: none"> —As the population of the city grows, it will need to rapidly expand to accommodate new residents and businesses. —With limited land use regulation, markets and communities can effectively govern land use. 	<ul style="list-style-type: none"> —Relative length and complexity of land use regulations, regulatory compliance, and dispute resolution. —Costs in terms of time, money, and steps needed to build.
Create an affordable and functional built environment	<ul style="list-style-type: none"> —The city must be widely accessible to low-income residents, the primary target demographic. —The city must facilitate easy access between home, work, education, play, and other necessities regardless of location. 	<ul style="list-style-type: none"> —Tracking commuting times and traffic congestion levels. —Cost of public and private transportation options. —Occupancy rates, land prices and rental rates, and the spatial distribution of various land uses.

First, the land use regulatory environment in a charter city must **encourage growth and development**. As the population of a charter city grows, the city will need to rapidly expand to accommodate new residents and businesses. A liberal land use regime that is broadly permissive of new development that meets simple regulatory requirements will be vital to the growth of the city. By adopting a minimalist approach to land use regulation, markets and coordination between private citizens can effectively govern land use in a charter city. In developing countries, establishing the road grid ahead of future development, as well as the location of parks and other public spaces,

has helped guide and enable the orderly outward expansion of the city.⁴

Openness to growth and development can be measured through the cost incurred in time, money, and procedures necessary to start and complete a construction project. Comparing these figures to similar data collected by municipal governments in the host country or other comparable countries, can serve as a relative indicator of the regulatory burden facing formal sector development. However, given the likely rapid expansion of the charter city, these standards may be too low to use as benchmarks.

BOX 22

Land Use Regulation without Zoning, Houston, Texas, United States

Discussed heavily throughout subsection 1, Houston, Texas, demonstrates how liberal land use regulation can foster substantial and affordable development. Houston also shows that market and private mechanisms can effectively govern land use in the absence of use-based zoning. Additional reading on Houston's private land use governance mechanisms can be found in the corresponding endnote.⁵ Urban economist Ed Glaeser has authored a useful comparison between Houston and New York, highlighting how Houston's liberal approach to land use makes it a far more affordable city for middle-income residents because of much lower housing costs, among other reasons.⁶

Readers should be aware that while Houston has been used as an example of non-use-based zoning approaches to land use, other elements of the city's urban development do not necessarily apply to the charter city context. For instance, Houston covers a very large geographic area, and a car is virtually a necessity to live there, both of which run counter to the aims of urban development in a charter city.



Although not a perfect measure, comparing employment growth with housing growth can give an indication of whether development is taking place quickly enough or not.⁷ Data about the developments being initiated and completed also provides a clear picture of the level and nature of residential, commercial, and industrial (among other types) development taking place, which provides an insight into what future infrastructure and other needs may entail.

Furthermore, if land use regulations are simple, noncompliance rates should be minimal. The charter city land use authority can solicit feedback from developers and residents via, for example, annual surveys regarding their perceptions of land use policies. Such regular survey feedback can be used by the charter city administration to gauge if both parties find the rules clear and acceptable for their needs.

Second, the **built environment in a charter city must be both affordable and functional**. Charter cities have the power to alleviate extreme poverty, but they must be financially accessible to low-income residents. A charter city that is only home to high-income residents is doing little to deliver on its goals. By delivering on the first key value and supplying ample new housing alongside gainful employment, a charter city can be affordable for virtually any potential resident.

In addition to affordability, the city must also be functional. People must have access to work, play, education, and other necessities in their neighborhoods and throughout the city. Getting from point A to point B in the city must not become a difficult, lengthy, or costly enterprise. Residents must be able to access services when needed. The city should be a physically pleasant and safe environment.

Metrics to track these ideals can include average vehicle speeds and surveys of satisfaction with transit and other services. These measures of congestion and transit satisfaction can help assess where new transit options or infrastructure may be needed, although a regulatory framework that allows ample private mass transit may help ameliorate this problem before it develops.⁸ The speed at which new housing or commercial developments are filled can also serve as an indicator of demands being met. A growing and happy population is a strong signal that the city is both affordable and functional. Traffic and pedestrian accidents, injuries, and fatalities can indicate where safety improvements are needed.

Building regulations in a charter city should uphold two key values: (1) **promoting a safe built environment** and (2) **efficient service**.

Table 11. Summary of Values and Goals for Building Regulation

Value	Meaning of the Value	Measurable Goals
Create a safe built environment	—Building regulations must promote safety but follow a risk- or outcomes-based framework as to not create prohibitively high costs.	—Share of developments meeting standards upon application for permitting.
Efficient permitting and regulatory services	—Permitting requirements should reflect the risk of the development in question.	—Share of developments meeting standards upon application for permitting. —Time and cost to complete inspections and

	—Legal construction on one's own land should face few barriers.	permitting. —Benchmark to the data about getting construction permits provided by <i>Doing Business</i> .
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First, the building regulations in a charter city must **promote a safe built environment**. Building regulations must be strong and enforceable to protect residents and workers. At the same time, these regulations must be clear and implemented fairly so that builders and regulators can effectively move through the building, permitting, and inspection processes. These regulations must also be responsive to the risks relevant to the location of the charter, as well as the risks associated with different types of development. For instance, a six-story apartment building poses a greater risk than a one-story house, just as a six-story apartment building in an earthquake zone is riskier than a six-story apartment building outside of an earthquake zone.

To track this value the permitting authority can assess what share of projects are meeting code requirements and how quickly each project moves through the permitting and inspection systems. The city can also track reported safety incidents or

violations, should they occur, as well as the legal and financial resolutions to any such incidents.

Second, the charter city must **carry out permitting and inspection processes efficiently**. Builders should easily be able to navigate the process and submit the required information. The permitting authority should be able to process applications and carry out inspections in a timely manner, at a limited cost. It should not take many months to secure needed approvals or receive needed inspections. Nor should it cost a significant percentage of the overall project value to complete the process.

Data on the time and cost to complete the permitting process can easily be collected by the permitting authority to assess its effectiveness and to reform as needed. Permitting and inspection information can easily be benchmarked to high-performing jurisdictions.

BOX 23

By-Right Development, Japan

In Japan, planning decisions are made at the national level and are considered quite liberal. Part of this liberal land use policy is by-right or as-of-right development. The Japanese government has created 12 simple types of land use zones that specify broad use categories that do not have highly specific requirements. These zones include various types of residential, commercial, industrial, and mixed-use zones. So long as a development meets the requirements of its zone, the development can proceed without discretionary review. This system prevents local municipalities from developing complicated and exclusionary regulations while also providing developers and residents with certainty about what development is permissible.⁹



Shibuya Crossing in Tokyo, Japan.

IV. IN PRACTICE

This section reviews the key elements of land use and building regulation that a charter city will need to create a functional, pleasant, and safe built environment: (1) efficient land use regulations, (2) functional public transportation, (3) accessible and affordable housing, and (4) effective building codes.

1. Land Use

Land use regulation refers to the laws and policies that govern how land can be developed. Zoning, the designation of specific parcels of land for specific uses, is one of many tools used to implement land use regulation. Zoning regulations exert a significant influence over where and how

land development is undertaken or if that development can even take place.

1.1 Zoning Regulations

There are two approaches to zoning that a charter city could sensibly choose to follow. The first is to adopt a very simplified version of the traditional use-based or *Euclidian* zoning, which segregates parcels of land by approved usages. This is the approach taken in the planning guidelines mentioned in the introduction to this chapter. The alternative to this approach is to abandon use-based zoning regulation and instead allow for market- and community-based mechanisms to govern land use.

Although most cities in the world do employ relatively complex zoning regulations to govern

urban development, a charter city does not have to follow suit to become a successful city.

Zoning has contributed to a host of problems in the United States, for example. By one estimate, strict zoning regulations that limited the supply of housing in 220 metropolitan areas lowered US aggregate growth by 36% between 1964 and 2009. In a counterfactual scenario with better zoning regulations, each American worker would earn an additional US\$8,775 per year.¹⁰

Restrictive zoning regulations in the US have largely been driven by homeowners that view the value of their home as a long-term investment vehicle. To protect this investment, voters tend to support zoning regulations that severely limit new development and effectively segregate communities by income level, often a proxy for race and ethnicity.¹¹ As the previously mentioned estimate suggests, the economic costs of this approach to land use regulation have been enormous, even without accounting for a litany of likely social costs as well.

1.1.1 Simplified Use-Based Zoning

The first and recommended approach to land use regulation that a charter city could follow is to adopt a very simplified form of use-based zoning that only features two zones: mixed-use (residential, commercial, retail, and so on) and industrial. This approach to zoning allows for the segregation of land uses that pose a significant risk to the environment or public health and safety away from residential and commercial areas while allowing for the mixed-use development needed to create affordable, sustainable, and vibrant communities elsewhere throughout the city.

After laying out an initial road grid for the city and designating the location of public buildings, parks,

green spaces, and other non-private land uses, a charter city can designate most of the built environment for mixed-use development. Planners can use these designations to design roads and streets specifically intended to support safe and accessible residential and commercial spaces that are connected to larger collector and arterial roads.

A smaller share of the road network can be designated for industrial development. By designating specific areas for industrial development, charter city planners can ensure that these areas are served by adequate road, rail, port, and other critical infrastructure necessary to facilitate business. A risk-based approach to industrial zoning can help guide the transition between mixed-use and industrial areas. Emissions, noise, and other standards can be adopted that would allow, for example, a logistics center to be located within a certain number of meters from a mixed-use development, but not a petrochemical plant. Regardless of the standards used to govern the development of mixed-use and industrial zones, these two areas should not be so far apart that workers in industrial zones could not access their place of employment within a 40-minute commute by bike, car, or public transportation.

1.1.2 No Zoning

One American city has shown that the highly segregated use-based approach to zoning regulation is not necessary for urban development. Houston, Texas, has no formal land use regulations and instead governs land use through a mix of large-scale public initiatives, private agreements governing land use, and development codes with a variety of planning tools.¹² While these alternative land use regulation mechanisms do create an environment with many of the features of a more

traditionally-regulated city, the lack of complex use-based zoning has helped create a city with a flexible land market, which has greatly helped the city's affordability relative to other top labor markets in the United States.¹³

In the absence of complex zoning regulations, various alternative mechanisms exist that govern land use regulation. Market factors already address many of the concerns that zoning attempts to solve. For example, a factory is unlikely to choose to set up operations in a neighborhood. Factories require easy access to major infrastructures like highways, ports, and airports. The heart of a residential community does little to facilitate access to critical infrastructure and would raise operating costs considerably. Residential, commercial, industrial, and other types of land use that are often explicitly segregated under use-based zoning regulations will largely emerge on their own if given the opportunity. The absence of a rigid zoning code will also allow for the market to drive adaptive reuse and redevelopment when older, existing land uses become obsolete.

In addition to market mechanisms, property owners can enforce restrictive covenants that include land use regulations for the local community. While historically such covenants were sometimes used for harmful purposes like enforcing racial segregation, they have also been used for more positive purposes. A community might decide to restrict the establishment of an undesirable type of business in the neighborhood, or to create and maintain parks, for example. Such covenants can also be created by industrial tenants to establish certain supplemental fire and safety standards although pre-emptive enforcement is still likely better in this case relative to reactive, court-based enforcement of such standards.¹⁴

In the absence of use-based zoning, alternative mechanisms can help govern the spatial distribution of industry and people. In conjunction with emissions and other pollution standards and a reliable system of public transportation, a charter city can utilize green infrastructure to help mitigate the health and environment effects of industrial development. Extensive green space can create physical space between the housing stock and industrial activity but can also help improve air quality, limit the effects of water runoff and other hazards.¹⁵

1.2 By-Right Development and Discretionary Review

By-right development, also known as as-of-right-development, allows projects that comply with zoning standards to go through a streamlined approval process. More specifically, this streamlined approach bypasses a discretionary review process.¹⁶ Planning departments with discretionary review authority can review projects for regulatory compliance and delay or halt projects found to be non-compliant. However, typically any individual can file for discretionary review of a project, which can introduce significant delays and costs to projects.¹⁷ Charter cities should only allow a discretionary review process if the proposed development does not conform to established zoning guidelines. So long as guidelines are widely permissible, the need for discretionary review should be limited. If a planned development meets all zoning or design requirements, it should be free to proceed. This will allow for an adequate quantity of development to proceed without significant delays, thereby encouraging an abundant supply of housing and commercial space, which in turn keeps costs affordable both for businesses and residents.

BOX 24**Low-Cost Informal Housing, Surabaya, Indonesia**

Kampongs are a type of informal housing settlement—often described as a type of urban slum—seen in Indonesia. While kampongs were not subject to planning, the Surabaya municipal government has worked for over three decades to upgrade these communities by providing water, sanitation, and storm drainage infrastructure, as well as social services. These communities, located near the urban core of Surabaya, provide a low-cost housing option within walking distance of job opportunities for those who cannot afford the car that would be necessary to access the same jobs from similarly priced formal housing.¹⁸ While charter cities should be able to avoid the emergence of urban slums through effective planning and liberal land use policies, this example demonstrates the importance of facilitating access to the central areas of a city for low-income residents.



1.3 Common Land Use and Zoning Practices to Avoid

This subsection details several common land use and zoning practices that should either not be included—or be included with very liberal requirements—in a charter city's zoning regulations.

1.3.1 Minimum Setbacks and Lot Coverage Requirements

In most zoning codes, buildings are required to be set back a certain number of meters from the boundaries of the property. Although intended to create green space on streets, large setback requirements introduce a host of problems for



The restrictive nature of San Francisco, California's land-use practices is evident when the city is viewed from above.

development.

Setbacks can greatly limit the buildable area of a lot, which in turn limits the total amount of housing or other buildings that can be constructed. This problem becomes particularly acute when there are small lots, typical of a residential neighborhood, as buildings must not only be setback 3.5 or more meters from the street but also from each other. By limiting the quantity of housing that can be built, housing prices rise.¹⁹

Setback areas also tend not to be very useful spaces. Dedicating more of a lot to front setback necessarily limits the space available in the back of the lot for a functional yard with some level of privacy for families, pets, gardens, and other such uses. European suburbs tend to have no setbacks, or very limited setbacks compared to North America, despite both being developed after the

widespread adoption of the car.²⁰ By not requiring a minimum setback, charter cities can create choice in what a home and neighborhood look like for developers and residents.

Similarly, maximum lot coverage requirements should not be used. These requirements dictate the maximum area of impervious surfaces that may cover a plot of land. By allowing property owners to use as much of the buildable area on their plot as desired, a charter city can gently facilitate more efficient land use. However, if a property owner wishes to leave significant green space on their plot, it is their right to do so.

1.3.2 Height Limits, Maximum Floor Area Ratios, and Maximum Occupancy Requirements

Most zoning codes feature maximum height limits

for building size. These limits arise from concerns about the aesthetics of taller buildings and about the effect of taller buildings on local communities, among others.²¹ Charter cities should not adopt such height limits.

Given that the city is being built from scratch at the time the zoning regulations are introduced, most development is likely to fit well with the buildings surrounding it. And over time, demand for housing in certain areas will incentivize developers to build upward, lest city residents face ever-increasing housing costs. Locking in a community to a specific height requirement can create serious market distortions.

In Washington, DC, a height limit of 48.7 meters became federal law in 1910. Washington's height limit has created an environment where many townhomes cost in excess of US\$2 million, but the majority of that cost actually derives from the land on which the house sits, not the house itself.²² In this distorted market, the houses represent only a small improvement value to the property. In a market without height restrictions, the house would contribute to a greater share of the property's value, not just the land itself. If Washington had an undistorted land and housing market without height restrictions, there would be a greater supply of taller apartment buildings, condominiums, and offices, leading to lower costs of living and doing business.

Charter cities should encourage market-driven land use, meaning that taller development will emerge in areas of higher demand. Removing obstacles to the emergence of a denser city can generate several positive spillovers. Denser cities are greener than their less-dense counterparts; per capita, energy consumption at home and for transportation is much lower in higher-density

cities than in lower-density cities, suburbs, or rural areas.²³ Density also creates greater wealth and productivity. A richer and larger labor market with better access to knowledge spillovers generates significant economic growth.²⁴ As the available buildable area of a charter city diminishes over time, density will naturally increase in the most in-demand areas of the city.

An important way to eliminate barriers to densification is to eliminate maximum floor area ratios (FARs). FAR refers to the ratio of built floor space to the area of a lot. A building with 1,000 square meters of floor space constructed on a 200 square meter lot would have a FAR of five. Like direct height restrictions, FAR limits inhibit the densification of a city. When FAR limits are set too low for an in-demand location, this can make the cost of development extremely high.

In Indian cities like Mumbai and Delhi, extreme FAR requirements in both cities result in not enough housing being built, which leads to the proliferation of massive urban slums. In the absence of FAR requirements in downtown Delhi (FAR of two) and Mumbai (FAR of 1.33), much new apartment housing would be built, and far fewer people would be relegated to unsanitary, dangerous, disconnected, and underserved slum communities.²⁵ Mumbai and Delhi are among the densest cities in the world, but they achieve this through crowding rather than building upward. Simply not having FAR requirements, or even adopting a minimum FAR requirement, will help charter cities avoid replicating India's experience where density is expressed through crowding rather than new development.

Finally, charter cities should not impose maximum occupancy requirements. Charter cities must remain affordable to low-income residents.



A slum in Mumbai, India.

While the very liberal approach to land use and building regulation should allow for sufficient quantities of housing to be built so that crowding in residences does not become a problem, it is possible that over time crowding can become an issue. Although crowding introduces legitimate concerns about public health and safety, maximum occupancy limits will effectively bar some people from residing in the city in low-cost housing that they might otherwise have been able to access. This runs counter to the purpose of charter cities, to facilitate access to economic and social mobility for low-income individuals and their families.

1.3.3 Minimum Lot Sizes and Unit Sizes

Many zoning regulations contain minimum lot size requirements, especially in suburban settings. For a housing development project to be approved, each lot must be larger than some set square

meterage. Large-lot zoning should be avoided in charter city housing development as it increases the cost of housing, encourages greater sprawl, limits walkability, and harms the environment.²⁶

Larger lots command higher prices, which may limit the scope of a housing development a builder may be willing to construct. By spreading out homes over larger lots, it also becomes more difficult to build a walkable community that is not wholly reliant on the car for transportation. This increases the cost of living but also helps introduce problems of traffic congestion and pollution. Given that charter cities are located in countries where car ownership is not ubiquitous, minimum lot sizes that encourage greater car use represent a direct challenge to the ability of the city to provide an opportunity for the average family.

Like minimum lot sizes and other regulations detailed in this chapter, the primary impact of minimum unit sizes is to bar the poor from

desirable urban areas. By allowing for very small apartment units to be developed in in-demand areas, the poor can effectively outbid the rich in competition over expensive land. Consuming less land and floor space per person allows a greater number of lower-income people to live in an area where, had there been minimum unit size restrictions in place, only wealthier individuals would have been able to afford to live. Although charter cities will initially not likely need a supply of very small apartments, over time this may change, as has been the case in Shenzhen as the city enters maturity.²⁷

1.3.4 Minimum Parking Requirements

Zoning regulations often set minimum off-street parking requirements for new development. Because not all parking in a city is used at all times, minimum parking requirements can lead to large tracts of urban land being used for unproductive parking lots rather than additional homes and businesses. The costs of providing this parking—borne by developers and businesses that must be able to provide the required parking—are then passed on to consumers in the form of higher prices.²⁸ In addition to unproductively wasting valuable urban land, subsidized parking creates sprawl and limits walkability by encouraging car-centric development.

Rather than set minimum parking requirements, charter cities should instead price on-street parking and encourage off-street parking when possible. While some developments will include their own off-street parking, pricing on-street parking accounts for the costs imposed on society by additional cars.²⁹ With minimum parking requirements, all residents and businesses must share the cost of an additional car on the road, even if they themselves do not use the parking. In the absence of such regulations, the costs of parking an additional car within the city can be paid directly by that driver through parking charges or indirectly through the added cost of including off-street parking in their housing development.³⁰

1.3.5 Minimum Street Widths

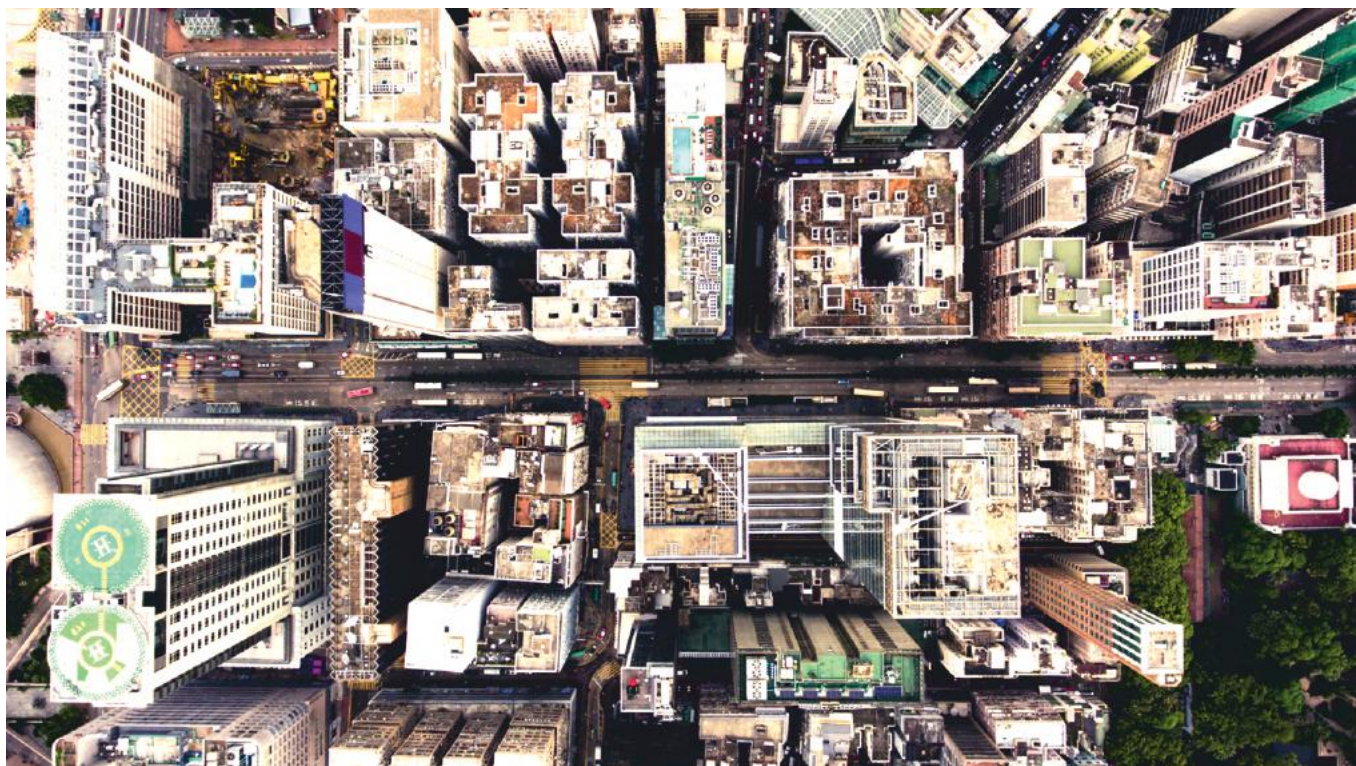
Street widths play an important role in the development of urban spaces. Not only do they influence safety for pedestrians and motorists, but also the kind of development that arises alongside them. In general, narrow streets are safer for neighborhoods. Narrower streets reduce car speeds, which in turn make pedestrians and cyclists safer.³¹ While major high-volume roads can be wider to accommodate a higher volume of traffic—including bus-based transit—and higher speeds, lanes should still not be larger than is necessary to accommodate all vehicles.³² Creating a hierarchy of roads will allow for effective traffic flow across the city while maintaining safety and walkability in neighborhoods.

BOX 25

Market Mechanisms in Effective Transit Management, Hong Kong

Hong Kong's Mass Transit Railway Corporation (MTR) operates the city's subway system, famous for its excellent service. The MTR is also notable, however, because it is one of the few major urban rail networks that generates a profit. This is possible because the Hong Kong government provides land above and around its transit stations at zero cost, which MTR is permitted to develop itself. In 2015 MTR generated

US\$2 billion in profit, with most of that coming from its property development rather than fares although fares also covered a remarkable 175% of operating costs.³³ This system incentivizes MTR to build retail and other development very close to transit stations, which greatly improves the accessibility of the city to more Hong Kongers. Charter cities should strongly consider following a similar model when establishing transit services so that these entities can generate a profit rather than rely on debt financing.



2. Transportation

Transportation policy in a charter city will help determine the location of residences and businesses as well as the modes of transport employed and the time needed to move people to and from home, work, school, and play. Transportation policies also play an important role in shaping the built environment surrounding transportation infrastructure, as mentioned in subsections 1.3d and 1.3e. An effective transportation system can significantly improve the quality of life for charter city residents, while a poor system can leave the city with greater congestion, more pollution, and longer commute times.

But at an even more basic level, the development of a road network plays a key role in creating parcels of land to later be developed. Building out a road network in advance of development creates public spaces—the road itself and sidewalks, as well as parcels owned by the city for public purposes—as well as private spaces to be developed into residential, commercial, industrial, and other uses.³⁴ The size and layout of a road network determine the size and layout of the buildable area of the city, which has a significant impact on the functionality, safety, and character of the city and its neighborhoods.

2.1 Public Transportation

Public transportation is a critical component of

mobility for any city. It's unlikely that in a charter city most residents will own a car, and so public transportation will be needed for trips longer than those permitted by walking. An extensive and reliable public transportation network can reduce the need for cars among city residents, which can reduce overall traffic and improve air quality.

Transit systems are typically comprised of some combination of busses and rail. Because rail transit modes come with significantly higher infrastructure costs than busses, charter cities should avoid building metros, light rails, or other rail-based transit systems and focus entirely on busses. An effective bus system can provide access to jobs throughout the city, regardless of where a person lives, in a timely manner and at a low cost.

When the charter city population is high enough that it might justify investment in transit with the carrying capacity of rail, bus rapid transit (BRT) is a viable alternative. When implemented well, like in Bogota, Lahore, and Mexico City, BRT can increase transit use, air quality, productivity, and labor market access.³⁵

The charter city administration can contract for bus service with private providers to control costs, rather than directly provide the service.³⁶ More specifically, relatively short-term performance-based contracts can ensure that the city receives the best possible bus services from the scarce resources dedicated to transit.³⁷

2.1.1 Micro Transportation

Micro transit, which refers to transit options with easily modified routes, on-demand service, smaller vehicles, and minimal physical infrastructure, will play an important role in creating mobility within a charter city. Micro transit can include rideshare

services, bike and scooter services, small buses and vans, and other such small vehicles.³⁸ These services provide transportation options that reduce the need for people to own a car while also reducing the need for the city to invest in capital-intensive transit infrastructure, like rail.

Private companies should be free to compete to offer these services throughout the city, as we're seeing in several major cities around the world where Uber, Lyft, Jump, and other smaller companies are providing a variety of micro-transit options. Beyond required vehicle maintenance and insurance requirements, this sector should largely be unregulated. Requiring operators to publish maps of their routes can help the city plan its own transit options, as well as infrastructure improvements.

Micro transit is already a dominant feature of the transportation network in most cities throughout the Global South. Minibus systems are already very common, although formal routes and stops for those busses are less common. A charter city can create a more formalized minibus system as its principal form of public transit, but with better mapping of routes and stops.³⁹

2.2 Cars

In addition to walking, bicycles, and transit, cars will also likely be part of the transportation mix within a charter city. While subsections 1.3d and 1.3e considered zoning issues related to cars, this section directly addresses the most significant externalities associated with cars.

2.2.1 Congestion Pricing

The first externality this subsection considers is that of traffic congestion. Placing an additional car

on the road does not create congestion up until the point at which the carrying capacity of the road is met. Above this volume of traffic, each additional car on the road increases the time it will take for all motorists to reach their destinations. And while the added time cost of one additional car is hardly noticed, in aggregate too many cars on a road will significantly slow the flow of traffic for all.

When the population of a charter city grows to the level that traffic becomes a problem, congestion pricing in core areas can be introduced to shift some peak traffic flow to other times and to shift would-be motorists toward other forms of transportation. In the absence of congestion pricing, drivers do not bear the full social costs of their use of roads. Although it may be difficult to determine the optimal congestion prices, which can be collected via electronic identifiers, implementing such pricing can help shift the cost of driving back onto the individual driver.⁴⁰ Congestion pricing has been implemented successfully in various forms in London, Stockholm, Singapore, and elsewhere.⁴¹

2.2.2 Pricing Parking

When cars are not in use, they must be stored

somewhere. This need to park cars imposes various social costs that, when parking is free, are not borne by the car owner (as discussed in subsection 1.3d, above). Each parked car is one less space available to other cars that need to park, and the land used for parking could be used far more productively. Free parking also encourages greater car use, which then contributes to the associated problems with car-centric urban planning, congestion, and pollution.⁴²

Parking charges ensure that car owners do not leave their cars in spaces longer than needed, which continually creates available parking spaces. By reducing the overall demand for parking via parking charges, a charter city can avoid having more land dedicated to parking that can instead be used for residential, commercial, or industrial use. Parking charges can also serve as a source of revenue for the city that can be put back into road maintenance or other public uses.

The city should consider not having or severely limiting on-street parking. This will allow for narrower streets and roads while also forcing car owners to fully internalize the cost of car ownership by making parking a privately provided good.

BOX 26

Bus Rapid Transit as an Alternative to Rail, Bogota, Colombia

Bogota's BRT system, TransMilenio, introduced in 2000, is among the most successful in the world. TransMilenio runs on dedicated lanes in the center of major roadways and is used by nearly 70% of Bogota's population, with 2.4 million daily riders. TransMilenio makes a profit on its operations, unlike most transit systems, which rely on subsidies. Despite its success the system still faces capacity problems and is somewhat disconnected from Bogota itself, given that it runs between freeways.⁴³

TransMilenio has been credited with improving Bogota air quality by over 40% due to reduced car trips. 9% of its riders previously commuted by private car, in a city with low car ownership rates.⁴⁴ Done well, BRT like TransMilenio creates an effective transit system at a fraction of the cost of rail.



3. Housing

Beyond zoning measures related to residential development, there are several other housing policy areas that a charter city should consider. In general, charter cities should strive to create a regulatory environment that is permissive of ample housing construction, as well as ample types of housing. Developers that create a mix of housing types, from large apartment buildings to single-family homes, offer charter city residents choice at a variety of price points.

3.1 Rent Control/Stabilization

Economists almost universally agree that rent control is a poor policy idea.⁴⁵ While rent control may help *some* low-income tenants afford an

apartment in the short-run, it creates substantial long-run distortions. Rent control measures tend to create housing mismatches, where people that were able to secure a rent-controlled apartment may continue to rent that unit well past when it makes sense for them to stay in that unit. For example, a two-person household may remain long-term in an apartment better suited for a family when they otherwise might downsize because of their below-market-rate rent.⁴⁶

Rent control measures also lead to significant distortions within the real estate market. Landlords are disincentivized to invest in building maintenance because they cannot recoup their investment through higher rents. Studies have found that when rent control measures have been lifted and building owners could charge market rates, the

value of those buildings increased tremendously, to their true level. Note that these building values did not increase because the landlords made investments in the properties but because their income-generating potential was increased. Similar effects were observed in neighboring properties.⁴⁷ Rent stabilization, under which rents increase by a set percentage, produces similar results to a flat price ceiling like with rent control.⁴⁸

For a charter city to grow in population rapidly, developers must be confident that they can continually recoup the full value of their investment and make continual improvements to raise that value.

3.2 Mixed-Use Development

Mixed-use development features multiple use types within the same location, including residential, retail, restaurant, office, and others. Mixed-use development makes accessing home, work, and play far easier for residents, reducing the need for private cars. Instead, people can access these spaces easily by walking, cycling, or using public (or micro) transit.

Mixed-use development creates pleasant, livable communities, but it comes with several other benefits as well. Because it reduces the need for private transportation and overall traffic, mixed-use development helps reduce carbon emissions and wasted commuting time. In Mexico City, which relegates much of its housing to the city outskirts, some families spend a quarter of their income on transport. Greenhouse gas emissions were made 70% higher, and US\$2.5 billion was lost each year in foregone economic activity.⁴⁹ By avoiding complex use-based zoning, mixed-use development will emerge naturally in a charter city, as it did before the introduction of modern

zoning in the early 20th century. Mixed-use development is also what tends to emerge in informal settlements, an indication this type of development is an organic, market-based response to resident demand.

3.3 Public Housing

Because a charter city will have few barriers to development, housing will be abundant and cheap in the charter city, and there will likely be a limited need for public housing. However, there may still be a role to play for the charter city administration in providing housing to the poorest residents of the city.

A charter city can help meet this need by using housing vouchers. Vouchers provided to the lowest-income residents of a charter city can help get them into housing that they might not otherwise be able to afford in a cost-effective manner. Vouchers also allow the housing market to function as it normally would, as a landlord is still receiving the asked rental price.⁵⁰ A voucher-based approach avoids the need for the city to develop or oversee a public housing program.

4. Building Regulations

While regulations governing land use and development should be restrained, there is a larger role to play for building regulations. Charter cities need to encourage growth but also ensure that buildings are not prone to collapse or fire or are likely to cause environmental hazards. Disasters such as the 2013 Rana Plaza collapse in Dhaka, Bangladesh, where more than 1,000 people were killed, showcase the potential outcomes of inadequate building regulation.⁵¹ A feasible medium between the lack of standards in informal settlements and highly complex and costly

standards imposed in some wealthy countries is achievable. While building regulations need to be strong and properly enforced, compliance with the construction permitting process must be such that it is easy to proceed with projects in a timely and low-cost manner.

The World Bank has identified eight critical

elements of a building regulatory framework: (1) building codes, (2) building permits, (3) independent third-party review, (4) sound and transparent urban planning requirements, (5) professional standards and oversight mechanisms, (6) product certification system, (7) liability and insurance systems, and (8) conflict resolution mechanisms.⁵²

BOX 27

Fire Safety and Structural Integrity after a Disaster, Dhaka, Bangladesh

In the wake of the Rana Plaza collapse in Dhaka, Bangladesh, the International Labour Organization prepared a comprehensive fire safety and structural integrity plan for garment industry factories. This plan includes extremely detailed guidelines for assessing the structural integrity and fire and electrical safety of factory buildings. This plan can serve as a model for charter city permitting authorities to follow in crafting their own building and safety requirements, especially for any factories that will produce garments or similar products.⁵³



4.1 *Performance-Based Building Codes*

Building codes are needed to ensure that building professionals, developers, investors, and regulators all operate under common and transparent standards for public health, safety, fire protection, structural efficiency, and environmental integrity. Clear building codes make regulatory compliance easier on the part of builders while also making permitting and inspection easier on the part of regulators.⁵⁴

Not all buildings will be subject to the same building codes. Buildings can be classified for different building code standards by their size, intended use, and intended occupancy. The building codes for a single-family house cannot be appropriately applied to a 10-story apartment building or a manufacturing plant.⁵⁵

Performance-based building codes have increasingly become standard practice around the world. Performance-based codes specify desired technical outcomes for structures rather than how that objective should be achieved, as is the case in a prescriptive building code. Performance-based codes allow for greater innovation in building design but require designers to demonstrate that a building will meet specified safety outcomes.⁵⁶

Because performance-based building codes only specify desired outcomes, the codes must be clear and simple to follow. Clear and simple codes are beneficial to both builders and regulators—the builder's uncertainty about the acceptability of their design is reduced, and the regulator can more easily make judgments as to whether a design meets code.⁵⁷

4.2 *Building and Occupancy Permitting*

The permitting process plays a dual role in construction, both as a safety gatekeeper and as a project facilitator. Permitting authorities need to ensure that standards for issuing permits are being met while also working quickly so that projects can continue moving forward. Permitting charges should either be high enough to cover the cost of inspections and enforcement, or the charges can be cross subsidized with revenue from violations.

Construction permitting should be housed online within the charter city's one-stop shop to make the process easier for both applicants and for permitting authorities. A standardized online procedure can help improve the consistency of the permitting authority's decision-making, boosting investor confidence.⁵⁸

In addition to the one-stop shop, there is also a role to play in the permitting process for private sector-led inspection services, discussed in the next subsection.⁵⁹

4.3 *Independent Third-Party Review*

While it is likely not necessary that the plans for a single home undergo significant regulatory review, larger and more complex building projects will require review by technical experts, as well as inspection during and after construction. Review and inspection that is independent of a builder help ensure that plans meet code and that constructed buildings are true to their previously approved plans.⁶⁰

Reviews and inspections can be conducted through a variety of mechanisms, including directly by the permitting authority, by private reviewers and inspectors retained by the permitting authority, by accredited third-party inspection agencies retained by the developer, by engineers uninvolved in the

design or construction, or by insurers and warranty providers.⁶¹ For a charter city, relying on a combination of these methods will ensure that the permitting authority does not become overwhelmed and that developments can proceed both quickly and safely.

4.4 Sound and Transparent Urban Planning Requirements

This element has previously been discussed. All land use plans and maps, as well as future growth and development plans, should be made available online for the benefit of developers. A map of all land parcels that details the rules governing any given parcel should also be made publicly available. Easy access to this information can speed up their planning processes and ensure that all plans meet any zoning or other land use requirements.⁶²

4.5 Professional Standards and Oversight Mechanisms

For review and inspections to be effective, especially those outsourced from the permitting authority to private third parties, professionals with qualifications in building design, building science, and relevant codes and standards will be needed. The permitting authority must develop a

set of standards by which firms or individuals can be assessed and recognized for their expertise in the relevant subjects.⁶³ Reciprocity with other permitting authorities in the country can help develop an early roster of approved private inspectors for use by builders. The International Finance Corporation's Environmental, Health, and Safety (EHS) Guidelines can serve as a useful starting point for developing a set of building standards for the charter city.⁶⁴

4.6 Product Certification Systems

Product certification systems for building materials, equipment, and systems can help make compliance and inspection processes earlier. If developers are working with known materials, equipment, and systems, they can know ahead of time that they will be in compliance while at the same time making the review and inspection process easier for regulators. For example, within the Single Market of the European Union, products, including construction materials, that meet market-wide standards are marked with a common sign of approval.⁶⁵ Product certification systems must be continually updated to allow for new innovations to be deployed in projects.⁶⁶ For simplicity, the charter city could accept certification systems from multiple jurisdictions, such as the US, UK, EU, and China.

BOX 28

Risk-Based Inspection to Improve Safety and Efficiency, Rwanda

Rwanda is one of many countries that has moved toward risk-based building inspection over the last two decades. A risk matrix is created that sorts buildings into low-risk, medium-risk, or high-risk categories. The risk determinations are made through a combination of building categories—residential, commercial, industrial, and so on, with sub-classifications—occupancy levels, fire resistance classifications, experience level of the building and design team, height and zoning location, and environmental concerns.

Where the building falls on the matrix determines the required inspections and forms for the project. Low risk building types only require an inspection as the need arises, such as if a neighbor complains. Higher-risk

projects can require mandatory inspections before construction starts, while the foundation is being laid, and after construction. Higher-risk projects can also be required to complete various forms related to inspection, whereas lower-risk projects are exempt. The published legislation also includes an inspection checklist for permitting authorities to follow that covers all the information that goes into a risk level determination.⁶⁷

4.7 Liability and Insurance Systems

Systems of liability and insurance are important if something does go wrong with a building after it has been inspected and approved. Insurance and liability systems include regulators (both private and public) as well as builders to ensure that they can confidently move their projects forward with the proper permitting. These systems are also important for aggrieved parties or plaintiffs in the event of a problem.⁶⁸

There are two main types of liability systems used worldwide. The first is called *joint and several liability*, also known as the *one percent rule*. In this system a party found only 1% liable can be forced to pay the entire amount of a settlement. However, that party is then eligible to try to recover some share of that settlement from parties they consider more liable. For example, if a permitting authority was found liable in the event of a building collapse, the permitting authority would be eligible to try and recover some of the settlement it owes from a private inspector, the builder, or any other parties

involved. The second type of liability is called proportional liability, under which parties only pay settlements in proportion to their share of fault. Several middle-income countries have been moving toward proportional liability, and a charter city should follow suit. Proportional liability can decrease the risk faced by each party involved in a construction project, allowing for greater freedom in reaching desired design and performance outcomes.⁶⁹

4.8 Conflict Resolution Mechanisms

When disputes related to building regulation arise, the permitting authority will need mechanisms in place to help find a resolution. To this end the permitting authority should have a body in place to interpret the technical requirements of code provisions, assess the sufficiency of code compliance, and make licensing determinations. Traditional remedies through the courts discussed earlier in the handbook should also be available to petitions raising a problem with the permitting authority.⁷⁰

¹ CCI's urban planning guidelines can be found on the Reference Guides section of our website here:

<https://www.chartercitiesinstitute.org/category/reference-guides>.

² "About Market Urbanism," Market Urbanism, <https://marketurbanism.com/about/>.

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⁸ Mobility data from companies like Google may be able to provide the information necessary to make such determinations.

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5.3 BUSINESS REGISTRATION

I. KEY TAKEAWAYS

- ✓ The business registration system in a charter city should facilitate new business formation rather than obstruct it.
- ✓ Registrants should be able to expect to receive approval of their application within several business days. The business registration process should be housed within a one-stop shop (OSS) where both online and in-person services like permitting and licensing are available to registrants, again lowering the barriers to registration. Processes for dissolving a company must also be developed.
- ✓ Overall, the charter city administration should prioritize two main values when creating its business registry as well as related procedures: (1) cost and (2) ease of use.
- ✓ The attainment of these two values will allow low-income entrepreneurs to actually afford to register their enterprises, which in turn augments compliance with business registration procedures as well as increases formality. Increased formalization within a charter city has several knock-on benefits that are also discussed.
- ✓ This chapter examines three key considerations in establishing efficient business registration procedures in a charter city: (1) how to go about setting up an OSS that links the registry together with other services, (2) the importance of transparency, and (3) the use of benchmarking for performance management.



II. INTRODUCTION

Fast, simple, and low-cost business registration—as well as licensing and permitting—is an important part of a well-functioning market economy. In many emerging markets formal sector entrepreneurship is made difficult, if not functionally impossible, in part because of onerous business registration processes. In some countries, it takes over one month and over a third of per capita income just to

register a business. Making it easier and less costly to legally form a business and secure licenses and permits can increase access to legal services, banking services, and social protections for entrepreneurs and their employees. In turn, this enables firms to grow larger and more productive, which both generates economic growth and increases tax revenues.¹

While larger, more productive firms can easily hire

lawyers, pay fees, provide detailed business plans, and handle large amounts of paperwork, a sole proprietor or a family with limited means simply trying to open up a small shop cannot accommodate these same burdens. Onerous regulatory barriers lock in advantages for firms with the means to comply or for those already in the market while locking out potential new entrants.

Business owners and employees in unregistered firms will likely be trapped in a low-growth, low-productivity equilibrium indefinitely, as informality impedes access to both finance and government services.² And even in the event that an informal entrepreneur—through their own industry and resourcefulness—begins to break out of this low-level equilibrium, they risk unwanted government attention if production is scaled up to a level that is typically seen in registered firms.

At the same time, the government will be starved for revenue if most firms operate informally.³ This can create a downward spiral where people have no incentive to register because they'll be paying taxes to receive low-quality or nonexistent services, but the government is unable to improve the provision of public goods and services because it collects such little revenue. Ultimately, the impact of a simple and low-cost business registration system will reach far beyond business formation, and it is therefore imperative that this process be effectively implemented. The long-run success of the charter city depends on it.

III. VALUES AND GOALS

Two central values animate the creation of an effective business registration system: (1) **cost** and (2) **ease of use**.

Table 12. Summary of Values and Goals for Business Registration

Value	Meaning of the Value	Measurable Goals
Decreased cost	<ul style="list-style-type: none"> —The fees and other expenses associated with registering a business should be minimal. —Fees should only be used to cover operating expenses, not generate revenue. 	<ul style="list-style-type: none"> —Benchmark to lowest cost countries as measured by <i>Doing Business</i>.⁴ —Strive for registration costs under 1% of per capita income.
Ease of use	<ul style="list-style-type: none"> —The registration process should be simple for registrants to complete and for registry staff to process. —In addition to registration procedures, the OSS should house all permitting and licensing procedures. 	<ul style="list-style-type: none"> —Benchmark to best performing countries as measured by <i>Doing Business</i> for the number of procedures and time to complete registration. —Strive for completing registration and other procedures within several days.

First, the major consideration for potential charter city entrepreneurs will be the **cost** to register their business: What are the fees associated with business registration, permitting, and licensing? Are there minimum capital requirements? Will the applicant need to pay a lawyer or notary to

complete the process? For even the average person in a low- or middle-income country, no extra expense is trivial. As such, cost should be minimized wherever possible.

Any fees levied should be to cover operating

expenses and not to generate revenue for the agency responsible for business registration. Minimum capital requirements place an undue burden on low-income individuals to save an inordinate amount of their income for registration when that income could instead be invested

directly in the business. Additionally, the registration process should be streamlined such that registrants do not need to hire a lawyer, notary, or other professional to complete the process.

BOX 29

Doing Business Strong Performer, Cote d'Ivoire

Since 2008 Cote d'Ivoire has made substantial progress in improving its business registration process.⁵ It has slashed the minimum capital requirement to register a business, along with other fees. The country created an OSS for business registration and has cut unnecessary procedures like labor ministry notification requirements. Cote d'Ivoire's OSS, the Investment Promotion Center, has been widely attributed for the dramatic improvement in the country's business environment in recent years.⁶

Now, the only required procedures to starting a business in Cote d'Ivoire are (1) to open a bank account, (2) to deposit the minimum capital requirement, which has been reduced to just 2.7% of per capita income, (3) to register at the OSS, (4) to obtain a company seal, and (5) to provide an address to the tax authority. This process can be completed in less than one week. In terms of both time and cost, Cote d'Ivoire outperforms not only the sub-Saharan African average but even the average high-income country.⁷



The cost to register a business should be benchmarked to the costs reported by the World Bank's Doing Business rankings.⁸ As a baseline goal, the cost to register a business (as a percentage of income per capita) must be below that of the host country. Doing so achieves the bare minimum in creating an enabling regulatory environment for businesses.

A more crucial goal is to strive for registration costs under 1% of income per capita, and even zero cost registration if possible. Approximately 30 countries have registration costs under 1% of income per capita, ranging from low and lower-middle-income countries like Rwanda and Timor-Leste to high-income countries like the United Kingdom and New Zealand.⁹ While the need to cover operating costs may make this goal difficult to achieve in the early stages of the charter city, as the population grows the quantity of registrations will also grow, allowing for wider distribution of

operating costs among registrants and a lower unit cost of registration.

Second, **ease of use** is another key consideration for a well-functioning business registry. The process should be both easy for registrants to complete and also easy for the city administration to process. It follows then that applicants should only be asked to provide essential information. This information includes the applicant's name, contact information, and the location of the business. By limiting the information collected, registration can be processed more easily, and a result can quickly be returned to the applicant. Providing an online option can further expedite the process. New Zealand's online company registration process provides a good example of the kind of bare essentials information the registration process should be requesting through the registration portal:¹⁰

1. The applicant creates a personal account with their name, email address, phone number, and residential address with New Zealand's RealMe identity verification system.
2. The applicant provides a company name that is unclaimed.
3. The applicant provides payment information for fees.
4. After the name has been approved, which took about 30 minutes on a test submission, the applicant gives the number of directors, shareholders, and shares. At this stage the applicant can also request to apply for a tax ID number.
5. The applicant provides an office address and additional addresses for services and communications, if applicable, as well as an email address. The applicant may also provide a phone number, mobile number, and fax number if desired.
6. The applicant must then indicate if the entity is controlled by a holding or parent company and provide a month that the company's annual return will be filed.
7. The applicant then provides the names, dates of birth, places of birth, countries of birth, residential addresses, and contact information of the company's directors. The applicant then does the same for company shareholders, indicating the allocation of total shares that the shareholder possesses.
8. The applicant may then choose to upload a company constitution although this step is optional.
9. The applicant then determines the company's tax obligations by identifying its primary business

activities.

10. The applicant can then, if needed, register for New Zealand's value-added tax (VAT). The portal asks various questions to determine VAT requirements and VAT payment/refund information.
11. At this point the company registration is complete.

Like with cost, ease of use can be benchmarked to the time and number of procedures in business registration, permitting, and licensing as reported by the Doing Business rankings. The baseline goal with respect to ease of use should be that business registration in the charter city can be completed in fewer days and with fewer procedures than the host country. The more important goal is to strive for as few procedures as possible, with strong performers requiring four or fewer and the best performers requiring just one procedure.¹¹ In terms of time to complete registration, strong performers report four days or less, with the best performers completing registration within one day. For example, the above New Zealand process takes only a few hours to complete.¹²

IV. IN PRACTICE

This section first overviews the step-by-step process of establishing a business registry. Next, several crucial considerations are elaborated upon: (1) key success factors (cost, time, and procedures), (2) how to go about setting up the agency that administers business registration, (3) best practices for the establishment of an OSS that links the registry together with other public services, (4) the importance of transparency, and (5) the use of benchmarking for performance management.

1. Key Success Factors: Cost, Time, and Procedures

The business registration process should require the following to be submitted by registrants through the OSS:

- A company name. A searchable list of registered companies should be made available so that applicants do not submit duplicate names.
- The contact information of the registrant(s), including the beneficial owners.¹³
- The address of the business, within the boundaries of the charter city, or the address of a registered agent for businesses established without the physical presence of the registrant.
- Upon registration the business must be assigned a unique ID number, such as a tax identification number, that other government entities can use in addition to the registry.
- The ID number is then used to register the business for VAT, which is linked to the tax authority. This can allow the business to file their annual returns through the same OSS where they conduct all other business.
- All the above must be able to be completed online through the OSS, although an in-person option should also be made available.
- Throughout the process, standardized forms should be used to better facilitate processing.
- In addition to the tax authority, linkages should be established through the OSS with other government entities like local public service providers, regulatory agencies, immigration services, and others. The OSS can become a central hub for businesses to interact with the charter city administration as needed.

The business registration process should *not* require:

- a minimum amount of capital;
- a bank account associated with the business;
- a company seal; or
- the use of a notary for documents.

In addition to the above non-requirements, individuals that are not nationals of the host country should be free to register or invest in a business of any kind in the charter city without the need to acquire a separate license to do so. Although additional steps may be needed to verify their information or that of a registered local agent, foreigners should otherwise enjoy the same privileges as host country nationals.

2. Setting Up the Administrative Entity

An administrative entity will be needed to facilitate the business registration system. This entity will be responsible for collecting, storing, and verifying registrant information, issuing certificates of registration, and linking applicant information to the tax administration and potentially other public agencies.

1. When the registration office is established, a standardized set of procedures for collecting the information listed above needs to be created.¹⁴ Online or in-person registrants need to be asked to supply the same information. Clear instructions and standardized forms to complete these procedures must be made available to both in-person and online registrants.
2. The registration office must be able to verify the accuracy of the information provided by an applicant. Registrants must not misrepresent their identity, the nature or location of the business, or any other information provided. If the information provided by an applicant appears unclear or incorrect, the registration office may ask the registrant to clarify or resubmit their information. Registrants that fail to do so successfully may be rejected. Creating a list of pre-approved forms of identification recognized by the charter city can more easily facilitate business registration.
3. The registration office needs to ensure that sensitive registrant information, especially information submitted electronically, is stored securely. When information must be shared with other government agencies, such as the tax authority, registrant information can be shared through an assigned identification number that can be used across government agencies. This data sharing should be transparent and trackable by the resident.¹⁵
4. After the registrant's information has been verified and their registration has been established with the tax authority, the registrant is to immediately be notified of their successful registration. Physical and electronic certificates of registration should be made available.
5. The business registry should be publicly searchable and disclose the business name, ID number, address, industry classification, registration status, incorporation date, taxes paid, and proprietor or director's name(s). If applicable, the business's local agent, parent company, and a contact phone number should also be made available.¹⁶ However, anti-spam measures should be considered to avoid this data being collected for marketing and other such purposes.
6. The registration office must collect statistics on the processing of registrations and set ambitious

processing timeline goals. At most, the process should take a few days, although faster processing is always preferable. The processing cost can be calculated, and fees adjusted accordingly, although they should be set as close to zero as can be achieved without slowing processing times due to lack of staff or resources.

7. The registration office must be prepared to conduct regular maintenance and testing of its online registration system and respond quickly to any problems that arise with the system to ensure that applications can continue to be processed securely and that any fees paid are not lost. Maintenance of the registry records themselves will also be important. Dissolved businesses should be indicated as such, for example. Registrants should be able to update their business' information, like the address or directors, as needed.

3. *One-Stop Shop and E-Services*

The business registry should be integrated into an OSS where all the necessary procedures can be completed. Housing business registration within an OSS where other administrative functions related to operating a business, like permitting and licensing, can make the process more efficient, saving registrants both time and money. Integrating other administrative entities into the OSS can facilitate information sharing across those entities, which in turn can make paying taxes, applying for building permits, and other interactions with the city administration easier.

OSSes and e-services have become standard practice in recent years, and various models exist when it comes to their implementation. Estonia has pioneered the provision of e-services globally. Estonia has used its e-residency program to allow anyone anywhere in the world to become an e-resident that can easily register a business in Estonia at a low cost after first rolling out its digital business registration service for domestic entrepreneurs. E-resident businesses have full access to the European common market, allowing Estonia to act as a quasi-entrepôt for Europe-focused business formation. The creation of new, large markets like the African Continental Free Trade Area presents an opportunity for charter

cities to occupy a position like Estonia has done for the European Union.¹⁷

The UN Conference on Trade and Development (UNCTAD) has also developed an e-business facilitation program to help create an enabling environment for business in low and middle-income countries.¹⁸ UNCTAD has developed an easy-to-use business registration system that has been set up in several countries. The same program also helps to make regulatory and compliance procedures simpler and more transparent. Rwanda is one country that has taken advantage of UNCTAD's services and a further discussion about its business registration system can be found below in the Case Study section below.¹⁹

OSSes are standard practice in special economic zones (SEZs) around the world. In addition to looking at the Estonian and UNCTAD programs, charter city operators can also look to successful SEZs both within the host country and abroad for guidance on effective business registration. SEZs that have demonstrated an ability to attract and retain investment will have on-the-ground expertise about what has and has not worked in the zone regarding business registration and OSSes.

In the United States the payment processing company Stripe has started a service called Atlas,

which offers easy business registration for startups. For a flat fee of US\$500, Atlas handles all the legal work necessary to form a C corporation (a tax classification in the US) in the state of Delaware, which has favorable corporate law. Atlas also helps customers file taxes, protect intellectual property,

and issue stock.²⁰ Although Atlas works from the point of view of helping entrepreneurs navigate the government's steps to register a business, its all-in-one model can still be useful in thinking about particular pain points when it comes to new business formation.

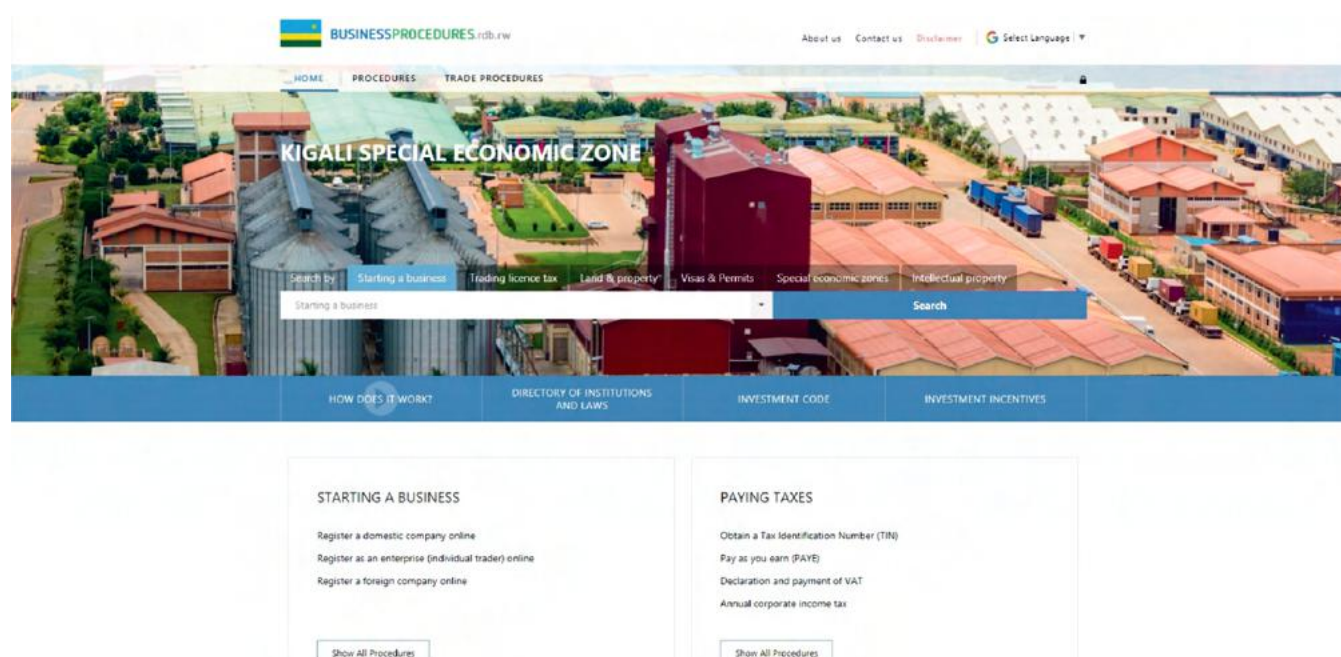
BOX 30

Multilateral Support for Business Registration Reform, Rwanda

Like Cote d'Ivoire, Rwanda has made great strides in improving its business registration system. Over the past decade, it has slashed fees and unnecessary requirements, as well as created an OSS. The OSS is included on an easy-to-use website created by the Rwanda Development Board in coordination with UNCTAD that, in addition to business registration, includes intellectual property registration, special economic zone licensure, visas, work permits, and more.²¹

Rwanda has also taken the added steps of exempting new small and medium enterprises (SMEs) from certain taxes for a fixed period, creating free VAT tax invoice software, and has allowed companies to register for VAT without opening a bank account.²²

In Rwanda, registrants simply need to (1) obtain an e-signature, (2) register the company online, (3) acquire the free VAT software, (4) register their employees with the Social Security Office, and (5) obtain a trading license. Completing these five procedures costs small- and medium-sized enterprises nothing and can be completed within four days. Rwanda also greatly outperforms its neighbors and the average high-income country.²³ Registration that can be completed at zero cost like in Rwanda should be seen as a top goal for a charter city's business registration system.



4. *Transparency and Public Messaging*

Setting clear expectations for potential entrepreneurs about the time, cost, and ease of registration can help inform their decision about whether to ultimately register within a particular jurisdiction.²⁴ Information about the purpose of particular fees and how those fees fit into the budget of the registry should be made available to reassure the public that such fees do serve a purpose. Statistics about processing times should also be made publicly available to show that the services promised are, in fact, being delivered. These expectations should also account for the possibility of needing a local address or local registered agent so that potential registrants are fully aware of the total cost associated with registration.

If the charter city business registry can achieve performance figures that are comparable or even better than for countries considered high-quality business environments, this streamlined registration process can be communicated in messaging to potential investors.

5. *Monitoring and Evaluation*

Tracking the performance of the business registry should be easy. Especially for online applications, the date and time of submission and the date and time of completion can be recorded instantly. Registrant feedback on the process can also be collected and analyzed, including the frequency of registrants reporting difficulty or needing assistance with the registry. This feedback can be utilized to identify procedures in the process whose functionality or time to complete can be improved. As stated in the Values and Goals section, the registry should limit the number of procedures to four or fewer and the number of days

to fully complete the registration process to four or fewer. When determining the processes and procedures necessary to dissolve a company, a longer process should be required to deter individuals from quickly forming new companies to escape from unsettled debts or legal issues.

In terms of monitoring and evaluating costs, registry officials can account for the costs of operating the registry and make projections regarding the expected number of registrations to set fees at an appropriate level that covers costs. Registration fees are easily compared to the fees charged in the host country's business registration process or in business registration processes employed in other countries. As stated in the Values and Goals section, registering a business should cost as little as possible, under 1% of income per capita if possible. Although income per capita will likely be higher in the charter city than the host country after some time, registry officials should continue to use the host country income measure to ensure that registration remains accessible to new residents.

The registry's performance, along with other functions housed within the OSS, can be benchmarked to the performance of these systems elsewhere. The World Bank's *Doing Business* measures are taken from the country's largest business city, which is likely to be a charter city's key competitor within a country for investment.²⁵ Benchmarking the performance here is a good first step. It is also appropriate to benchmark performance against countries in the same region and at a similar income level. High-performing systems, like those highlighted earlier or expanded upon in the case studies below, can serve as long-run performance goals.

BOX 31

Additional Resources for Business Registration

The World Bank has provided a toolkit on reforming business registration for practitioners. The toolkit identifies good and bad policies, provides a guide on the use of information and communication technology, and details the key tasks in setting up and implementing a registry. It includes a sample checklist of action items to follow and several country case studies.²⁶

The World Bank's *Doing Business* project provides research, data, and resources on good policies related to business registration and an examination of the process in each country. It has tracked business reforms for over a decade, providing solid evidence of the direction in which reforms regulating business activity have been moving.²⁷

Djankov et al. (2002) is the key academic contribution that has inspired the World Bank's *Doing Business* project and similar efforts to improve the regulatory environment, especially in developing countries.²⁸ This area of research has been an important component of a broader literature within economics and political science on the importance of institutions on economic growth, including the seminal work of Daron Acemoglu, Simon Johnson, and James Robinson.²⁹

Regulatory incentives have proven to be among the most important factors in determining the success or failure of special economic zones. Simple and low-cost business registration is an important first step that special economic zones have learned to get right, and charter cities should follow suit.³⁰

¹ Doing Business (2019i). “Starting a Business.” World Bank Group: Washington, DC. Available at: <https://www.doingbusiness.org/en/data/exploretopics/starting-a-business/why-matters/>; La Porta, R. & Shleifer, A. (2014). “Informality and Development.” *Journal of Economic Perspectives*, 28(3): pp. 109-26; Bruhn, M. (2013). “A tale of two species: Revisiting the effect of registration reform on informal business owners in Mexico.” *Journal of Development Economics*, vol. 103: pp. 275-83.

² La Porta, R. & Shleifer, A. (2014).

³ Lockhart, K. (2020). “Addressing the ‘Charter Cities as Tax Breaks’ Critique.” Charter Cities Institute: Washington, DC. Available at: <https://www.chartercitiesinstitute.org/post/addressing-the-charter-cities-as-tax-breaks-critique>.

⁴ For benchmarking purposes, the performance of digital services may require additional benchmarking beyond *Doing Business*, as this area is not the principal focus of that report. The United Nations Department of Economic and Social Affairs’ “E-Government Survey” is a useful tool for this purpose. Available at: [https://publicadministration.un.org/egovkb/Portals/egovkb/Documents/un/2020-Survey/2020%20UN%20E-Government%20Survey%20\(Full%20Report\).pdf](https://publicadministration.un.org/egovkb/Portals/egovkb/Documents/un/2020-Survey/2020%20UN%20E-Government%20Survey%20(Full%20Report).pdf).

⁵ Doing Business (2019j). “Business Reforms in Starting a Business.” World Bank Group: Washington, DC. Available at: <https://www.doingbusiness.org/en/reforms/overview/topic/starting-a-business>.

⁶ IFC (n.d.). “Open for Business: Côte d’Ivoire Ushers in a New Era of Growth.” International Finance Corporation: Washington, DC. Available at: https://www.ifc.org/wps/wcm/connect/news_ext_content/ifc_external_corporate_site/news+and+events/news/za_ifc_investment_climate_cote_divoire/. See also <https://cepici.gouv.ci/>.

⁷ Doing Business (2019k). “Ease of Doing Business in Côte d’Ivoire (Starting a Business).” World Bank Group: Washington, DC. Available at: <https://www.doingbusiness.org/en/data/exploreeconomies/cote-divoire>.

⁸ Doing Business (2019i).

⁹ Ibid.

¹⁰ Ibid.

¹¹ Ibid.

¹² Beneficial ownership transparency has been a growing global trend in financial regulation. See Eastwood, S., Roberts C., and Leveson, D. 2020. “Beneficial Ownership Transparency: a Spotlight on International Beneficial Ownership Registration.” Mayer Brown. Available at: <https://www.mayerbrown.com/en/perspectives-events/publications/2020/12/beneficial-ownership-transparency-a-spotlight-on-international-beneficial-ownership-registration>.

¹³ See, for example, New Zealand's guides on registering and incorporating a business: <https://companies-register.companiesoffice.govt.nz/help-centre/starting-a-company/>.

¹⁴ Estonia has implemented such a system for data transparency to bolster public trust in the country's e-governance system. See Plantera, F. 2019. “Data tracker – tool that builds trust in institutions.” E-Estonia. Available at: <https://e-estonia.com/data-tracker-build-citizen-trust/>.

¹⁵ See, for example, New Zealand's Companies Register: <https://companies-register.companiesoffice.govt.nz/>.

¹⁶ Mason, J. (2020c). “These three countries are in the lead to be Africa's e-hub after the free trade agreement.” *Quartz Africa*. Available at: https://qz.com/africa/1945847/after-afcfta-free-trade-deal-who-will-be-africas-estonia-e-hub/?utm_term=mucp.

¹⁷ See <https://businessfacilitation.org/> and <https://etradeforall.org/>.

¹⁸ See <https://rwandatrade.rw/>, and <https://businessprocedures.rdb.rw/>.

¹⁹ See <https://stripe.com/atlas>.

²⁰ See <https://businessprocedures.rdb.rw/>.

²¹ Doing Business (2019j). “Business Reforms in Starting a Business.” World Bank Group: Washington, DC.

²² Doing Business (2019l). “Ease of Doing Business in Rwanda (Starting a Business).” World Bank Group: Washington, DC. Available at: <https://www.doingbusiness.org/en/data/exploreeconomies/rwanda>.

²³ Doing Business (2018). “Starting a Business: Transparency of information at business registries.” World Bank Group: Washington, DC. Available at: <https://www.doingbusiness.org/en/reports/case-studies/2018/sab>.

²⁴ Doing Business (2019m). “Doing Business 2020: Data notes.” World Bank Group: Washington, DC. Available at: <https://openknowledge.worldbank.org/bitstream/handle/10986/32436/211440app.pdf>.

²⁵ Rahman, Aminur, et al. (2013). “Reforming Business Registration: A Toolkit for the Practitioners.” World Bank Group & International Finance Corporation: Washington, DC. Available at: <http://documents.worldbank.org/curated/en/577211468155378578/pdf/840140WP0Box380usiness0Registration.pdf>.

²⁶ Doing Business (2019i). “Starting a Business.” World Bank Group: Washington, DC. Available at: <https://www.doingbusiness.org/en/data/exploretopics/starting-a-business/>.

²⁷ Djankov, S. et al. (2002). “The Regulation of Entry.” *The Quarterly Journal of Economics*. 117(1): pp. 1-37.

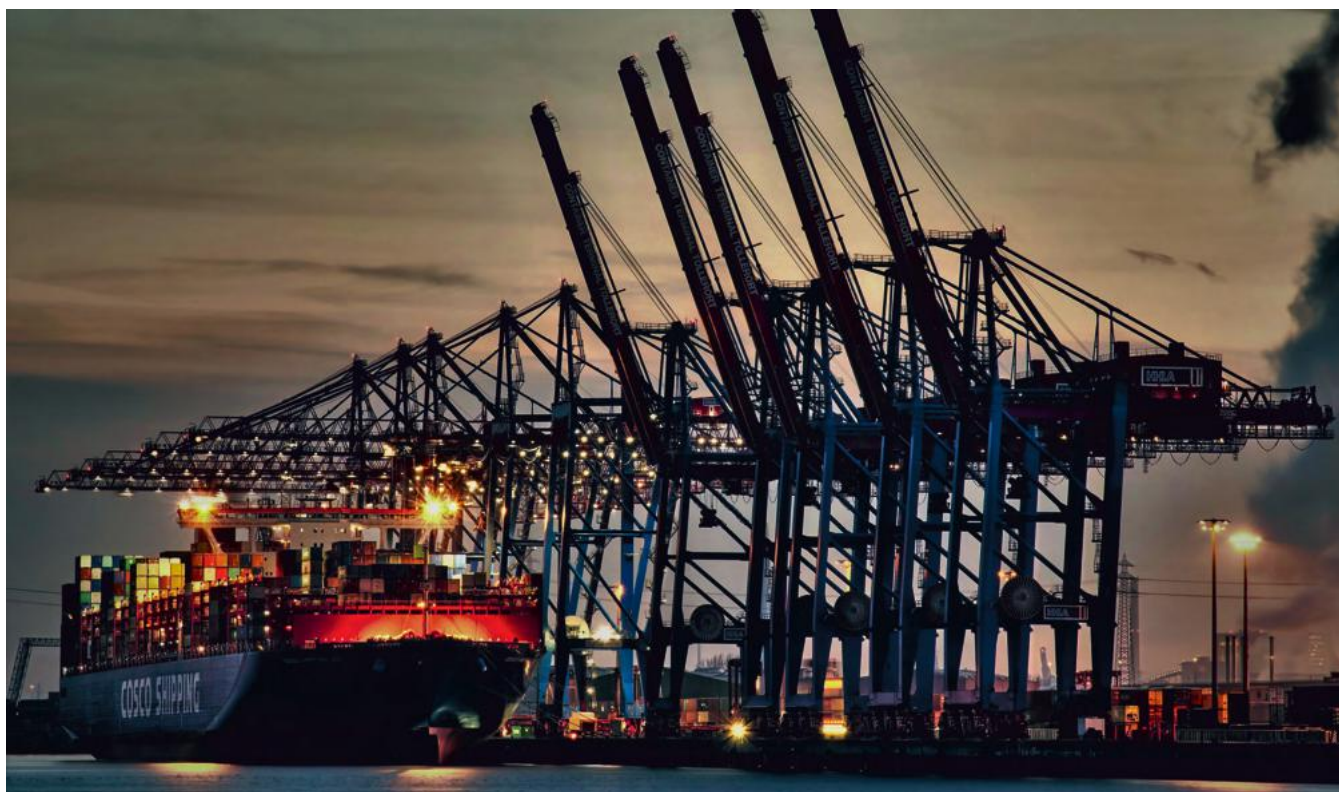
²⁸ Acemoglu, D., et al. (2004). “Institutions as the Fundamental Cause of Long-Run Growth.” NBER Working Paper No. 10481, National Bureau of Economic Research: Cambridge, MA. For a non-academic presentation of these ideas, see: Acemoglu, D. & Robinson, J. (2012). *Why Nations Fail: The Origins of Power, Prosperity, and Poverty*. New York: Crown Publishing (2012).

²⁹ Alexianu, M., et al. (2019). “Doing Special Economic Zones Right: A policy framework.” IGC Synthesis Brief, International Growth Centre: Oxford. Available at: https://www.theigc.org/wp-content/uploads/2019/11/WEB_SEZ-synthesis-paper-2019.pdf.

5.4 CUSTOMS

I. KEY TAKEAWAYS

- ✓ An efficient customs regime results in lower trade costs, which in turn helps spur business activity and increase economic growth.
- ✓ In order to lower trade costs, this chapter suggests that charter city customs agencies focus on three main values: (1) the minimum burden principle, (2) cooperation and collaboration, and (3) transparency.
- ✓ In particular, this chapter reviews the five essential factors in the establishment of an effective customs regime: (1) data sharing, coordination, and integration with the host country government; (2) the implementation of customs rules that strengthen trade facilitation; (3) the use of risk management best practices; (4) leveraging technology, in particular a one-stop shop; and (5) capacity building and human resources.
- ✓ Recommendations for particular customs management software and potential partners to help with technical assistance and capacity building are provided.
- ✓ Ultimately, if there is to be easy movement of goods and services between the charter city and host country, tight coordination and integration within the host country's customs administration will likely be necessary. This handbook recommends that a charter city have its own special branch of the national customs administration located within the city. The charter city administration should appoint the leader of this special customs branch, although it remains a component piece of the parent customs administration.



II. INTRODUCTION

Trade facilitation has been a major focus for many countries and for several multilateral organizations in recent decades¹ as the world has become more globalized with the growth of multinational firms whose production networks and suppliers span many national borders, so-called global value chains (GVCs). With this globalization has come associated trade liberalization—especially since the 1990s—and the perception throughout the Global South that low-income countries must open themselves to trade if they are to participate in the potential benefits that integration within GVCs can bring.²

When production takes place in multiple countries, and goods cross borders several times before ever touching an end consumer, trade facilitation—or the acceleration of the movement of goods across boundaries through the implementation of border rules that are simple, fast, known *ex ante*, predictable, and low-cost—is essential. A well-functioning customs agency is the most important factor in promoting trade facilitation in a charter city.

The main benefit of a high-performing customs agency is lower trade costs, which in turn helps generate increased business activity and economic growth.³ Indeed, a day's delay when trading goods is equivalent to applying a tariff of greater than 1%.⁴ On top of lowering trade costs, several knock-on benefits include greater export diversification, increased government tax revenues, employment creation, heightened foreign *and* domestic investment, and even reduced pollution.⁵ Lower trade costs can also positively impact inclusiveness. For example, a reduction in trade costs benefits small- and medium-sized enterprises (SMEs) relatively more than larger firms and low-income

countries relatively more than high-income countries.⁶ It also improves the conditions for starting up SMEs in general but specifically improves opportunities for *female* entrepreneurs to transition from the informal to the formal sector.⁷

Of course, in addition to the above benefits, customs agencies and customs officials across the globe have a justified reputation for corruption. This is especially true in many low-income countries—or in post-conflict border areas—where some customs officials earn relatively low wages and where illicit cross-border trade occurs, including drug smuggling, counterfeiting, human trafficking, and arms dealing.⁸ Therefore, in addition to trade facilitation discussed above, a key role of customs agencies in charter cities will be to minimize corruption and illicit trade flows, and by doing so augment security, not just within the charter city but across the wider region. These security and corruption-related issues pertaining to customs are often referred to as risk management. Indeed, these two functions—trade facilitation and risk management—are often complementary as several of the articles within the WTO's Trade Facilitation Agreement serve to reduce malfeasance. In particular, the transition toward completing the pre-clearance of goods electronically *before* these goods arrive at the border tends to significantly lower opportunities for corruption.⁹

This chapter examines how the customs agency in a charter city can most effectively (1) bolster trade facilitation, (2) implement risk management best practices, and (3) leverage recent advances in technology to lower the time required to engage in trade, to reduce the number of procedures and forms necessary, and to ultimately lower overall costs. On the whole, by decreasing trade costs, efficient customs regimes spur greater business

activity and generate increased economic growth.

III. VALUES AND GOALS

An efficient charter city customs agency should

strive to uphold three key values: (1) the **minimum burden principle**, (2) **cooperation and collaboration**, and (3) **transparency**.

Table 13. Summary of Values and Goals for Customs¹⁰

Value	Meaning of the Value	Measurable Goals
Minimum Burden Principle	<p>—The charter city's customs rules and activities should be minimally burdensome in terms of time, cost, and documentary requirements.</p>	<p>—Measurable goals that charter city administrations can use to track progress on the overall burden imposed on traders can be taken from World Bank's Doing Business Index on trading across borders.</p> <p>—This <i>Doing Business</i> methodology tracks the time and costs associated with border compliance, documentary compliance, and domestic transport of imports and exports.¹¹</p>
Cooperation and Collaboration	<p>—Charter city customs agencies should prioritize coordination and integration with the host country, with the regional trading bloc, and with other countries.</p> <p>—Charter city customs agencies should ensure a collaborative and participatory relationship with their business community, investors, and traders.</p>	<p>—A simple measure of the degree of cooperation is the number of jurisdictions with which the charter city has negotiated mutual recognition of its customs rules and its authorized operators. These jurisdictions should be weighted by their volume of trade with the charter city (i.e., jurisdictions that trade heavily with the city should carry relatively more weight).</p> <p>—The degree to which the charter city's one-stop shop is integrated and interoperable with the host country's customs management system and the scope of data shared between the two can be used as an indicator of cooperation.</p> <p>—Another gauge of the level of collaboration between the charter city administration and the host country is whether the charter city has a seat on the host country's national trade facilitation committee, whether the city can provide meaningful input, and how often this group has substantive meetings.</p> <p>—Two measures can be used to track collaboration with traders and the business community: (1) the number and quality of traders included in the charter city's authorized operator program and (2) the level of participation of the business community in providing comments and feedback on any proposed customs rules or regulations.</p>

Transparency	<p>—Transparency when it comes to customs and trade facilitation refers to information availability, ensuring the participation of the business community in customs decisions, providing advanced rulings, allowing predictable appeals, and clearly publishing fees and charges ex ante.</p>	<p>—Charter city administrations should leverage the OECD's Trade Facilitation Indicators (TFIs), which enumerate specific measures around transparency and predictability among other indicators.¹²</p>
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IV. IN PRACTICE

This section overviews the significant components of an effective customs regime. Broadly, there are five key components that a charter city administration must take into consideration when establishing its customs agency: (1) data sharing, coordination, and integration with the host country government; (2) implementing rules, processes, and procedures to bolster trade facilitation; (3) instituting risk management best practices; (4) leveraging technology to help each of the three preceding considerations; and (5) capacity building and human resources.

1. Data Sharing, Coordination, and Integration with the Host Country Government

When it comes to customs duties within a charter city, for the purposes of this subsection, it is assumed that within the concession agreement negotiated with the host country, a charter city is granted free trade zone (FTZ) status within all or, at the very least, part of its jurisdiction. Generally, free trade zones permit goods to be imported duty-free, transformed into higher value-added products, and/or exported out of the free trade zone by companies operating within the zone. If exported *outside* the host country, the company avoids all customs duties. If a company exports *into* the host country, it is typically required to pay all applicable customs duties. These customs duties are usually applied in one of two ways, at the

discretion of the company. First, duties can be applied to the value of the finished product. Second, duties can be applied to the combined value of all inputs.

There are instances where free trade zone rules deviate from the general model explained above, so precisely clarifying what a charter city's free trade zone status permits within its given country context is an important first step in setting up a customs regime. For example, the entire charter city may be deemed a free trade zone, as is the case in Hong Kong or Macao, where there are no customs duties. Alternatively, only a particular part of a charter city may be granted free trade zone status, as is the case of the FTZ *within* Shenzhen. The charter city administration will ideally be given the authority to decide whether and where it will create an FTZ and the specific rules associated with these FTZs. However, more often than not the host country will already have set rules attached to its granting free trade zone status that, once granted, is very difficult to alter and may require legal changes to national legislation.

The charter city customs regime should be integrated within the host country customs administration. There are three main reasons behind this recommendation. First, trade and customs activities between the host country and the charter city will be extremely intertwined. Second, the easy movement of goods and services

between these two jurisdictions is a paramount objective. Third, given that a charter city is not sovereign, the city is still subject to the international agreements and treaties to which its host country is a signatory, including agreements that have implications for customs rules.¹⁴

While the above three factors necessitate integration, customs agencies across the world have a justified reputation for corruption and graft. To avoid these problems of pervasive malfeasance, the charter city administration should endeavor to set up a special division or branch of the host country customs administration within the city. Moreover, the charter city administration should be given both appointment and termination powers over the leader of this special customs branch. Providing this authority to the city administration helps prevent the charter city's customs branch from falling victim to the culture of corruption and poor performance that often

characterizes customs administrations more generally.

Additionally, while the charter city customs branch should be given authority to set and implement customs rules, policies, and procedures, the host country customs administration should retain oversight over risk management considerations (see subsection 3 below).¹⁵ Such an arrangement allows the charter city to make progress on overall trade facilitation and lowering trade costs, and at the same time leaves security issues largely to the host country—issues the host country is unlikely to forgo its authority over. For example, oftentimes with free trade zones, the host country is concerned with goods 'leaking out' of the FTZ into its customs territory. Ultimately, the roles, responsibilities, and precise nature of this coordination and integration need to be established from the outset.

BOX 32

Dominican Republic's Free Zones Representation at Trade Negotiations

Because charter cities are hubs of economic activity, commerce, and trade, it makes sense that they be involved in international trade negotiations, if not representing themselves independently, then at least as part of their host countries' broader contingent of trade representatives.

For example, the free zones of the Dominican Republic have a voice at trade negotiations through two entities. First, CNZFE is a statutory body created by the government and made up of both public and private sector representatives. CNZFE regulates free zones but also participates in negotiating agreements with foreign governments that impact free zones. Second, the Dominican Association of Free Zones (ADOZONA) is a non-profit business association that represents free zone operators and companies. Among the several functions ADOZONA performs are two that directly impact trade: (1) it intercedes on behalf of free zone companies to ensure the expedited movement of imports and exports, and (2) it represents free zones during the Dominican Republic's trade negotiations.¹⁶

One place where a charter city's special customs branch could start in order to get a seat at the table in host country trade negotiations is the national trade facilitation committee. These committees are required to be established under the WTO's Trade Facilitation Agreement (TFA), with the purpose being for them to play a coordination role between domestic border agencies in order to eliminate redundant procedures or duplicate documentation requirements. This coordination role is supposed to entail the roll out of shared or interconnected computer systems across domestic

border agencies, the enablement of customs data to be available to border agencies in real-time, and the promotion of inter-agency collaboration when it comes to approving authorized operators (discussed further in the subsection on risk management).¹⁷

Because the TFA came into force in early 2017, most of these committees were established relatively recently, and most of the above activities were likely carried out even more recently. As such, these national trade facilitation committees in the relevant host country could likely share some lessons learned with charter city customs officials. And vice versa, if the national customs administration is in the early stages of implementing the TFA, charter city customs officials can engage in knowledge transfers with them. Ultimately, charter cities should be permitted to advocate for themselves at international trade negotiations, seeking easy, low-cost, and minimally burdensome cross-border trade.



Most free zones in the Dominican Republic are members of the Dominican Association of Free Zones (ADOZONA), which represents free zones at international trade negotiations.

2. Trade Facilitation

The charter city administrators and customs authorities can take several steps to promote trade facilitation:

2.1 Policy and Legal Framework

Many countries, particularly in the Global South, maintain policies or laws on the books that are inconsistent with TFA measures in particular and modern border procedures more generally. For some key modern procedures that are often not

included in antiquated national legislation, see below:¹⁸

—**Pearrival declaration.** Permits traders to submit declarations for goods *before* these goods arrive within the customs territory.

—**Separation of release from final determination of charges.** Allows traded goods to be released *before* relevant charges, fees, duties, or taxes (if any) have been paid.

—**Acceptance of copies.** Only an estimated 60%

of low- and middle-income countries accept *copies* of documentation as opposed to the original, and even then the acceptance of copies still overwhelmingly requires that another government agency possesses the original. In fact, only 8% of low- or middle-income countries accept copies without any exceptions. Relatedly, laws should also be altered to allow the acceptance of digital certificates and signatures.¹⁹

—**Advance comment.** To uphold the TFA measures²⁰ pertaining to transparency and predictability (discussed more below), legislation will need to be updated to require relevant laws to be published *in advance* so they can be commented on.

—**Coordination and implementation of OSS.** In many countries national laws need to be updated to allow for greater inter- and intra-agency coordination and cooperation between border and customs authorities, as well as to permit the establishment of an OSS that facilitates such coordination and data sharing—OSSes are also referred to as single windows by most WTO documents. Key legal and policy alterations necessary for an effective OSS framework include (1) the ability to appeal in case of a dispute with the OSS process, (2) legal restrictions around confidentiality and data sharing, (3) legal mechanisms in the event that inaccurate data is submitted or OSS data is incomplete, and (4) the ability to electronically archive submitted data and establish audit trails.²¹

Given that the charter city customs branch is within the host country's customs administration, it is crucial that charter city administrations ensure that the necessary alterations are made to national laws such that modern customs and border procedures can be effectively implemented.

2.2 Transparency and Predictability

The first six articles of the TFA seek to enhance transparency and predictability when it comes to importing, exporting, and transit processes. These can be distilled into five categories: (1) the availability of information, (2) encouraging consultation and participation with the business community, (3) advance ruling, (4) rules that govern appeals, and (5) trade fees or charges.²²

—**Information availability.** Requires that countries make data on trade, border, and customs rules relatively easily accessible via online tools and general publication and dissemination. Another component of information availability pertains to setting up mechanisms where traders can submit inquiries to quickly receive answers around trade-related questions. One frequent challenge here is that many countries of the Global South either don't have service level agreements that dictate a particular response time for inquiries, or the inquiry portals do not have hours of operations aligned with commercial realities. Information that must be provided includes the basic steps of importing, exporting, and transit processes; the duties and taxes levied (if any); the process to make appeals; a publicly available and searchable list of relevant trade agreements with other countries that traders may have to adhere to; average release times across goods classifications; and the publication of advance rulings online, among others. For this information availability pillar to be attained, charter city administrators should also have relevant forms, documents, and user manuals easily downloadable from its customs website.

—**Business community involvement.** Transparency and predictability include engaging in consultations with and seeking comments from

the trading community when designing customs and border-related procedures and day-to-day operations. Still, only 29% of low-income countries circulate drafts of proposed trade legislation or policies for comment before these rules enter into force, and only 14% actively seek the trading community's participation during the actual drafting process for these new rules.²³ This can and should be improved upon by charter city customs authorities.

—**Advance ruling.** Traders are provided more certainty and predictability regarding customs requirements when advance ruling mechanisms are in place, which in turn facilitates trade. What's more is that information from these advance rulings can be channeled into risk management platforms. This is an area where charter city customs officials can distinguish themselves from host country or regional customs officials, as the implementation of timely advance ruling mechanisms remains a work in progress in much of the Global South.

—**Appeals processes.** The right to a fair, transparent, and timely appeal helps ensure that customs and border agencies are held accountable for the uniform application and enforcement of customs rules. The main challenges here include allowing traders enough time to appeal a decision, providing sufficient time to file and lodge the appeal, and rendering an ultimate decision in a way that is time-sensitive and avoids unnecessary delays whenever possible. Service level agreements/service delivery targets should be established by the charter city customs branch around these aspects of the appeals process (in coordination with the national customs administration where necessary).

—**Fees or charges.** Information on the applicable fees, charges, and penalties should be easily accessible to traders, such as being posted on the customs agency website. In addition, periodic reviews of fees and penalties that seek to eliminate outdated, onerous, or unnecessary charges should be conducted. In charter cities, fees and charges should be minimal and when applied should only cover the cost of services rendered. When new fees are set to enter into force, there must be a sufficient time period that allows for traders to be adequately notified. Moreover, any penalties applied should be proportional to the particular transgression. On top of this, in many low-income countries, the compensation of customs officials is linked to the charges or penalties that they levy, which misaligns incentives by creating a conflict of interest. Customs fees, charges, and penalties should be independent of compensation. Not only this, but when a charge or penalty is applied, a few procedural guarantees should be universally applied: (1) transgressors should be provided a written explanation about the penalty being levied, (2) transgressors should be notified of the applicable legal provisions that they have violated, and (3) the penalties applied should be moderated if the transgressors voluntarily disclose a breach.



2.3 Streamlining Formalities

An essential aim of a charter city customs agency must be to minimize the number and complexity of formalities required to engage in trade, including documents and steps for importing, exporting, and the cross-border transit of goods. Some key challenges in these areas that charter city administrations can improve upon are discussed below.

—**Simplification and reduction of document requirements.** Low-income countries often require an unnecessarily large number of documents and report high average time requirements needed to prepare such documents. Documentation requirements should be minimal, standardized across time, and harmonized across jurisdictions where possible.²⁴

—**Leverage technology.** Since the negotiation of the TFA, many more low- and middle-income countries seem to be allowing for the electronic pre-clearance of various import and export processes. This not only saves traders time and money but reducing face-to-face interaction with customs officials lowers the opportunities available for corruption. Still, the charter city customs branch can further improve upon this positive development by publicly disseminating precisely which import and export processes can be pre-cleared electronically—obviously, the more, the better—as this information is often lacking on customs websites across the Global South.

—**Pre-shipment inspection.** Despite the TFA requiring members to end pre-shipment inspections and eliminate mandatory use of customs brokers, almost half of sub-Saharan

African countries continue to have pre-shipment inspection rules on the books. Charter city customs branches should *not* require pre-shipment inspections as these inspections have proven to be costly and inefficient for traders, and there are better and more efficient alternatives. If the national customs administration pushes back on this reform, the charter city administration should make the benefits of such a change clear in terms of time, cost, and scarce bureaucratic resources.

—**Rejected goods and temporary admission.** Customs rules should allow goods that have been rejected by applicable authorities and agencies such as food safety, drug enforcement, and agriculture for whatever reasons, including sanitary, environmental, or product standard issues, to be returned to the exporter. Temporary admission refers to goods being permitted for importation for a specific period of time (e.g., six or 12 months) and for specific uses *without* having to pay customs duties on these imports. Examples include goods being displayed at a trade exhibit, foreign-registered cars used by visitors or travelers, shipping containers that are imported in order to be filled, etc. Temporary admission is typically used in reference to two specific practices: (1) inward processing and (2) outward processing. First, inward processing is when a good has been returned to local manufacturers for parts, materials, or repairs. In this instance, the charter city customs branch should not levy customs duties on the local manufacturer, given the manufacturer exports the repaired or processed product within a specific period of time. Second, outward processing is when a local, previously imported and duty-paid good is sent back abroad for repairs or further processing and allows this good (now repaired) to then be re-imported without having to *again* pay customs duties or

taxes, given the re-importation occurs within a specified period of time. Charter city customs branches should ensure they permit temporary admission for both inward and outward processing.

—**Automated border procedures.** Many countries in the Global South have yet to fully embrace automated border procedures. Such automation includes the processing and clearance of goods pre-arrival; implementing a mechanism that allows any fees, charges, penalties, or other customs levies to be paid electronically; integrating this electronic payment mechanism with the system in place for automated declarations; and allowing traders to submit signatures and certificates in digital, as opposed to analog, formats. However, in order for these automated border systems to work, the charter city administration must ensure that its customs branch has access to both reliable electricity and reliable and speedy internet. Without adequate power and connectivity, efforts toward automated border procedures are in vain.

—**Perishable goods.** Perishable goods obviously need to be given priority when it comes to treatment by customs officials. Charter city customs branches should institute expedited physical inspection, provide adequate storage facilities if need be (e.g., refrigeration with reliable power), and schedule required examinations rapidly. The city's customs branch should have clear service delivery targets that require pre-specified response times for all these considerations pertaining to perishable goods. Furthermore, separating the release of these goods from their charges and clearance should be a priority in general, but especially for perishable goods. This may require updates to national laws (see above).

3. Risk Management

In the context of customs, risk management refers to the methods that customs agencies use to decide which imports, exports, transit transactions, or traders are subject to some type of control and typically specifies the type and extent of control imposed. The ultimate aim when it comes to risk management should be to focus control efforts on only high-risk transactions while working to expedite the clearance of low/lower risk transactions. However, as mentioned above, it's likely that the host country customs administration will retain significant, if not complete, control over risk management and security-related issues. Still, this doesn't mean that the charter city customs branch cannot work in coordination with national customs officials to nudge them toward implementing the best practices outlined below.

—**Post-clearance audits (PCAs).** PCAs refer to when customs officials verify that customs rules and other applicable legislation and regulations have been complied with by auditing the books and accounting records of traders *after* the goods have been released; this audit typically occurs at the trader's physical premises. PCAs are seen by experts to be one of the most effective tools available to customs agencies to facilitate trade, as it permits immediate release of imported goods while ensuring risks are managed through subsequent audits and controls.²⁵ Oftentimes PCAs may require alterations to national policies or legal frameworks.

—**Authorized operators (AOs).** AOs refer to “special or preferential customs treatment provided to reliable traders.”²⁶ The concept is similar to how the heightened scrutiny involved in becoming a NEXUS member allows these pre-screened travelers expedited processing when

entering the United States or Canada.²⁷ Charter city customs branches should work with national authorities to allow AOs streamlined formalities for imports, exports, and transit transactions. Charter city customs branches should especially focus on registering domestic SMEs as AOs, because not only would this strengthen linkages between local small- and medium-sized enterprises and the city, but SMEs are often the entities most negatively impacted by onerous, time-consuming, and costly customs practices. AO arrangements in low-income countries tend to focus on deferred payments for customs levies and taxes as well as quicker release times. By contrast high-income countries typically provide AOs with additional benefits, including lower data and documentation requirements, the use of lowered guarantees, and post-clearance audits at the premises of the AO.²⁸ The charter city customs branch should provide expansive trade facilitation benefits for AOs, and these benefits should be clearly listed and publicly available on the customs website. In addition to the benefits, the city customs branch should also clearly publish the selection criteria for AOs, procedures to attain AO status, and the time by which a decision on AO status will be rendered.

It should be noted that PCA and AO programs can be seen as complementary. For example, while PCAs can uncover high-risk traders, they can also pinpoint low-risk traders that can then be funneled toward AO status and the associated streamlined, cost-saving procedures that AOs are afforded. Moreover, charter city administrations should prioritize the negotiation of mutual recognition of their AOs with other WTO member states, but especially with the city's host country and with the relevant regional trading bloc(s). Such mutual recognition is one of the reasons why it is important that charter city customs branches be given a seat at international trade negotiations (see

Box 32 above).

4. *Technology: One-Stop Shops in Customs*²⁹

An OSS in the domain of customs serves the purpose of allowing traders to file, in a single portal, all customs and licensing documentation or data required for imports, exports, and transit transactions. Additionally, traders should receive all notifications through the OSS. The main benefits of an effective OSS include reducing the red tape, time, and costs associated with trade, and thereby improving access to trade for all, including small- and medium-sized enterprises that have been historically barred from cross-border exchange due to the cumbersome and costly nature of customs rules. On top of these main benefits, there are myriad ancillary benefits. First, a functional OSS promotes more transparent and consistent information, more uniform application of customs rules, and more predictable processes when it comes to customs clearance. Second, lower costs, reduced time requirements, and fewer bureaucratic forms to fill mean that the human and financial resources that would have otherwise been dedicated to fulfilling burdensome customs regulations are now freed up for better use, increasing the productivity of traders, bureaucrats, and the broader economy. Third, an OSS can help with accountability and risk management by effectively segregating traders into low- and high-risk and focusing scarce resources on preventing or uncovering illicit trade in this high-risk group while expediting clearance for the low-risk group. Fourth, by reducing costs and red tape, an OSS can induce greater compliance from traders, and by doing so boost tax revenues and increase formality. Fifth, a well-functioning OSS within the charter city can foster further cooperation, data sharing, and general integration with both the host country

and the broader region.³⁰

Given all these above benefits, the implementation of an effective OSS must be a top priority for the charter city customs branch in conjunction with the national customs administration. This subsection focuses on the institutional setup and implementation of an OSS. Additionally, in the next subsection recommendations are provided for customs management software as well as for potential partner organizations that can provide capacity building and technical assistance.

4.1 *Institutional Elements*

Institutional elements in this context refer to the functioning and general effectiveness of the OSS across three main dimensions: (1) the structure, (2) the services provided, and (3) the financing sources.

—**Structure.** First and foremost, flagship projects involving multiple stakeholders across diverse teams, functions, and agencies invariably end up failing to meet their objectives if a project lead is not placed at the helm. Given the importance of the OSS to the smooth functioning of city services, the charter city administration should task an independent and high-performing delivery unit with the implementation and ongoing operation of the OSS.

The charter city's customs branch should have significant input with the OSS delivery unit, as customs play an integral role in all border-related processes. By virtue of the OSS' importance to reducing trade costs and thus spurring business activity within the charter city, the head of the customs branch should ideally be part of the OSS delivery unit, reporting directly to the City

Manager on progress. Moreover, given that tight integration and coordination with the host country's customs administration will likely be necessary, the charter city's head of customs should also be tasked with ensuring interoperability and data sharing capabilities between the host country's IT systems and those of the charter city. In addition to these structural considerations, in the ideation and development phase of the OSS, the charter city administration should place a high priority on consultations with private-sector traders in order to fully understand the most important needs the OSS should aim to address. This emphasis on user/trader feedback should continue throughout development and implementation, such that as traders use the OSS, they can provide real-time insights, suggestions, and feature requests that can then be incorporated through an iterative process.

Lastly, a key structural factor that should be incorporated into the charter city's OSS development and implementation is coordination mechanisms across a host of issues. First, coordination between agencies responsible for inspections and controls (e.g., food safety, drug enforcement, etc.) must occur so that there is no duplication of efforts, thereby avoiding costly and unnecessary delays for traders. Second, interagency coordination must aim to harmonize and simplify documentation requirements and to ensure that *one-time submission*³¹—a core principle of an OSS—is achieved in practice. Third, coordination is required in the governance structure of the OSS from the outset of the project. For example, when the Association of Southeast Asian Nations (ASEAN) was in the process of developing a regional OSS, it set up a central steering committee that reported directly to the ASEAN director general of customs, as well as a technical working group, which assisted on the

software and data side of the project, and a legal working group, which assisted on necessary legal changes.³² Similarly, the South Korea Customs Service (KCS), when creating its OSS, had its Management Planning Division establish a cross-functional task force that included customs officials, traders, business consultants, and software engineers.³³

—**Services.** The OSS should allow for the fulfillment of as many regulatory requirements and customs rules around importing, exporting, and transit transactions as possible.³⁴ A key service that the OSS should offer is for traders to be able to calculate—in advance—any fees, taxes, or charges levied for transacting goods. Another essential service to include within the OSS is automated border clearance, which is discussed in more detail above.

—**Financing.** Successful OSS implementation requires sustainable funding sources. Financing through governments and user fees are the most common sources for an OSS. However, charter city administrations should also look into options to finance OSS implementation through public-private partnerships or donor support—the ASEAN OSS project, for example, leveraged both of these.³⁵ Justification for financing can be supported by OSS cost-benefit analyses. For example, South Korea's OSS was able to recoup its investment by the fourth year following implementation.³⁶

5. *Capacity Building and Human Resources*

Governments and charter city administrations can pass all the trade facilitation laws and regulations they want, but without the necessary training and know-how on how these reforms can be implemented in practice, the laws will remain



Inefficient border rules and procedures result in significant wait times, increasing transaction costs and hindering trade.

unactionable.

Due to a lack of requisite skills in many countries across the Global South, capacity building and technical assistance are often necessary when implementing updated systems for customs and cross-border trade, including an OSS. When it comes to specific software, the Automated System for Customs Data (ASYCUDA) is the most widely

used customs management software to facilitate trade and transport.³⁷ The UN Conference for Trade and Development (UNCTAD) provides technical assistance in the implementation of ASYCUDA.³⁸ In addition, both the WTO and the World Customs Organization (WCO) provide training and capacity building on the implementation of the Trade Facilitation Agreement.³⁹

¹ For a comprehensive overview of the efforts of WTO members toward the implementation of the landmark Trade Facilitation Agreement, see OECD (2018b). “Trade Facilitation and the Global Economy.” OECD: Paris. Available at: <https://www.oecd.org/publications/trade-facilitation-and-the-global-economy-9789264277571-en.htm>.

² World Bank (2020a). *World Development Report 2020: Trading for Development in the Age of Global Value Chains*. World Bank Group: Washington, DC. Available at: <https://www.worldbank.org/en/publication/wdr2020>.

³ See, for example, OECD (2018b), p. 3: “The TFA is expected to reduce trade costs between 12% and 18%, and increase world trade.”

⁴ World Bank (2020a): p. 6.

⁵ WTO (2015). “Aid for Trade at a Glance 2015: Reducing Trade Costs for Inclusive, Sustainable Growth.” World Trade Organization: Geneva: p. 121.

⁶ Ibid. p. 111: “a 1% decrease in global trade costs would yield an increased global income of US\$40 billion at a minimum, the bulk of which (63%) is expected to be realized by developing countries.”

⁷ OECD (2018b): p. 3.

⁸ Note that while customs officials in low-income countries often argue that their low wages are the main reason for rampant corruption, in reality most customs officials are quite well paid relative to the population as a whole. Accordingly, customs experts suggest that “this [‘low wages’] argument is unlikely.” See Cantens, T. (2012). “Is It Possible to Reform a Customs Administration? The Role of the Customs Elite on the Reform Process in Cameroon” in Amsden, A.H., DiCaprio, A., & Robinson, J.A. (eds). *The Role of Elites in Economic Development*. Oxford University Press: Oxford.

⁹ Moore, M. et al. (2018). *Taxing Africa: Coercion, Reform, and Development*. Zed Books Ltd: London. p. 129.

¹⁰ For additional measures and indicators around trade facilitation and customs see the World Customs Organization's (WCO) Guide to Measure the Time Required for the Release of Goods (TRS Guide), as well as the associated TRS software (<http://www.wcoomd.org/en/topics/facilitation/instrument-and-tools/tools/time-release-study.aspx>). In addition, see WCO's Customs International Benchmarking Manual (Available at: http://www.wcoomd.org/en/topics/facilitation/instrument-and-tools/tools/customs_international_benchmarking_manual.aspx).

¹¹ Doing Business (2019n). “Trading Across Borders Methodology.” World Bank Group: Washington, DC. Available here: <https://www.doingbusiness.org/en/methodology/trading-across-borders>.

¹² See <http://www.oecd.org/trade/topics/trade-facilitation/>.

¹³ Indeed, linkages between the charter city and the surrounding region of the host country, especially linkages with small- and medium-enterprises, are highly encouraged.

¹⁴ One of the more recent international trade agreements with ramifications for customs agencies around the globe is the Trade Facilitation Agreement, negotiated under the auspices of the WTO in 2013 and 2014, which entered into force on February 22, 2017 (after ratification of two-thirds of WTO member states). This is discussed in more detail in the next subsection. For more details see: https://www.wto.org/english/tratop_e/tradfa_e/tradfa_e.htm.

¹⁵ Other areas that the charter city customs branch should work in tight coordination with the host country customs administration are (1) updating the policy and legal framework (see subsection 2.1); (2) information and data sharing (see subsection 2.2); (3) technology integration and interoperability (see subsections 2.3 and 4); (4) automating border procedures (see subsection 2.3); (5) capacity building, human resources, and sharing lessons learned (see subsection 5).

¹⁶ For more on ADOZONA see here: <https://adozona.org/en/sobre-adozona/>.

¹⁷ TFA Article 7.7 requires a mechanism to be put in place for trading entities that can be given special trade facilitation privileges because they meet special criteria related to, for example, a record of compliant and secure trading, good management, and solvency. These entities are referred to as authorized operators (or AOs). Authorized operators are discussed more in the subsection on risk management. See OECD (2018b), p. 40.

¹⁸ WTO (2015): p. 118.

¹⁹ OECD (2018b): p. 38-39.

²⁰ TFA Article 2 states that traders and the business community should have opportunity to see and ideally comment on proposed trade or customs rules before they enter into force. See https://www.wto.org/english/tratop_e/tradfa_e/tradfa_e.htm.

²¹ OECD (2018b): p. 69. Note that the implementation of one-stop shops is further discussed in subsection 4 of this chapter.

²² OECD (2018b): p. 31.

²³ OECD (2018b): p. 33.

²⁴ For example, the UN Centre for Trade Facilitation and Electronic Business (UN/CEDACT) develops both UN data and trade documentation standards and tools that are freely accessible and used throughout the world. See <http://www.unece.org/cefact>. The charter city customs branch should work in conjunction with the national customs administration to harmonize (and minimize) documentation requirements.

²⁵ OECD (2018b): p. 40.

²⁶ For more on AOs see <https://www.tfafacility.org/article-7#:~:text=7.4%20Members%20are%20encouraged%20to,of%20the%20legitimate%20objectives%20pursued>.

²⁷ See <https://www.cbp.gov/travel/trusted-traveler-programs/nexus>.

²⁸ OECD (2018b): p. 41.

²⁹ Most customs organizations and documents refer to one-stop shops as ‘single windows.’ To be consistent with other chapters in this handbook we use the term ‘one-stop shop.’ However, the two can be seen as synonymous.

³⁰ OECD (2018b): p. 62.

³¹ ‘One-time submission’ aims to have traders file requisite documents and data into the OSS and, once filed, the trader should *not* be asked for the same information again. See <https://www.tfafacility.org/article-10>.

³² OECD (2018b): p. 73.

³³ Cantens, T., Ireland, R., & Raballand, G. (2013). *Reform by Numbers: Measurement Applied to Customs and Tax Administrations in Developing Countries*. World Bank Group: Washington, DC. p. 140. Available at: <https://openknowledge.worldbank.org/handle/10986/11967>.

³⁴ See the above subsection 2 on Trade Facilitation and subsection 3 on Risk Management for a host of customs rules to include within the OSS.

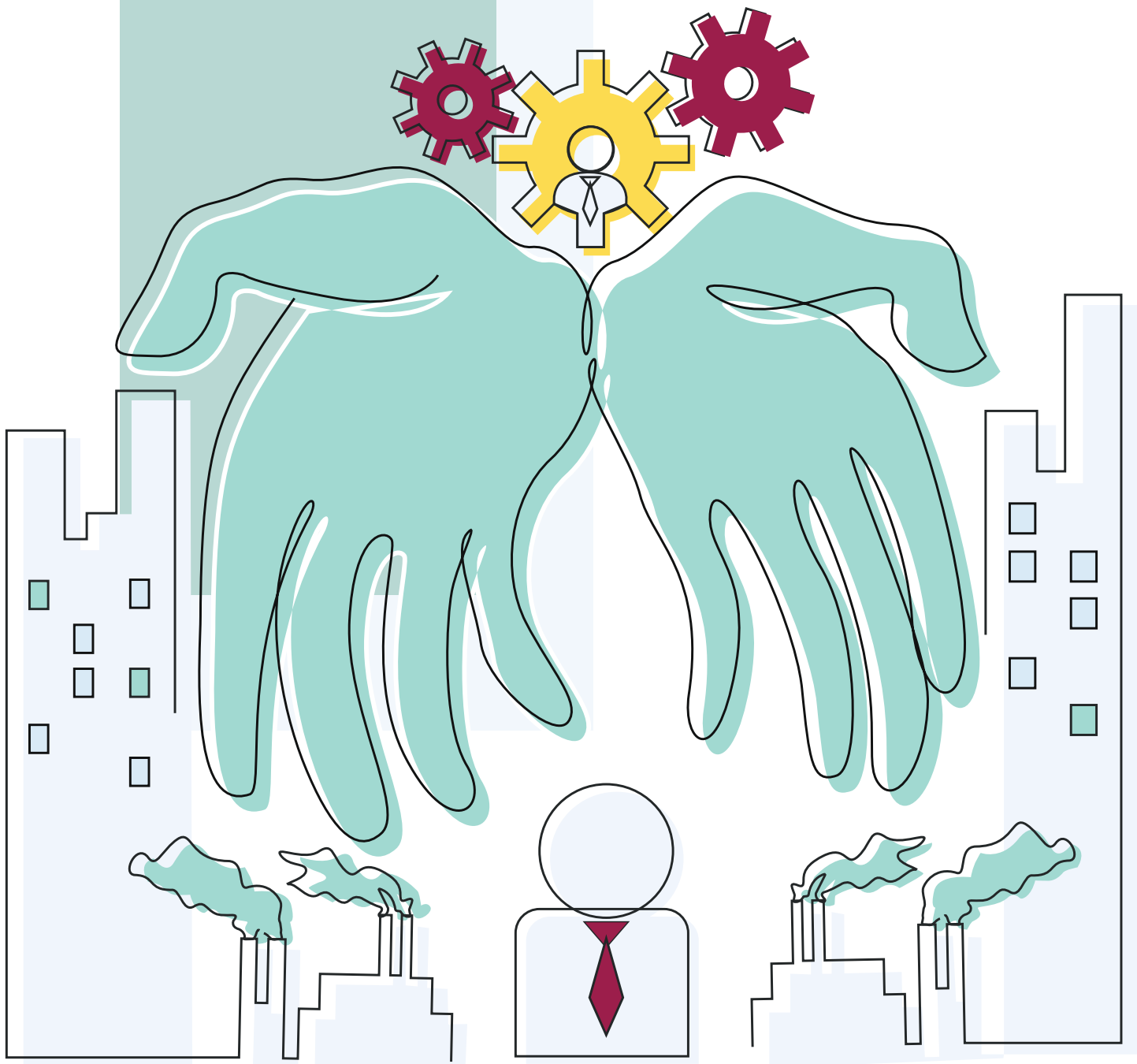
³⁵ OECD (2018b): p. 74.

³⁶ Cantens, T., Ireland, R., & Raballand, G. (2013): p. 140.

³⁷ The most up-to-date version is ASYCUDA World. See <https://asycuda.org/en/>.

³⁸ See <https://unctad.org/topic/transport-and-trade-logistics/customs-automation-ASYCUDA>.

³⁹ For WTO capacity building see <https://www.tfafacility.org/regional-workshops-and-other-activities>. For WCO training and capacity building information see <http://www.wcoomd.org/en/topics/capacity-building.aspx>.



PART 6: LABOR LAW

6. LABOR LAW

I. KEY TAKEAWAYS

- ✓ Workers depend on labor laws for fair treatment from employers, and firms make major investment and hiring decisions based partially on these laws. Labor law is thus an integral component of the regulatory regime in a charter city.
- ✓ Charter city labor law should prioritize four key values: (1) maximize jobs, (2) flexibility and upward mobility, (3) simplicity, and (4) uniform enforcement of workers' rights.
- ✓ This chapter lays out three overarching components of effective labor law: (1) the key labor provisions to be included in the charter city's labor-related legislation that arise from the International Labor Organization's core protections and guidelines such as minimum wage, work hours, paid leave/holidays, forced labor, child labor, dismissal, collective bargaining, and health and safety; (2) the steps in establishing an efficient labor administration; and (3) setting up enforcement mechanisms.



Child labor remains a significant problem in the Global South. Pictured are children at work in a cotton field in southeastern Turkey.

II. INTRODUCTION

This chapter of the *Governance Handbook* discusses how to effectively create and enforce

labor law for a charter city. A principal goal for a charter city is to generate significant employment opportunities for low-income residents of the host

country. Doing so requires striking an appropriate balance between protecting workers and supporting greater economic growth.

Given that the average annual income for the target residents of a charter is approximately US\$1,500, CCI generally recommends implementing labor regulations limited in scope, as overly stringent labor regulations can discourage employment, investment, and productivity growth.¹ At the same time, certain protections are essential to prevent mistreatment and abuse. Regardless of the level of worker protections, charter cities must also develop the administrative capacity to enforce the labor standards it chooses to adopt and sanction employers that violate those standards.

Relative to most advanced economies, labor conditions throughout the Global South are quite poor. In some cases, these conditions result from the absence of regulation or poor enforcement. However, poor conditions also often result from overly onerous labor regulations whose compliance and enforcement costs are so high that workers are instead pushed into the informal economy. This is especially true for workers in household enterprises, where the usual employer/employee dynamics do not exist, and sparse resources limit improvements to safety and sanitation.²

In some cases labor standards and workers' rights are diminished beyond an already low baseline in attempts to attract additional foreign investment with the promise of exceptionally cheap labor. Forced labor, child labor, and discrimination based on ethnicity, sex, national origin, and other factors are still persistent problems throughout the Global South as well. At the same time, many of the labor policies these countries have adopted with good

intentions are simply ineffective or even harmful. For example, a minimum wage set at or even above the prevailing average wage in a country leads to higher unemployment within the formal sector and encourages informality.³

Most countries in the Global South lack the state capacity to effectively enforce the labor standards they currently have in place. Countries that struggle to build basic infrastructure, collect taxes, register businesses, or control pollution will surely struggle to effectively enforce their labor laws, especially if these laws are overly onerous and near impossible to navigate.⁴ Properly training inspectors requires dipping into the state's limited financial resources, and the rule of law must be strong enough so that once hired and trained, these inspectors won't be easily bribed into allowing transgressors to evade sanctions and enforcement.

The goal for labor regulations, especially at the *beginning* of any charter city development, should be enacting simple, easy-to-follow rules that do not overburden employers. Only then will employers be sufficiently enticed to adhere to formal rules. Simplicity not only helps generate employment for charter city residents but, importantly, it reduces informality, which ensures labor standards are more easily and effectively enforced. Enforceable standards provide more effective protections for labor than would otherwise be the case when labor is directed into the informal sector.

III. VALUES AND GOALS

The labor law and labor administration in a charter city must aim to uphold four values:

Table 14. Summary of Values and Goals for Labor Law

Value	Meaning of the Value	Measurable Goals
Maximize jobs	<ul style="list-style-type: none"> —The charter city should generate significant employment, which fuels economic growth. —The goal of generating employment includes creating quality jobs that offer better compensation and other such benefits than what is available elsewhere in the country. 	<ul style="list-style-type: none"> —Total jobs created and rate of job growth. —Number of jobs tied to each employer, including the share of employment generated by micro, small, and medium enterprises. —Average wage data. —Share of the population employed in various sectors.
Flexibility and Upward mobility	<ul style="list-style-type: none"> —The labor market requires flexibility regarding hiring and firing. —Workers require adequate protections that can evolve over time. —The city must invest in generating upward mobility through investment in skill generation. 	<ul style="list-style-type: none"> —Benchmarking labor standards based on city income level. —Employer surveys on reported ease of hiring and firing. —Promotion of employees within firms and development of career pathways that are not firm-dependent. —Share of host country nationals in decision-making and/or management positions. —Successful pairing rate of graduates of training or skill-building programs with employers.
Simplicity	<ul style="list-style-type: none"> —A simpler labor law regime allows for easier compliance, enforcement, and dispute resolution. 	<ul style="list-style-type: none"> —Demand for legal counsel by workers in resolution of labor disputes. —Time and cost to resolve cases in small claims tribunal or other dispute resolution mechanisms. —Measure the access of low-income workers to dispute resolution mechanisms.
Uniform enforcement	<ul style="list-style-type: none"> —Enforcement of labor law should be uniform across all employers. —The labor inspection entity requires a strong culture of and reputation for impartiality and fairness in enforcement, investigations, and dispute resolution. 	<ul style="list-style-type: none"> —Sanctions issued proportional to the degree of harm and likelihood of a repeated offense. —Frequency of sanctions by industry and firm size.

First, for a charter city to be successful, it must generate significant employment. For most charter cities, especially in the early stages, that employment will likely come from a large manufacturing sector. A manufacturing industry that first produces simple products like textiles or plastics and then moves into more complex

products over time has been the driving force behind transformational economic change in numerous countries throughout history, including several in recent decades. China, Taiwan, South Korea, Singapore, and others have ridden waves of industrialization to rapid economic growth and the eradication of dire poverty within two

generations. Similarly, in the nineteenth and early twentieth centuries, manufacturing-led transformations took place in the United States, the United Kingdom, and Europe.

With respect to labor law, all these countries only saw the introduction of stringent labor regulations *after* mass employment had been generated and incomes had substantially risen. At the same time, there was significant competition for workers between firms and industries, to the point that the most serious health and safety violations were no longer commonplace.⁵ Although industrial and manufacturing employment in emerging markets

may be terrible in terms of working conditions, manufacturing jobs still offer a viable path out of the kind of extreme poverty that persists in subsistence agriculture or—worse—perennial unemployment.⁶ Although this story does not play out equally well in all cases, there are no other proven better alternatives to manufacturing that can generate such broad-based economic development at scale.⁷ There is also some evidence that industrial development is particularly beneficial for women, whose opportunities for economic and social mobility may otherwise be limited.⁸

BOX 33

The Divergent Economic Outcomes of Bangladesh and India

Today, Bangladesh is widely known as a hub for garment manufacturing. Bangladesh's success in garment manufacturing raises the question—why has India not experienced a similar boom? Although the divergent economic trends in India toward services and in Bangladesh toward manufacturing arise from a complex set of factors, labor law has played a crucial role.

In 1947 India adopted wide-ranging labor legislation that, among other things, limited the ability of firms to contract with workers. This legislation and its pro-worker amendments have been credited with increasing urban poverty and lowering output, employment, investment, and productivity in India's formal manufacturing sector, pushing what manufacturing India does have toward the informal sector.⁹ In 1958, Pakistan—which Bangladesh was then a part of—repealed the Indian labor regulation, so when Bangladesh was created in 1971, it did not have an extensive set of labor regulations in effect.¹⁰

Since the 1970s Bangladesh has seen substantial growth in manufacturing activities as a share of GDP, while India has recently undergone a decline in manufacturing.¹¹ While these divergent paths are attributable to more than just labor law, this area has played a critical role. Although India's GDP per capita is higher, its growth rate has been far more variable, and there are concerns about the country's ability to continue developing with a services-based economy.¹² A manufacturing economy enabled by a comparatively flexible labor law regime presents an opportunity for more broad-based growth than services can provide, and that opportunity should not be regulated out of existence as was the case with India.

Given this track record, charter cities should not prematurely stunt the potential for such development with excessive labor regulation.

Outside of South and Southeast Asia, there has been much skepticism about the potential to replicate the kind of manufacturing-driven

economic booms that lifted large segments of China and the East Asian Tigers out of poverty. This skepticism is misguided. Although onerous labor regulation is only one component of overall labor costs, it does contribute to significantly higher labor costs, as well as labor rigidity which can stifle growth.¹³ In Africa, where industrialization is most needed, labor costs in many cases are already much higher than in contemporary manufacturing hubs in China, Bangladesh, and elsewhere. This is an unfortunate state of affairs because such high labor costs prevent the kind of manufacturing-led growth discussed above from even getting started.¹⁴ Ultimately, charter cities must work to maximize jobs for their residents—preferably manufacturing jobs at the outset—by reducing overly burdensome labor regulations.

An important caveat to the above point about labor costs is that labor costs also rise when labor productivity rises, as more productive workers can demand higher wages. Increased productivity and higher wages are a signal of economic growth, one of the principal purposes of a charter city.¹⁵ Therefore, when considering labor costs and industrial development, it is important to discern between costs associated with regulation and costs associated with rising productivity.

The charter city can collect employment data from registered businesses to track employment generation. If businesses can supply the necessary information, the city can also generate information about expenditure per job created, as well as the rate of job growth in the charter city. These figures can give an indication of the cost of the regulatory environment in the charter city, as well as the general strength of the economy. Easy business registration can also bring more would-be informal firms under the umbrella of firms that are covered by labor regulation and monitoring.¹⁶

Second, labor law must create a flexible labor market and upward mobility for workers. Workers require protections, but at the same time, firms need flexibility in hiring and firing so that they can effectively respond to market conditions or terminate poorly performing employees. Charter cities must avoid extensive labor market rigidity, where excess or poor performing employees are extremely difficult to terminate. The worker protections in a charter city will also likely evolve over time, as the standards that can generate nontrivial disemployment effects for a US\$2,000 per capita GDP city are likely different from those in a US\$12,000 per capita GDP city. The city can also encourage upward mobility through investment in skills upgrading that prepares residents for more advanced careers in charter city industries.

To measure labor market flexibility, employers can be surveyed on the ease of hiring new workers, as well as their ability to terminate workers when necessary, relative to the host country or other jurisdictions. Workers can also be surveyed relating to their job search in terms of how difficult they found it to find work. Regarding the measurement of upward mobility, firms can be surveyed about the promotion of charter city residents within the firm, as well as the level of employment of host country nationals in key positions relative to foreign nationals. Pairing graduates of training or skill-building programs with firms in the city can provide direct knowledge that such programs are generating mobility.

Third, labor law in a charter city should be simple. While many high-income countries have a complicated schedule of rules and regulations for very specific jobs and work environments, a charter city should strive to be general in its



A textile factory in Ethiopia.

approach to the law. A single minimum wage, a single set of standard working hours, standard overtime policies, and other such policies will help make compliance easy for employers, boosting investment and employment. When employees can easily understand their rights and easily report violations to the labor administration easier, employers are incentivized to follow the law. Simplicity will also make it easier to train inspectors and for those inspectors to actually enforce the law. As the administrative capacity of a charter city grows over time, it can then begin to experiment with more complex labor regulations modeled after those in higher-income countries.

To measure the simplicity of labor law, the extent

to which legal counsel is necessary to resolve disputes can give an indication of complexity. The length of any cases in the small claims tribunal or other dispute resolution mechanisms, as well as the number of cases that arise in the first place, can also serve as indicators of the clarity and simplicity of labor law.

Fourth, labor law in a charter city must be applied uniformly across all employers. Large firms must face the same scrutiny as small- and medium-sized enterprises. This includes household enterprises, which should be able to easily register under the procedures discussed in the “Business Registration” chapter of the handbook. Developing a strict culture within the labor administration of uniform

application of the law can help reduce the likelihood that employers engage in corruption or bribery when they've knowingly violated the law. Not to mention, uniformity discourages those employers from engaging in misconduct in the first place.

Sanctions need to be proportional to the severity of the labor violation. A violation that poses a minor risk of injury or illness can be addressed adequately with warnings, but offenses that pose a grave risk to health and safety must be addressed swiftly and with the appropriate gravity. The sanctions issued by labor inspectors must also be both enforceable and reasonably actionable by the offender—third-party auditing may be particularly useful for this purpose.¹⁷ Adequate time must be given so that employers can remedy a violation. At the same time, the penalties enacted must be enforceable either under administrative law or through the charter city's court. Sanctions must be reasonable such that if they are appealed to the courts, the correct decisions of the labor administration can be upheld, and precedent can be established.

Statistics can be kept by labor regulation enforcement officers to measure the application of labor law, showing how often small, medium, and large enterprises are cited for violations. Sanctions issued for similar offenses should be similar across firms, indicating that enforcement is indeed unbiased. However, risk-based assessments based on individual firm compliance records and/or on the nature of the industry in question may help in directing limited enforcement resources to where they are most needed.

IV. IN PRACTICE

This section covers both the key areas of labor law

that a charter city will need to address and setting up a labor administration system.

1. Labor Law

In general, a charter city should aim to adopt labor policies that are in line with International Labour Organization standards. The city is legally bound to do so for all ILO conventions that have been ratified and are in force in the host country. Below are eight key areas of labor policy that a charter city will need to address.

1.1 Minimum Wage

The minimum wage is a key tool to ensure that no workers are paid at an egregiously low level for their labor. At the same time, a minimum wage that is too high will raise the cost of additional workers and generate some level of unnecessary unemployment. In many emerging markets, the minimum wage has been set so high, in some cases in excess of 100% of the value added per worker, that it can both generate negative employment effects *and* encourages informality, where labor laws effectively do not apply.¹⁸

A common international rule of thumb is to set the minimum wage to approximately 40% of average income.¹⁹ Because one of the primary goals of a charter city is to create significant employment, likely through low-cost manufacturing, setting the minimum wage for a charter city between 20 and 40% of the average national wage is appropriate. Within this range, workers can enjoy a level of protection from extremely low wages without the creation of a significant negative effect on employment. Sector-specific minimum wages have been used by many countries to better account for the differences in income and productivity across industries and could be a



useful approach for charter cities to adopt, although added complexity is introduced in setting the designated wage levels.²⁰

The charter city administration should adjust the minimum wage on a fixed period basis to help create greater certainty for both workers and employers about future wages.²¹ While some countries use a mathematical formula to adjust their wage, this might be difficult to do for charter cities located in a country that does not reliably produce high-quality inflation data or other economic statistics. To make setting the minimum wage in a charter city simpler, a review of the minimum wage every two years is appropriate. When making minimum wage adjustments, policymakers should try to account for inflation, labor productivity, and the total number and share

of workers affected by the change.²² Any increase in the minimum wage should not be so dramatic that it has the potential to generate significant unemployment.

Minimum wage compliance can be enforced through a variety of methods, although none is perfect. Statistical estimates of noncompliance can be generated through the use of household or labor force surveys to determine a general picture of minimum wage non-compliance. However, this approach is likely not necessary until the charter city has seen population growth to the point that widespread labor inspection becomes difficult.

In order to make enforcement easier, granting the charter city labor inspection agency the power to issue fines in an administrative procedure is

appropriate. This can reduce the reliance on courts for enforcement, which are often too costly for individual workers to seek redress.²³ However, this could potentially be a function served by the charter city's low-cost small-claims court.

1.2 Work Hours

Charter cities should follow ILO standards regarding work hours. Charter cities should have a 48-hour work week to afford workers the greatest possible opportunity to raise themselves and their families out of poverty. Setting the cap at lower levels would deny the poorest people the opportunity to earn desperately needed additional income. Certain adjustments to the normal work hours are also appropriate, including the averaging of work hours across different days, to allow for more work on some days and less on others, as is often the case with shift work.²⁴

Under ILO conventions, some exceptions to the standard work hours are made. Permanent exceptions to the normal working hours have been made for intermittent work, which has long periods of inaction between action; complimentary and preparatory work that for technical reasons must be carried out beyond normal working hours; and certain exceptional public interest cases. Temporary exceptions to normal work hours have been made for abnormal pressures and unforeseen additional work, as well as accidents, force majeure incidents, or urgent work. It is worth noting that many workers are willing to work beyond the standard 48-hour work week if overtime wages are paid.²⁵

Countries have taken a variety of approaches to place limits on exceptions, including general limits on work hours, specific limits on permanent exceptions, and specific limits on temporary

exceptions. In some cases, specific limits have only been set for specific sectors. In setting any exceptions to standard work hours, labor regulations should emphasize the need for flexibility.²⁶

Provisions must be made for overtime compensation. Many countries require an increase of 25 to 50% over normal pay; a rate in this range would be appropriate for charter cities. While some countries pay different rates for day and night overtime or have overtime pay scales that increase with the number of hours worked, a single overtime premium would be the easiest for a charter city to implement.²⁷

By establishing a set limit on daily work hours, a specific daily rest period has implicitly been created. Work breaks during the day vary significantly by country. A common standard is that for five to six hours of work, at least a 30-minute break is warranted. A longer single break, or more frequent but shorter individual breaks, are typically warranted for a full workday or a workday exceeding normal hours.

In addition to daily work hours and breaks, there are also standards regarding weekly rest. Standard practice is that workers are entitled to, at minimum, 24 hours of consecutive rest per week. However, special exceptions are typically made for certain types of workers, such as those in health, security, public utilities, essential consumption, and other such areas. In these cases more flexible alternative rest schemes have been established to ensure that these workers are still able to enjoy rest periods, including the rotation of staff, rest periods on nontypical rest days, or splitting up the allotted rest time between different days. Some countries have also made provisions for financial compensation in addition to or in place of rest

time. Charter cities should prioritize creating flexibility for working arrangements to best allow residents to support their families while also getting the time away from work that is needed.²⁸

1.3 Paid Leave and Holidays

International paid leave standards vary by country. At the absolute minimum, workers should receive one week of paid leave for a year of continuous service. In most world regions, however, workers have enjoyed at least two weeks or more of paid annual leave since the 1960s. In many countries paid leave requirements go into effect after six months of service, including periods of sickness, injury, and other excused absences. Many

countries make provisions for greater annual leave periods for longer service. Most countries require that the standard working wage be paid during periods of paid leave.²⁹ Charter cities should follow this common practice.

Because a charter city should be a place in which families can raise their children in a healthy environment, the city should implement some form of parental leave. Paid maternity leave is mandated in virtually every country and should be mandated in a charter city. Fewer countries have paid paternity or the more generic parental leave, but this is something to consider for the charter city. Given that only several dozen countries worldwide have paternal or generic parental leave,



A textile factory in Bangladesh.

this may not be feasible for a charter city to implement.³⁰

1.4 Forced Labor

It is universally understood that forced labor is an unacceptable practice, yet millions of people around the world are considered forced laborers. Charter cities must include protections against forced labor. All work or service in a charter city must be voluntarily offered by workers. Any labor that is exacted from a worker under threat of physical violence, psychological coercion, retention of important documents, rights, or privileges, or other coercive means is to be prohibited.

Debt bondage and similar practices should also be prohibited. Migrant workers and other vulnerable groups are typically threatened by forced labor, as their immigration privileges or personal safety may be held against them by employers.³¹ Charter city labor inspection officials will need to be vigilant against all the above practices.

1.5 Child Labor

Charter cities should follow ILO conventions on child labor, which place limits on the employment

of workers under the age of 18. Any work that can jeopardize the health, safety, and wellbeing of the worker should be restricted to those 18 and older, although exceptions may be made for those at least 16 years old with the appropriate training. Those between the ages of 13 and 15 should be permitted to work on a part-time basis with parental approval; however, the work should not pose any clear risk to their health or development. For this group, work should also not limit their attendance in school or participation in a vocational or other training programs.³²

1.6 Worker Dismissal

It is crucial for labor market flexibility that employers have wide latitude over when to discontinue relationships with employees. There is empirical evidence to suggest that when protections against dismissal are too strong, employers may be reluctant to hire additional workers in the first place. When labor markets are too rigid and employers cannot easily terminate an employee for a valid reason, labor productivity growth suffers, which drags down the growth of the entire economy. Stringent prohibitions against firing also limit the extent of hiring in new, expanding sectors.³³

Employers should be prohibited from terminating employment based on:³⁴

- union membership, union activity, or acting as a workers' representative
- lodging a whistleblower complaint against the employer for legal or regulatory violations
- race, color, or ethnicity
- sex, gender, or sexual orientation
- marital status, family responsibilities, or pregnancy
- religion, political opinion, nationality, or social origin
- absence during maternity/paternity/parental leave
- temporary absence due to illness or injury
- age (subject to laws regarding retirement)
- absence due to compulsory military service or civic obligations

Employers may terminate employment based on:³⁵

- declining economic activity
- liquidation of the enterprise or declaration of bankruptcy by the enterprise
- unsatisfactory results of a probationary period
- poor employee performance
- breach of duties by the employee
- unpermitted absences
- theft
- intentional damage to property
- violent behavior
- imprisonment

Sanctions should be in place for employers that disguise the true reason for the termination or force an employee into “voluntary” separation. The charter city should consider limits on the use of short-term contracts for employees that are in fact doing long-term, open-ended work as means of avoiding giving that employee deserved benefits, although this comes at the cost of diminished labor flexibility.³⁶

1.7 Collective Bargaining

The right to collective bargaining is recognized as a fundamental labor right by the ILO. Charter cities should protect the rights of workers to organize and collectively bargain while also protecting workers' rights not to join a union if they do not wish to. While some countries see collective bargaining at the industry or sectoral level, others only see it at the workplace or enterprise level.³⁷ Some empirical evidence exists to suggest that firm-level organization may have positive productivity benefits while industry-level organization may lower productivity.³⁸ However, workers should be free to organize voluntarily at the desired level. Unless prohibited by a legal agreement with a labor union, employers should be able to hire temporary workers in the event of a

strike, as it needs to remain an attractive destination for investment.

1.8 Health and Safety

Protecting the health and safety of workers in a charter city is paramount. While this is a very extensive area of labor law, the ILO has developed a guide for national occupational health and safety programs that could easily be adapted for use in a charter city.³⁹ The ILO has also developed a database of health and safety legislation, in addition to its conventions.⁴⁰ More specifically, the areas covered by the 1981 Occupational Safety and Health Convention No. 155 include the material elements of work (workplaces, tools, etc. and their design, testing, installation, use, maintenance, etc.), interactions between workers and those material elements of work, training to meet minimum health and safety standards, and protections from disciplinary action for workers that conform with health and safety policies, among other considerations.⁴¹ The ILO has also created additional legal instruments that provide detailed guidelines regarding specific risks, including occupational diseases, pollution, chemicals, machinery, hygiene, and other categories.

To help ensure that the necessary standards are met, the charter city's labor administration could provide education and training to firms (especially micro, small, and medium enterprises) on best practices, preventative measures, and responses to threats to the health and safety of workers. This could reduce future compliance costs for firms while also better protecting their workers. Providing subsidized hygiene products and personal protective equipment is another option for the city to pursue that can encourage their widespread adoption.

2. Labor Administration

A capable system of labor administration and inspection is necessary to ensure that a charter city's labor laws are followed by employers. The ILO has created a guidebook covering the fundamentals of labor administration that would likely serve as a useful reference for creating a charter city's labor administration system, even if certain proposed labor regulations go beyond what is feasible for a charter city, especially at the outset.⁴²

At the most basic level, a labor administration system is responsible for developing labor policies, creating policy documents and regulations, and the implementation and enforcement of labor

laws. In practice, this translates into developing, adopting, and enforcing labor standards; establishing the framework for industrial relations between employers and workers; coordinating activities of various government bodies related to training and unemployment programs; and collecting statistics and conducting research on labor issues, for both enforcement and future policymaking purposes.⁴³

The labor administration should be composed of three main divisions:

1. **Administrative services** is responsible for managing the human and financial resources of the administration itself.
2. **Support** gathers statistics and conducts research, is responsible for labor administration communications, provides legal services, and other such functions.
3. **Technical** is responsible for labor standards and inspection, relations between labor and management, and employment promotion and development.⁴⁴

When the charter city is initially established, the scope of this administration can generally be limited to essential duties like inspection but can be expanded over time as the population of the city grows.

BOX 34

Additional Resources

The World Bank's Doing Business Index last ranked countries based on their ease of employing workers in 2010. That year *Doing Business* also took account of the consistency of labor laws with ILO conventions to better capture worker protections. Although it no longer ranks countries on the relative ease or difficulty of employing workers, the *Doing Business* projects still collects extensive data on contracts, minimum wages, workdays, work hours, over time pay, leave and holidays, worker dismissal, severance pay, and unemployment protections.⁴⁵ Charter city developers can use the data presented here to benchmark their own policies against jurisdictions they intended to emulate and develop a more thorough understanding of common practices.

Many of the reports cited in the above subsections provide specific examples of country policies relevant to that area of labor regulation and administration and should be explored. The examples provided cover high-, middle-, and low-income countries and covered each region of the world. These examples can help provide additional benchmarks beyond those identified by CCI in this section of the handbook. An additional recommendation is simply to analyze the labor law and administration of the host country and compare it directly to the proposals outlined above. In many cases, only a slight modification of existing law will be necessary to deliver improved economic performance.

One additional resource that will prove useful is NORMLEX, the ILO's database of labor conventions and country-specific labor law.⁴⁶ All ILO labor conventions, protocols, and recommendations can be viewed here, as well as a complete roster of the countries that have ratified them and whether or not those laws are currently in force. NORMLEX also allows users to easily access the labor laws of any individual country, which will provide useful benchmarks to follow when crafting labor laws.

3. Labor Standards and Inspection

The main aim of labor inspection is to ensure that the standards adopted by a charter city for work hours, wages, safety, health, discrimination, and other factors are being upheld by employers. Labor inspectors are also responsible for investigating accidents and communicating information to employers and employees. Labor inspection works through a combination of two main functions: (1) enforcement measures and (2) preventative measures.

First, enforcement includes scheduled visits to employment facilities to inspect conditions, interviewing management and employees, and identifying non-compliance. Inspections can also be organized in response to complaints, accidents, and disputes. A channel for the receipt of anonymous complaints or a mechanism to conceal the identity of whistleblowers from employers should be established so that violations can safely be reported to the labor administration.

Second, inspectors and the labor administration generally can also work to provide information about labor requirements to both employers and employees. Such information can serve to prevent

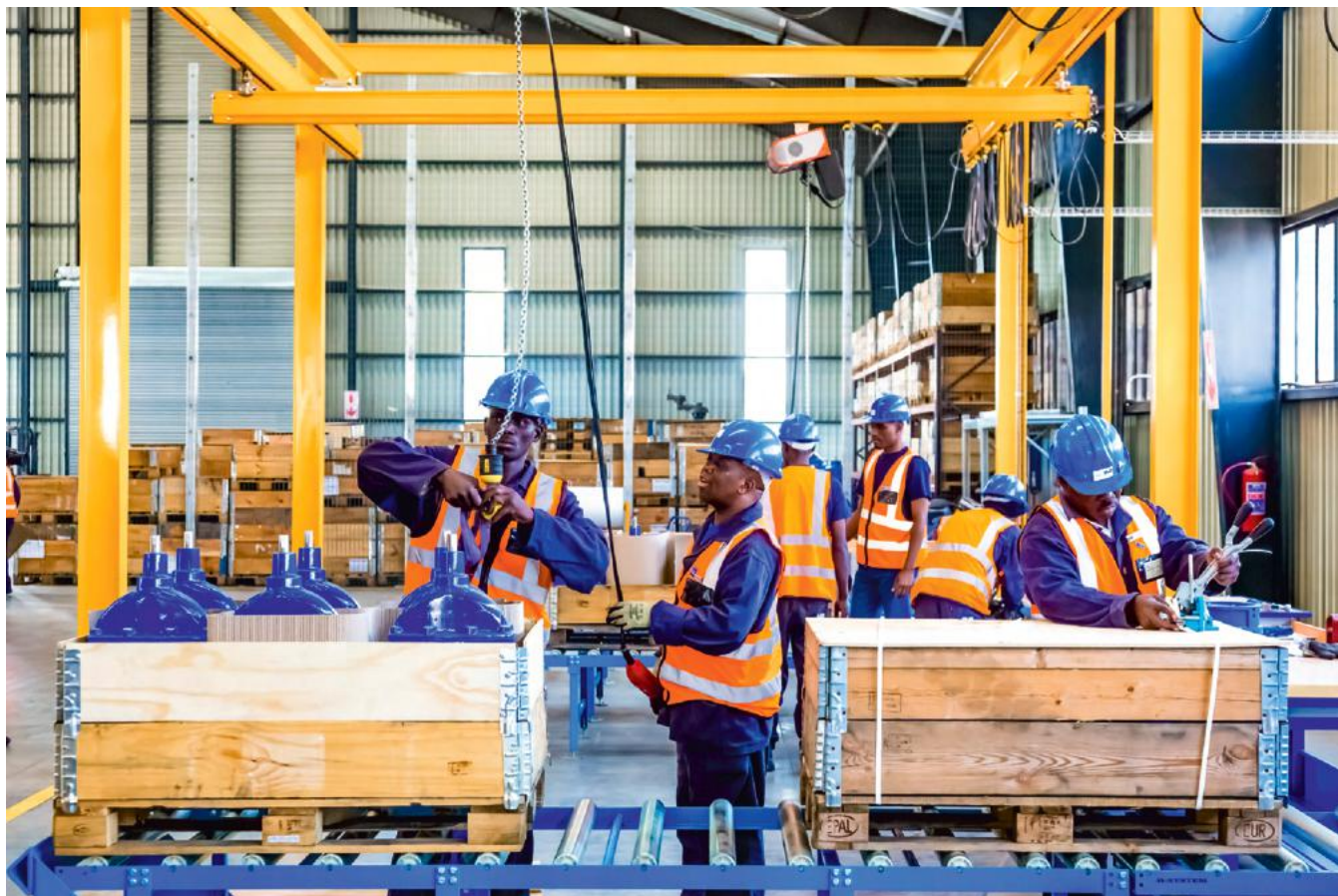
cases of noncompliance from arising in the first place. Depending on the enterprises operating in a charter city, specially trained inspectors with expertise in chemical works or electrical installations, for example, might be necessary to supplement the standard inspection force.⁴⁷

When instances of noncompliance are identified, labor inspectors need to have the authority to issue appropriate sanctions. These can include verbal or written warnings, administrative orders, administrative fines, increased regulatory scrutiny, and even prosecution. While there should be opportunities given to correct relatively minor issues before issuing a serious sanction, inspectors must prioritize the health, safety, and wellbeing of workers.⁴⁸

Labor inspectors need the appropriate powers to be able to carry out their duties. Inspectors must be able to enter a workplace freely, without notice, at any given time. Unannounced, random visits enable the inspector to observe the true conditions in a workplace. Announced visits are also possible; however, this presents an opportunity for employers to hide potential violations. Inspectors need the power to investigate the entire premises of a workplace, to interview any employer or staff

member, and to inspect any of the employer's books or records relevant to labor standards. Furthermore, inspectors should have the power to draft administrative orders to remedy violations or to require more immediate action in the event of an immediate threat to health and safety. Failure on the part of an employer to follow a lawful order of

an inspector may result in more serious sanctions. It should be noted that labor inspectors are not all-powerful and that their decisions may be appealed by an employer to a superior official or body within the labor administration or to the appropriate court.⁴⁹



An industrial valve manufacturing and assembly plant in Johannesburg, South Africa.

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³ Nataraj, S., et al. (2019).

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⁵ Benjamin Powell, "Meet the Old Sweatshops: Same as the New," *The Independent Review* vol. 19, no. 1 (2014), pp. 109-22. <https://www.jstor.org/stable/pdf/24563262>

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⁷ Christopher Blattman and Stefan Dercon, “Everything We Knew About Sweatshops Was Wrong,” *The New York Times*, April 27, 2017, https://www.nytimes.com/2017/04/27/opinion/do-sweatshops-lift-workers-out-of-poverty.html?_r=0.

⁸ Sam Bowman, “Some Evidence that Sweatshops are Good for Bangladeshi Women,” Adam Smith Institute, September 10, 2014, <https://www.adamsmith.org/blog/international/some-evidence-that-sweatshops-are-good-for-bangladeshi-women/>.

⁹ Timothy Besley and Robin Burgess, “Can Labor Regulation Hinder Economic Performance? Evidence from India,” *The Quarterly Journal of Economics* vol. 119, no. 1 (2004), pp. 91-134, <https://academic.oup.com/qje/article-abstract/119/1/91/1876083>.

¹⁰ Kaushik Basu, “Why is Bangladesh Booming?” Brookings Institution, Tuesday, May 1, 2018, <https://www.brookings.edu/opinions/why-is-bangladesh-booming/>.

¹¹ See <https://data.worldbank.org/indicator/NV.IND.MANE.ZS?locations=IN-BD>.

¹² See “GDP per capita, PPP – India, Bangladesh,” World Bank data, <https://data.worldbank.org/indicator/NY.GDP.PCAP.PP.CD?locations=IN-BD>; See also “GDP growth – India, Bangladesh,” World Bank data, <https://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG?locations=IN-BD&start=2000>; Mihir Sharma, “The Robots Aren’t Here Yet,” Bloomberg, September 14, 2016, <https://www.bloomberg.com/opinion/articles/2016-09-15/why-india-can-t-leapfrog-past-factories>.

¹³ Besley, T. and Burgess, R. “Can Labor Regulation Hinder Economic Performance? Evidence from India.” *The Quarterly Journal of Economics* vol. 119, no. 1 (2004), pp. 91-134.

¹⁴ Alan Gelb, “Can Africa Be a Manufacturing Destination? Labor Costs in Comparative Perspective,” Center for Global Development Working Paper no. 466, October 2017, <https://www.cgdev.org/sites/default/files/can-africa-be-manufacturing-destination-labor.pdf>; Stephen S. Golub, Ahmadou Aly Mbaye, and Hanyu Chwe, “Labor Market Regulations in sub-Saharan Africa, with a Focus on Senegal,” Development Policy Research Unit Working Paper no. 201505, December 2015, http://www.dpru.uct.ac.za/sites/default/files/image_tool/images/36/Publications/Working_Papers/DPRUpercent20WP201505.pdf.

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²² Ibid.

²³ ILO. (2016b). “Chapter 6 – How to enforce minimum wages?” Minimum Wage Policy Guide, International Labour Organization. Available at: https://www.ilo.org/wcmsp5/groups/public/---ed_protect/---protrav/---travail/documents/genericdocument/wcms_508531.pdf.

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²⁶ Ibid.

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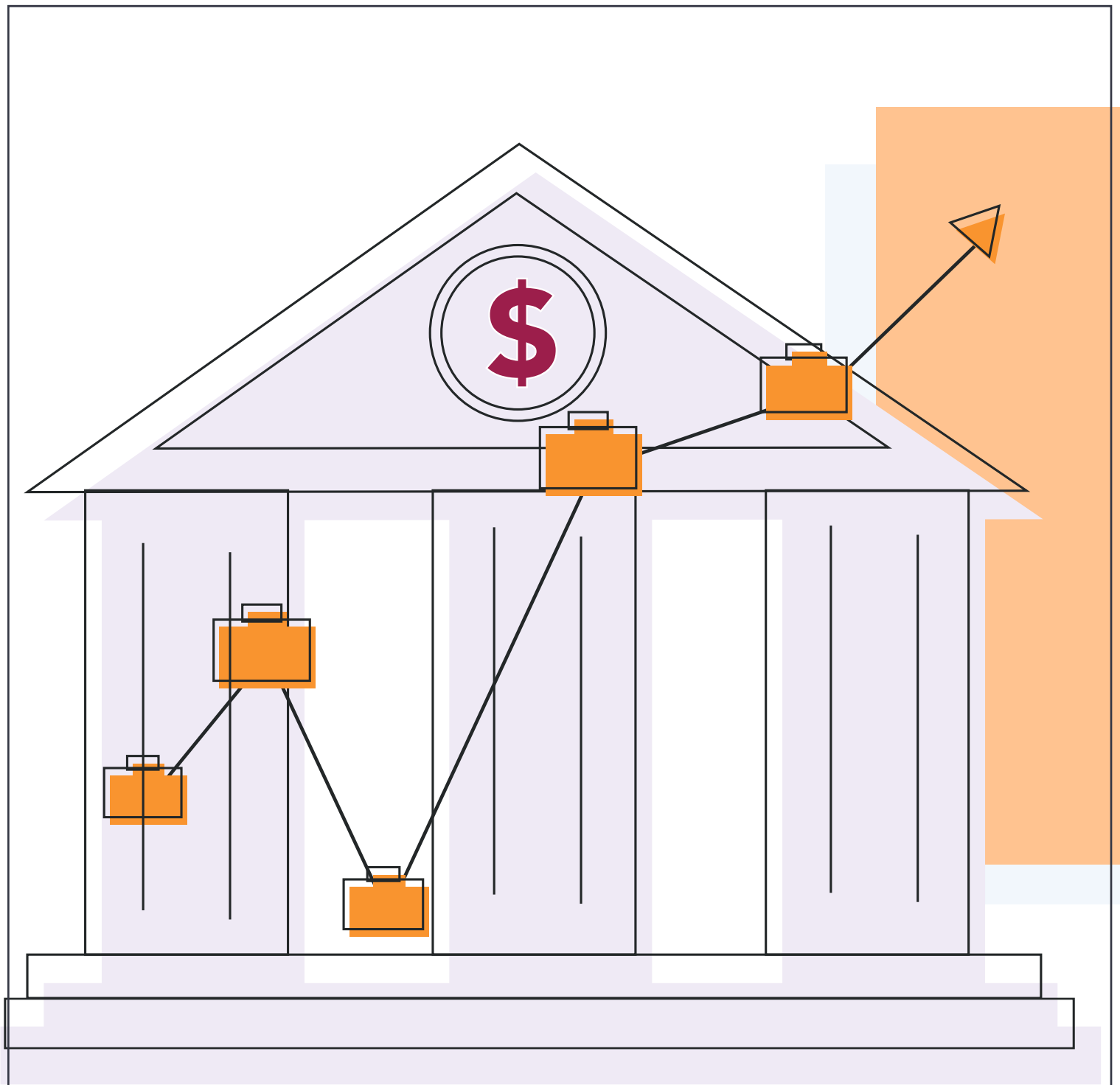
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PART 7: MONEY AND FINANCE

7. BANKING AND FINANCIAL REGULATION

I. KEY TAKEAWAYS

- ✓ Banking and financial regulations influence the flow of credit to individuals, households, firms, and governments. Credit availability is crucial when it comes to the delivery of capital-intensive public goods and to the dynamism of the private sector, both of which are essential for overall economic growth.
- ✓ Many banking and financial regulations around the world, and especially across the Global South, often inadvertently or purposefully result in the continued financial exclusion of small- and medium-sized enterprises (SMEs). Charter cities must change this status quo.
- ✓ Charter city financial regulators should prioritize four main values: (1) starting up and operating a financial institution should be easy, (2) credit should be easily accessible, including for SMEs, (3) bankruptcy law should be clear and entrepreneur-friendly, and (4) the charter city financial system should remain in alignment with international conventions and standards.
- ✓ This chapter reviews four key elements to an effective banking and financial regulatory regime: (1) the agreement with the host country, (2) linked institutions and the broader regulatory environment, (3) the Basel regulatory framework versus Mervyn King's PFAS framework, and (4) other compliance and risk management policies.



A small-medium enterprise producing leather in Kolkata, India. Many SMEs across the Global South lack access to credit.

II. INTRODUCTION

Credit availability is vitally important to both the

provisioning of capital-intensive public goods such as roads, schools, etc., and to a properly functioning private sector. In much of the Global

South, the necessary banking and information infrastructure to reliably provide such credit to governments and enterprises, including small- and medium-enterprises, does not exist. Readily accessible capital markets can facilitate foreign investment, as well as the formation and expansion of domestic firms, both of which are important drivers of growth and employment.¹ Banking regulation in a charter city should aim to expand access to financial services for those who need it and are creditworthy. This is especially true for the SME segment of the market—given that SMEs are a disproportionately large contributor to the overall economy across countries of the Global South.

Banking systems do not operate in isolation—the court system, land and mortgage registries, and other functions of government play important roles in facilitating the delivery of financial services.² By effectively executing on these complementary tasks, a charter city can foster an improved operating environment for financial service providers in which much-needed credit and other banking services can be supplied to a wider customer base with lower risk.

While working on expanding access to financial services through an accommodative regulatory environment, charter cities must always adhere to internationally accepted standards governing risk management and law enforcement activities.

Money laundering and terrorist financing are significant concerns for banks in developing countries, as is macroeconomic instability, and financial institutions in charter cities must be prepared to effectively combat these risks in compliance with international standards.³ Compliance with such standards will be important for attracting capital from investors and institutions headquartered in countries with stronger banking oversight, as these entities are often concerned with meeting their more stringent regulations at home. The regulatory environment for financial institutions should likewise encourage business development rather than further tax haven-like activity.

Regulation of banking and financial services is an incredibly vast subject requiring highly specific subject matter expertise. Given the literature's extensiveness combined with the space constraints of this handbook, this chapter necessarily focuses on the key components of an effective banking and financial regulatory regime. In addition to this handbook, it is strongly recommended that charter city developers consult extensively with relevant regulators and industry experts.⁴

III. VALUES AND GOALS

A charter city should aim to uphold four key values when it comes to banking and financial regulations:

Table 15. Summary of Values and Goals for Banking and Financial Regulation

Value	Meaning of the Value	Measurable Goals
Easy to start up and operate a financial institution	<ul style="list-style-type: none"> —To provide credit and financial services to city residents and investors, financial institutions must exist within the charter city. —Making it easy to start a bank or other financial services firm within 	<ul style="list-style-type: none"> —Number of banks and financial institutions within the city —Total value of the financial institutions operating in the city —Both domestic and foreign financial institutions operate in the city

	the charter city can allow for a rapid expansion of credit and services.	<ul style="list-style-type: none"> —Ease of access to credit information (e.g., land registry, mortgage registry, past/current loans), perhaps via an annual survey of financial institutions —Gross non-performing assets (GNPA) to total assets ratio
Easy for individuals and SMEs to access credit	<ul style="list-style-type: none"> —Individuals and firms need access to credit to start or expand their businesses. —Credit constraints are a primary roadblock to SME creation in the Global South. Charter cities can alleviate this problem with a more effective and accessible financial system, including for low-income individuals and enterprises. 	<ul style="list-style-type: none"> —SME and individual borrowers report that accessing credit is easier than in the host country (via regular resident surveys). —Total credit to charter city GDP (if combining both public and private credit, as a percentage of city GDP) should be well above 100%. —Mobile banking and other services are fully supported. —Microcredit is supported, and interest rates are not predatory (the normal range of interest rates charged by microfinance institutions is between 20% and 40%).⁵
Permissive and clear bankruptcy law	<ul style="list-style-type: none"> —Banks and other lenders will be unwilling to extend credit if the law does not guarantee their right to collect a debt or take possession of collateral in a timely and low-cost manner. Such guarantees provide creditors with predictability (often lacking in the Global South). —Similarly, entrepreneurs will be unwilling to start a business if failure will result in a vicious cycle of debt for years to come.⁶ 	<ul style="list-style-type: none"> —Time and cost involved to resolve bankruptcy cases —Recoveries from defaulted loans —Survey of bankers'/lenders' attitudes toward the charter city's bankruptcy rules and processes (both for individuals and for companies)
Alignment to international conventions and standards	—Compliance with international standards lowers the risk of operating in the city for both foreign and domestic financial institutions.	<ul style="list-style-type: none"> —Extent of the regulatory framework meeting regional and other international standards on money laundering, terrorist financing, know-your-customer rules, and IFRS standards. —Audits should be done quarterly and disclosed.

IV. IN PRACTICE

This section overviews the key elements of an effective regulatory framework for banks and financial institutions in a charter city, including (1) the agreement with the host country, (2) linked institutions and the broader regulatory environment, (3) the Basel regulatory framework versus Mervyn King's PFAS framework, and (4)

other compliance and risk management policies.

1. *Host Country Agreement*

Each chapter of this handbook assumes very broad regulatory and administrative authority has been devolved to the charter city. With regard to banking and financial regulation, however, it is unlikely that the city will receive full autonomy

over this regulatory domain in negotiations with the central bank, treasury, or other relevant authorities of the host country.

With the above limitations in mind, the charter city developer should push for as much authority as (1) the host country legislative and regulatory authorities are willing to grant and (2) as much authority as the city developer believes they will be able to effectively execute. Assuming more financial regulatory authority than can reasonably be managed, relative to the capacity of the host country, can deter investment and attract fewer financial institutions to the city. Taking on more authority than can be effectively managed may also leave the charter city exposed to compliance problems regarding money laundering, terrorism financing, and other compliance issues.

2. Linked Institutions and the Broader Regulatory Environment

Several key areas outside the direct purview of financial regulation must be executed effectively in order to provide an improved operating environment for banks and other financial institutions. Three of these areas include the courts, land registration, and tax administration.⁷

Effective legal mechanisms that work to protect the rights of both borrowers and lenders are important for developing a functional financial system. The courts in a charter city must be able to enforce the terms of secured transactions, giving lenders the confidence to make credit available to prospective borrowers.⁸ Entrepreneur-friendly collateral and bankruptcy laws, combined with effective court enforcement, can remove one of the most important obstacles to SME growth in developing countries.⁹ The United Nations Commission on International Trade Law's Model

Law on Secured Transactions is an excellent starting point for developing relevant statutes for a charter city.¹⁰

Clear land titling and property registries can help provide information about potential borrowers to financial institutions, which facilitates lending. Banks can more confidently offer mortgages when they possess greater knowledge about pieces of property or legal issues associated with the parcel, as well as information about the prospective borrower.¹¹ Empirical evidence from Brazil suggests that an effective titling system can increase overall credit use while decreasing borrowing from relatives and increasing borrowing from commercial banks.¹² This shift away from family-based lending toward commercial lending, and overall higher levels of lending, can help facilitate the creation of more SMEs and a more mature financial system.

As mentioned in both the “Land Registration and Administration” and “Tax Policy and Administration” chapters, this handbook recommends a leasehold model wherein the charter city administration leases land to all residents and firms within the city jurisdiction in exchange for monthly rental payments. This recommended model shouldn't typically be a problem for lenders if the title system is very reliable, legally secure, and accurate. Still, this isn't guaranteed—especially at the beginning of a charter city development. As such, some banks and financial institutions may be resistant to accepting leased land as collateral. In these instances, the charter city administration should negotiate with lending institutions to see if they're willing to provide credit if the city administration acts as a co-mortgagee or loan guarantor for its lessees.

Typically, if the tax code levies an income tax, a connection to the banking system's income data would be required. However, this handbook doesn't recommend income taxation, so if this advice is followed, integrating the charter city revenue authority's tax rolls with income data from banks wouldn't be strictly necessary. This has the benefit of greater privacy protections

overall. But given the recommendation of a cash transfer system in the chapter “Social Protection,” direct transfers into beneficiaries' bank accounts remain the simplest and most easily monitored of the available delivery options. Ultimately, it is up to each charter city to decide whether that merits integrating the revenue authority's tax rolls with the banking sector's income data.

BOX 35

Leveraging Technology in Financial Service Provision: The Case of M-Pesa in Kenya

New financial technology (fintech) has revolutionized the delivery of financial services for communities that have historically had limited access to such services. The spread of mobile phones throughout the Global South has led to the development of robust mobile-based payment and bank account systems that greatly expand access to financial services for much of the population. For example, Kenya's M-Pesa system massively expanded access to financial services in Kenya—over 96% of households use the service. Services like M-Pesa have enabled households to increase their consumption, as well as send and receive remittance payments more easily and securely.¹³

Effectively regulating any area touched by emerging technologies requires a nimble regulatory approach. Traditional regulatory approaches have and will continue to struggle with governing such emerging technologies.¹⁴ Fintech regulation should be forward-thinking but can also look to best practices. Kenya and other countries that saw rapid take-up of mobile financial services can provide a starting point for formulating a regulatory approach toward new fintech innovations.¹⁵



Over 96% of Kenyan households use the mobile money platform, M-Pesa, greatly expanding access to financial services.

3. *Basel Regulatory Framework vs. Mervyn King's PFAS Framework*

This subsection will briefly cover the Basel Framework, a voluntary banking regulatory framework established by the 28-member jurisdictions of the Basel Committee of the Bank of International Settlements (BIS). The Basel Framework sets standards for capital and leverage requirements, risk calculation, and banking supervision, among other categories.¹⁶

Although most countries are not members of the Basel Committee, most non-members have taken limited steps toward implementation. However, lower-middle- and low-income countries typically do not possess the capacity to fully implement the Basel Framework and instead have done so in a piecemeal fashion. Lower-income countries have largely chosen to implement the simpler elements of the Basel Framework as a mechanism to lessen the risks of financial instability, but also as a reputational effect for foreign investors, to signal the maturity of the country's financial system.¹⁷

Full and immediate implementation of the Basel Framework is impractical for a charter city.¹⁸ The city's financial system will take time to develop, and the infrastructure needed for full implementation cannot reasonably be developed in a short period of time, nor does it need to be. The charter city administration should instead cooperate closely with the central bank and other relevant regulatory bodies of the host country to develop a financial regulatory framework that is accommodative of the institutional capacity of all parties involved. Indeed, the regulatory

framework proposed by the former governor of the Bank of England, Mervyn King, both aligns with these objectives of cooperation and is likely to be much more effective than the Basel Framework for reasons discussed below.

Much of the Basel Framework is merely concerned with the standardization of reserve requirements, which isn't the most effective route to addressing systemic and institutional risk management issues. Instead, this handbook recommends leveraging Mervyn King's alternative regulatory framework to Basel: the pawnbroker for all seasons (PFAS) framework.¹⁹ In essence King's PFAS framework has two main steps. First, banks will be continuously assessed for their risk levels by the host country's central bank, and based on these risk levels, all bank assets will be assigned a "haircut." In this context a haircut refers to the percentage difference between an asset's current market value and the amount that the central bank can sell that asset for in the event of a crisis (i.e., riskier assets are assigned larger haircuts). In this first step, any bank's current assets minus the calculated haircut equals that bank's *effective liquid assets*. Second, the central bank now looks at the liabilities side of all banks' balance sheets—short-term, unsecured debt, total demand deposits, etc.—that could be run at short notice; this is a bank's *effective liquid liabilities*.

King's PFAS framework then says that the regulatory requirement on banks and other financial intermediaries should be that effective liquid assets are greater than effective liquid liabilities:

Formula 1—King's PFAS Framework

$$(\text{Current Assets} - \text{Haircut}) > \text{Effective Liquid Liabilities (1)}$$

$$\text{Effective Liquid Assets} > \text{Effective Liquid Liabilities (2)}$$

Under King's PFAS framework in the event of a liquidity crunch, the central bank can simply lend to a distressed bank against its assets at this pre-assessed haircut rate. Such a framework has several major benefits over the status quo. First, it alleviates a lot of the information asymmetries and guess work that currently has to occur in midst of a crisis or bank run as to whether or not a bank is financially sound. Second, the PFAS framework also has the added benefit that this one regulatory rule (see above Formula 1) could replace almost all traditional prudential capital and liquidity regulations. This mainly stems from the fact that under this framework, host country central banks

can simply change the haircut rate for different asset classes if it notices any issues or outsized risks arising, and once the haircut rate is altered, this signals banks to shift their allocations accordingly. In short, the rule acts as a kind of mandatory insurance. Third, under this PFAS framework host country central banks remain largely involved in the banking and financial regulations of the charter city (via their calculation of haircuts), which is more politically feasible than charter city administrators seeking sweeping financial independence from the host country's chief monetary authority.



The Bank for International Settlements promulgates the Basel Framework, a voluntary banking regulatory framework.

4. Compliance and Risk Management

The twentieth century saw the rise of globalization and with it the turn away from vertically integrated firms toward the fragmentation of firm activities and supply chains across jurisdictions and dispersed geographies. If charter city businesses are engaged in—or want to be engaged in—international or regional trade, or if they desire to integrate into global value chains, it necessarily involves the establishment of formal relationships with foreign banks. Therefore, international compliance and risk management standards must be upheld and adhered to within the charter city.

The major compliance policies and standards pertaining to combating financial crimes are set by an intergovernmental policy-making body called the Financial Action Task Force (FATF). This subsection focuses on three compliance and risk management issues that must be addressed by charter city administrations when formulating banking regulation: (1) anti-money laundering (AML), (2) counter-terrorism financing (CTF), and (3) more general know your customer (KYC) rules.

In addition to and distinct from compliance issues related to fighting financial crimes, macroprudential regulations are also touched upon below. Macroprudential regulations can be broadly split into two categories: (1) crisis prevention rules and (2) crisis management rules.

4.1 Anti-Money Laundering and Counter-Terrorism Financing

Both AML and CTF are bundled here under one sub-heading as they are both addressed by FATF's recommendations. The standards set forth by

FATF comprise not only its list of recommendations around AML and CTF, but also interpretive notes to guide individual jurisdictions as they devise legal frameworks that best apply the promulgated standards.²⁰ When formulating banking and financial sector regulations, charter city administrations should ensure AML and CTF compliance by incorporating FATF's recommendations.

4.2 Know Your Customer Rules

KYC rules can be considered a subset of, or at least complementary to, broader AML rules. KYC rules are in place so that institutions—especially financial institutions—undertake necessary steps to verify the identities of their clients and to detect any fraud risks such clients may pose. KYC rules can differ slightly across jurisdictions. For example, in the United States KYC rules evolved as a result of the passage of the 2001 Patriot Act and since have been further enhanced by the Treasury Department's Financial Crimes Enforcement Network (FinCEN) in 2016 with its issuances pertaining to customer due diligence (CDD). On top of the US, the EU's General Data Protection Regulation (GDPR) became active across the globe in May 2018. In addition to this GDPR, the EU also passed the Second Payment Services Directive (PSD2); both of these regulations add to the number of compliance steps financial institutions must go through to adhere to KYC standards.²¹

Taking from FinCEN's requirements²² around customer due diligence, there are four key elements:

- Customer identification and verification
- Beneficial ownership identification and verification of the persons who control/own legal entities

—Understanding the nature and purpose of customer relationships to develop a customer risk profile

—Ongoing monitoring for reporting suspicious transactions and on a risk basis, maintaining and updating customer information

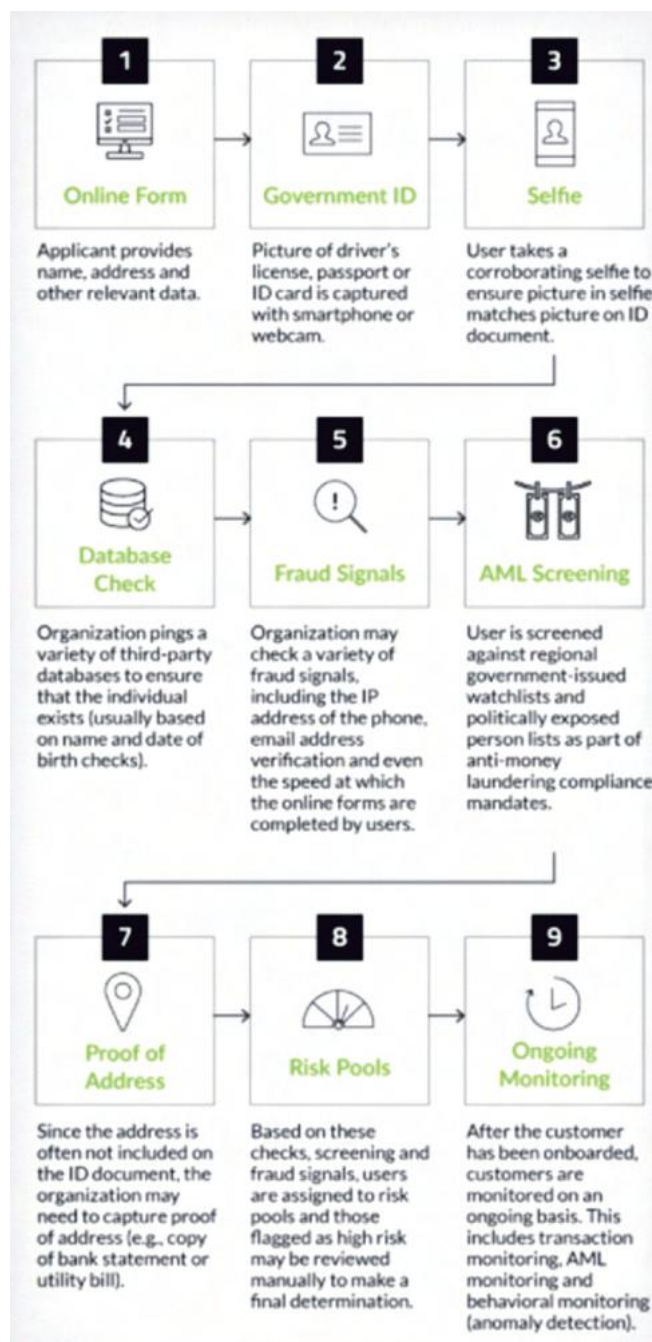
Figure 2 shows nine steps that banks typically take in order to satisfy the above four elements.²³

With the heightening stringency of KYC and AML rules in recent years, banks have faced steep increases in compliance costs, and customers have faced ever more time-consuming and inconvenient identity verification requests that often make opening a bank account overly cumbersome. To help lower these compliance costs while still meeting regulatory KYC and AML standards, banks and financial institutions are increasingly turning to technological and automated systems for identity verification. Charter city administrations can similarly outsource these identity verification activities to software vendors to help ease this compliance burden. Some relevant vendors include market leading Jumio, IdentityMind, Beam Solutions, ShuftiPro, Vialink KYC, and Accuity. Alternatively, charter city administrations can implement their own identity management systems to complete the four elements involved in complying with KYC rules (above). This handbook recommends the latter option, given that the vast majority of what these software vendors do is simply pull data from various government databases.

4.3 Micro- and Macprudential Regulations

Above and beyond the risk management practices described above to guard against outright financial

Figure 2. Sample Customer Due Diligence Flowchart



crimes (KYC, AML, CTF rules), risk management also entails the implementation of sound, prudential banking practices. A healthy financial sector is one that effectively allocates resources and risk and by doing so drives economic growth. Healthy financial institutions broaden

access to opportunities for all businesses and individuals. In contrast, unhealthy ones can cause immense damage through macroeconomic instability or outright financial crisis while benefiting only a very narrow few. Indeed, economists Stephan Broadberry and John Wallis illustrate that the ability of countries to avoid or reduce the frequency of *negative* growth episodes (shrinking), rather than their ability to sustain *positive* growth rates (growing), is a more significant predictor of contemporary levels of economic development.²⁴ Effective microprudential and macroprudential financial regulations are a key tool to avoid or temper shrinking episodes.

This subsection reviews tools that banking regulators and policymakers can use to encourage the formation of a healthy banking sector and discourage excessive and unnecessary risks of the kind that can spiral into prolonged stagnation, deep recession, or unforeseen crises. It should be noted that many of the prudential regulations discussed below are rendered unnecessary if a charter city is able to implement a banking regulatory framework that aligns with Mervyn King's PFAS regime (see section 3 above). Still, in case such a haircut regime is not implemented, a discussion of the regulatory tools below is useful. Broadly, these regulatory tools can be split into two main categories: (1) crisis prevention and (2) crisis management.

4.3.1 Crisis Prevention

This subsection discusses some of the commonly used tools that policymakers and banking regulators use to mitigate against the risk of both individual bank failure (microprudential policies) as well as systemic risk to the financial system as a whole (macroprudential policies). These tools include (1) capital and liquidity requirements, (2)

currency controls, (3) audits/monitoring, (4) bank and regulator governance.

i. Capital and Liquidity Requirements

Stricter capital and liquidity requirements for financial institutions have been put in place in countries around the globe in response to the global financial crisis (GFC) because of a near-universal agreement that banks were excessively leveraged (undercapitalized) and overly illiquid.²⁵ Capital requirements specify a particular capital ratio (measured as a percentage of total assets) that individual banks must hold. Liquidity (cash) requirements came about because many banks in the lead-up to the GFC decided to finance potentially illiquid assets with short-term debt. To guard against this risk, liquidity requirements specify a particular proportion of bank assets must be held in cash or other liquid assets that can be quickly converted to cash in order to meet short-term obligations.

In formulating capital and liquidity requirements, charter city administrations have the option of enacting steadfast *rules* or providing room for *contingency* or *discretion*. Steady rules, if well-designed, provide the benefit of being able to 'set and forget' and also function as pre-commitment devices that work against the innate human bias toward inaction. However, the downside when it comes to setting firm rules is that they're often difficult to design *ex ante*. As a result, well-intentioned (though poorly designed) rules can encourage financial institutions to engage in regulatory arbitrage, where strictly defined requirements lead banks to dedicate significant resources to evading these requirements or otherwise shifting their risk in unintended ways.²⁶

Given the above trade-offs, this handbook

recommends that charter city administrations opt for contingent or discretionary regulations when it comes to capital and liquidity requirements. That is, these regulations should activate in response to specific adverse events as opposed to being permanent requirements designed *ex ante*. This is in line with this handbook's rule of thumb to avoid the knowledge problem when formulating regulations.²⁷ For example, the United States' FDIC Improvement Act of 1991 stipulates that bank regulators undertake a series of increasingly more interventionist actions against banks when bank capital dips under particular levels.

This contingency has three important benefits. First, contingent regulations are less burdensome to adhere to as they're only applicable during specific instances, which implies banks will devote

fewer resources into evasion efforts. Second, as contingent regulations are more flexible, they can quickly be intensified or de-escalated when necessary, making it more likely that they're able to bring about the desired effect(s). Third, when regulations are *not* contingent but permanent, and they end up being *mistaken*, such regulations could have the ultimate effect of coordinating a mass of financial institutions into committing the same mistake. This obviously has consequences for resilience and overall financial stability—the larger the regulator's remit, the greater the risk. Contingency helps reduce this risk.²⁸ Charter city bank regulators should see the Swiss National Bank's note on its *guided discretion* approach to capital requirements as a useful model.²⁹

Moreover, at the outset of a charter city



Many SMEs, especially female owned and operated SMEs across the Global South, have difficulty securing credit.

development, it may prove more difficult to attract the initial banks to the city or to spur bank formation. Oftentimes this will not be due to a lack of economic opportunity for the bank(s) in question, but due to the first-mover problem and that it's typically very costly for such banks to start in new jurisdictions—especially for smaller, domestic banks serving SMEs or other underserved segments. In addition to often-expensive bank licenses, startup costs also include whatever capital requirements have been set, and typically those startup costs must be paid or in place upfront before any operations commence. One policy tool the charter city administration could use to lower startup costs is to allow capital requirements to *lag* behind the bank's total deposits. For example, once a would-be bank pays, say, US\$300,000 for its bank license, the policy can stipulate that the bank can then begin operations, and its capital requirement can then increase as its deposits increase. By reducing large upfront costs, much-needed bank formation will be encouraged.³⁰

ii. *Currency Controls*

Many governments across the Global South have enacted currency controls, often in hopes of preventing exchange rate volatility, speculative attacks against the local currency, or the flight of US dollars out of the country. Currency, or foreign exchange controls, typically take three main forms or a combination thereof: (1) limitations placed on residents that restrict the buying or selling of foreign currencies, (2) limitations placed on foreigners buying or selling the local currency, and/or (3) limitations on transferring any (or particular) currencies across the country's border.

While exchange rate volatility can be an issue, and particular warning indicators should be monitored

on an ongoing basis, exchange rate controls tend to negatively impact trade³¹ and economic growth.³² For example, studies show that countries that enact exchange controls often increase border inspections and augment documentation requirements in order to reduce evasion of the imposed controls, which in turn results in significantly increased trade costs for firms engaging in exporting and importing. Indeed, one study found that “a one standard-deviation increase in the controls on foreign exchange transactions reduces trade by the same amount as a rise in tariff by 11 percentage points.”³³ Moreover, in countries with poor governance and rampant corruption, exchange control regimes—enforced by corrupt bureaucrats—are subject to being undermined or manipulated by paying bribes to these bureaucrats to look the other way, or by this bribery resulting in increased transaction costs for exporting and importing firms. Not to mention, these foreign exchange controls can make it much more difficult for banks to manage risks when lending to importers and exporters.³⁴

Unfortunately, it is not likely many host country central banks or ministries of finance will be overly keen to give up control over currency flows within the charter city to the city administration. Still, given the potential costs associated with currency controls outlined above, if charter city administrations are unable to secure full devolved powers over currency flows, then they should at least seek some representation on the relevant central bank or Ministry of Finance committee. Additionally, many special economic zones (SEZs) also permit full repatriation of profits from the SEZ.³⁵ This can be used during negotiations with host country central banks as a precedent that liberalized currency rules within a particular country exist.

As the failure of foreign exchange controls in many countries of the Global South attests, currency risks aren't going away any time soon. The question for charter city administrations and banks operating within these cities then becomes: *If not currency controls, then what?* There are a few potential options to mitigate currency risk. First, look to organizations like the IFC that offer long-term local currency financing throughout emerging markets.³⁶ Second, the charter city should enact a legal framework and supporting regulatory regime that enables effective futures contracts and currency swaps. These alternatives can protect against currency risks without the downsides that accompany foreign exchange control regimes. A third option is a type of 'free currency zone' within the charter city where transactions could be made in any currency or, more likely, a specified list of currencies. This zone could enable traders to deal in both hard currencies (Euros, US dollars, etc.) as well as possibly cryptocurrencies or synthetic currencies.

iii. Audits, Monitoring, and Information Sharing³⁷

The best way to ensure a healthy banking sector is not crude limitations on bank size or overly inflexible rules on bank activities, but an effective auditing, monitoring, and information sharing regime. A charter city administration must undertake monitoring and auditing activities in conjunction with the monetary and banking authorities of the host country—typically the central bank. The roles and responsibilities of each when it comes to regulating banks and financial institutions within the charter city must be established from the outset.

At a minimum, banks and financial institutions should be required to have quarterly third-party

audits, and these audits, along with relevant financial documents, should be both publicly published and shared directly with the necessary regulatory authorities. As these audits and public disclosures are typically done by banks even in the absence of a public mandate in order to demonstrate their health to depositors and investors, these auditing requirements are not overly burdensome.

The most significant critique when it comes to relying on auditors and monitors to regulate banking and financial institutions is that these regulators are typically paid significantly less than their private-sector counterparts, they tend to be less talented, and they are oftentimes significantly more risk-averse. This implies that the bankers have much stronger incentives—and ability—to evade than the auditors/monitors do to regulate effectively. Notwithstanding these doubts, auditors/monitors have two main benefits that could help temper illicit or overly risky banking practices. First, regulators tasked with auditing or monitoring risk have different incentives that encourage them to keep an eye out for *low-probability* risks of financial disaster; the private sector faces incentives that are quite the opposite. Second, regulators can require data from banks and firms across the financial industry that allows them to ascertain a decent, high-level picture of aggregate exposures, pinpoint where potentially dangerous risks are concentrated, and thereby take appropriate remedial action.³⁸

This second point around data can be broken down further. In order for these regulators to effectively monitor risk, data collection and use can be categorized into three main buckets: (1) data and information must be reliable and intelligible, (2) data should be used by regulators as early warning indicators, and (3) data submitted to regulators



Many banks and financial service firms in the Global South have inefficient, unreliable, and unintelligible data and records management that can stymie both effective lending practices, as well as monitoring and auditing efforts.

should be disclosed in a responsible manner.

—**Reliability and intelligibility.** When it comes to reliability and intelligibility, monitors are frequently hindered in their task because each bank currently calculates its own risk, exposures, and other values in its own unique way. This means that bank reports are not comparable across institutions. Therefore, standardization—especially with illiquid securities, assets, and positions—should be established whereby regulators set standard procedures and methods to calculate these various values across the industry and mandate that this information be shared by

banks on a regular (typically quarterly) basis with the appropriate authorities.³⁹

—**Early warning indicators.** Charter city banking regulators should utilize warning indicators to preemptively detect excessive risk and spur a commensurate response. Banking authorities monitor three main areas to assess risk concentration over time: (1) vulnerabilities to the economy as a whole due to overly exuberant growth in total credit or asset prices; (2) vulnerabilities within particular (real) sectors due to, for example, growth in credit in the housing sector or risk build-up in the corporate sector; and

(3) vulnerabilities in the financial sector due to, for example, mismatches in debt maturity or in foreign exchange reserves. For the first, the Basel Committee suggests using the credit-to-GDP gap as an indicator to warn regulators about excess growth in credit. For the second, both rapid growth in mortgage debt and/or in real estate prices can be used to indicate risk exposure in the housing sector.⁴⁰ Several warning indicators are suggested for maturity and foreign currency mismatches and can be examined in multiple studies (IMF, 2014; CGFS, 2012; ESRB, 2014).⁴¹ On top of these indicators, another common component of early warning systems involves stress tests that are used by regulators to analyze the capacity of banks and financial institutions to continue to operate across scenarios of varying economic severity. For charter city administrations, stress tests may make sense in later stages of the city development but are not necessary for early stages when banking activities remain relatively small.

—**Disclosure of data/loan registry.** Data and information should be publicly and responsibly disclosed. Oftentimes regulators and supervisors of banks can be subject to political pressures: in booms regulators are encouraged by their political bosses to be overly lax to keep the good times rolling, and in downturns regulators are pushed by pols to punish banks and be overly stringent. This is the opposite of what these scenarios demand. One way to overcome these political pressures and ensure effective monitoring and auditing even during boom times is to release the information and data collected to the public.⁴² When such public disclosure of information pertaining to both aggregate and firm-specific exposures is released to markets after some delay, this will effectively force monitors/auditors to explain their decisions in the event risk is deemed to be too

excessive.⁴³ Moreover, relevant components of this information should be collated by regulators and made available to all banks operating in the charter city. In particular, credit registries should be established using this data (and, where possible, data on past loans), and should be made available and searchable for all financial institutions. Ideally this credit registry should be linked to a searchable land registry and mortgage registry. Through sharing credit information, the information asymmetries that hamper the vast majority of lending in the Global South, especially to SMEs, can be reduced; access to credit for SMEs can be augmented; lower interest rates can be ascertained by borrowers; borrower discipline can be enhanced—borrowers can now expect their credit rating to follow them and have actual consequences; and overall bank supervision and credit risk management can be improved.⁴⁴ By allowing banks to benefit from public information disclosure, regulators make these data requirements more palatable to follow. Charter city administrations should consult the World Bank's credit infrastructure services team, as they have a proven record of setting up private credit bureaus and credit sharing information platforms across the Global South.⁴⁵

iv. Banking Governance

While this subsection deals with bank governance, regulatory governance—how regulatory agencies are set up and managed, policies decided upon, actions taken, rules enforced, and roles and responsibilities assigned—is also an important consideration. The IMF, BIS, and FSB provide a useful overview of best practices for establishing effective financial regulatory governance.⁴⁶

When it comes to bank governance, an effective board of directors is key. The board in any financial

firm is a further check against mismanagement. As such, boards should not become merely box-checking bodies without any de facto powers; if they do, they've lost their fundamental purpose. Too often bank board members are ill-informed about the bank they purport to govern, overly cozy with senior management, and/or out of touch with modern finance such that their judgment is rendered irrelevant at best.⁴⁷ Implementing two practices could help combat board ineffectiveness. First, risk management leaders within banking and financial institutions should be required to directly report to the board of directors at regular intervals (e.g., quarterly) so that board members stay abreast about their firm's risk exposure. Second, the risk committee of the board should regularly meet with heads of units across the bank to get up-to-date information on firmwide risk from those with the most intimate knowledge of day-to-day operations.⁴⁸ These meetings should occur *without* the presence of the bank's top management so that their subordinates aren't pressured into providing the board with unrealistically rosy assessments.

In addition to the above two actions, charter city regulators should refrain from placing excessive restrictions on appointments to bank boards. Many countries typically enact such restrictions to prevent conflicts of interest. While this sentiment is admirable and conflicts of interest should be avoided, in countries of the Global South, these restrictions often serve to further constrain an already limited talent pool from which banks can select competent directors to serve on their boards.⁴⁹ This results in suboptimal board appointments, which in turn means this important check on bank mismanagement—the board of directors—is undermined.

4.3.2 Crisis Management

While the previous subsection went over some tools banking regulators can use to prevent or mitigate against severe financial crises from happening in the first place, this subsection assumes a crisis has happened and delineates tools a charter city administration should utilize to best combat the crisis. These tools include (1) the provision of deposit insurance guarantees and (2) expansive resolution authority. While many crisis management tools will remain with the host country central bank and Ministry of Finance, the below information is useful to inform charter city administrators' discussions with host country authorities in the event of a crisis.⁵⁰

i. Deposit Insurance Guarantees

Deposit insurance prevents bank runs during financial crises, as depositors are reassured by the fact that their savings are guaranteed up to a certain threshold. Deposit insurance arguably doesn't provide much value when it comes to the larger, systemically important banks—as these large banks already have an *implicit* guarantee that the government will come to the rescue with a bailout in the event of near collapse, so they have little use for an *explicit* guarantee like deposit insurance. However, in a charter city located in a country of the Global South, smaller banks are more likely to be involved, especially at the beginning of its development, and deposit insurance *does* help keep these small, undiversified banks afloat when a crisis hits. This is important as it is typically these local banks that lend to underserved segments and SMEs.

Therefore, instead of mandating deposit insurance for all banks, the charter city administration should ensure at least one deposit insurance company is set up within the city to provide the option for those banks that demand it. Additionally,

the charter city administration should not place firm thresholds on the number of deposits to be insured but should allow the deposit insurance company to be flexible in this regard.⁵¹ Deposit insurance is a great way for banks, especially relatively newer or smaller banks with less of an established history, to effectively advertise how safe they are to potential depositors.

ii. Resolution Authority

When banking or financial crises are sufficiently severe, even in the presence of extremely effective bank supervision or of conservative capital requirements, banks may still be pushed inexorably toward collapse. In such a scenario, proper resolution and recovery powers are necessary. Bank resolution occurs “when authorities determine that a failing bank cannot go through normal insolvency proceedings without harming public interest and causing financial instability.”⁵² Resolution allows the core business to continue to function and thereby bolster financial stability, while the parts of the business that can't be redeemed are subjected to insolvency in a more orderly manner.

There are two main issues with resolution mechanisms as they currently operate in many countries. First, many regulators do not have resolution authority over all types of financial institutions. For example, the FDIC can resolve commercial banks in the US, but it has no resolution powers when it comes to non-bank financial firms or bank holding companies. When risk concentrates over time in the peripheral, less regulated shadows of the financial sector, and regulators have very little *ex ante* knowledge about where the next crisis will stem from, it makes little sense to restrict resolution authority in this way. Second, regular insolvency proceedings in

bankruptcy court take far too long in the midst of a fast-moving crisis (especially for banks with more complex or cross-border structures). Thus, in essence, appropriate resolution authority allows charter city regulators to act as a quicker bankruptcy court in order to rapidly restructure important banks on the brink of collapse while allowing their essential parts to continue operations. Both the FDIC model in the US and the European Commission's Bank Recovery and Resolution Directive (BRRD) require financial institutions to pay into a resolution fund *before* a crisis begins, with the BRRD stipulating contributions be based on bank size and overall risk.⁵³ Both resolution funds also clearly establish that in the event that stabilizing the financial system requires more resources than anticipated, industry participants are the ones ultimately on the hook for the bill, not taxpayers.

5. Concluding Caveat

It should be made clear that many of the policy tools and responses discussed in this chapter of the handbook will not be necessary for the early phases of a charter city development. Nascent banking systems are obviously different entities entirely from more advanced and sophisticated banking systems. As such, while a light and flexible regulatory touch makes sense at the outset in order to encourage much-needed bank formation and credit growth, banking and financial regulations should advance as the complexity, size, and depth of the city's financial system advances. Again, a regulatory philosophy of contingency and discretion—or so-called *soft governance*⁵⁴—is likely the optimal model in this complex and ever-changing regulatory domain.

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PART 8: PUBLIC HEALTH, WELFARE, AND SOCIAL SERVICES

8.1 EDUCATION

I. KEY TAKEAWAYS

- ✓ Education is a vital service for the residents of a charter city. Although access to education has been improving throughout the Global South, reading and mathematics proficiency among children remains abysmal.¹ Basic literacy and numeracy are necessary skills for productive participation in an emerging economy.
- ✓ Charter cities must provide an accessible and quality education system to their young residents to ensure they are fully equipped to take advantage of the economic opportunities available to them.
- ✓ The charter city education system should prioritize two key values: (1) equitable access and (2) practical outcomes.
- ✓ This chapter reviews the four main components of this handbook's recommended education system: (1) a comparison of recent research on public and low-fee private schools and specific policies pertaining to (2) primary, (3) secondary, and (4) tertiary education within the charter city.



II. INTRODUCTION

The principal objective of a charter city is to create an enabling environment for sustained economic growth. An effective education system is an important building block toward that objective, both as an incentive to attract new residents and as a mechanism to prepare young residents to flourish in the city economy.

Improving access to and the quality of education throughout the Global South is an important part of a broader development strategy to alleviate poverty. Better education at the most basic level—ensuring children can read and do basic math by the end of primary school—generates substantial returns for income, health, gender equality, and other considerations.² Focusing on widespread access and achievement in this area is likely to generate the greatest long-term returns for the young residents of charter cities, rather than immediately pursuing a more complex education system based on Western models.³

Like basic primary education, schooling at the secondary level should be practical. While some students may be served well with a highly academic program that prepares them for a university education, many will be better served with a technical or vocational program that prepares them to participate in the labor market—whether that be in the charter city or elsewhere in the world. Technical and vocational training features prominently in Sustainable Development Goal 4, a signal that such education will be an important component of an effective, modern education system.⁴

Beyond primary and secondary education, university

programs, especially those focused on science, technology, engineering, and mathematics (STEM), are engines of innovation and will attract talented people to the city. While the industry of most charter cities is likely to be focused on manufacturing, processing, and trade activities, their complexity will grow over time, along with the need for professionals with advanced training in fields like computer science and management.

At the individual and societal levels, the returns to greater education are substantial, particularly in low- and middle-income countries. By one estimate, primary education in low-income countries generates a private return (income) of over 25% and a social return (public spending and benefits) of over 22%. Moreover, in low-income countries, secondary and higher education generates greater returns at both the individual and social levels than in middle- or high-income countries. Greater education also generates very substantial returns for women, who in many such countries face barriers to accessing the same educational and economic opportunities as men.⁵

More widespread access to education is associated with a host of positive outcomes—higher growth, better health, and greater civic engagement, among others. These effects also tend to be intergenerational. Children whose parents attended school are much more likely to attend school themselves and experience the previously discussed private returns to investment in education.⁶

III. VALUES AND GOALS

A successful charter city education system will be focused on two principal goals: (1) **equitable**

Table 16. Summary of Values and Goals for Education

Value	Meaning of the Value	Measurable Goals
Equitable access	<ul style="list-style-type: none"> —Regardless of ability to pay, gender, race, ethnicity, ability, or any other such consideration, all children must be afforded access to a quality education. —Primary education must be made available for all children. —Appropriate academic, vocational, and technical education must be made available for adolescents and adults. 	<ul style="list-style-type: none"> —Student attendance and performance can be tracked and assessed against objective levels. —Attendance and performance tracking can include relevant factors including family income, gender, ethnicity, and other factors. —Tracking data allows for easy comparison to host country and international data.
Practical outcomes	<ul style="list-style-type: none"> —By age 10, children must be able to read and complete basic mathematics. —Secondary education must adequately prepare students for either a university education or provide the technical skills and training needed to find work. 	<ul style="list-style-type: none"> —Student performance on reading and mathematics assessments by the end of primary school —Employment outcomes and/or university acceptance rates after completion of secondary education —Surveys of students and employers to assess the adequacy of preparation for their current or intended employment

First, access to education in a charter city must be **equitable** for all children. Regardless of family income, gender, race and ethnicity, ability, or any other such consideration, all children in a charter city must be afforded a primary education and appropriate options for secondary education.⁷

In terms of measurable goals, the charter city administration can track student attendance and performance while accounting for income, gender, ethnicity, and other factors. This information can be used to assess the accessibility and responsiveness of the education system relative to the host country and international baselines, as well as continually identify areas for improvement.

Second, the education system in a charter city must be focused on generating **practical outcomes**. For a charter city to become an engine of economic opportunity and mobility, with an economy that becomes more complex over time, the children that grow up in the city must first

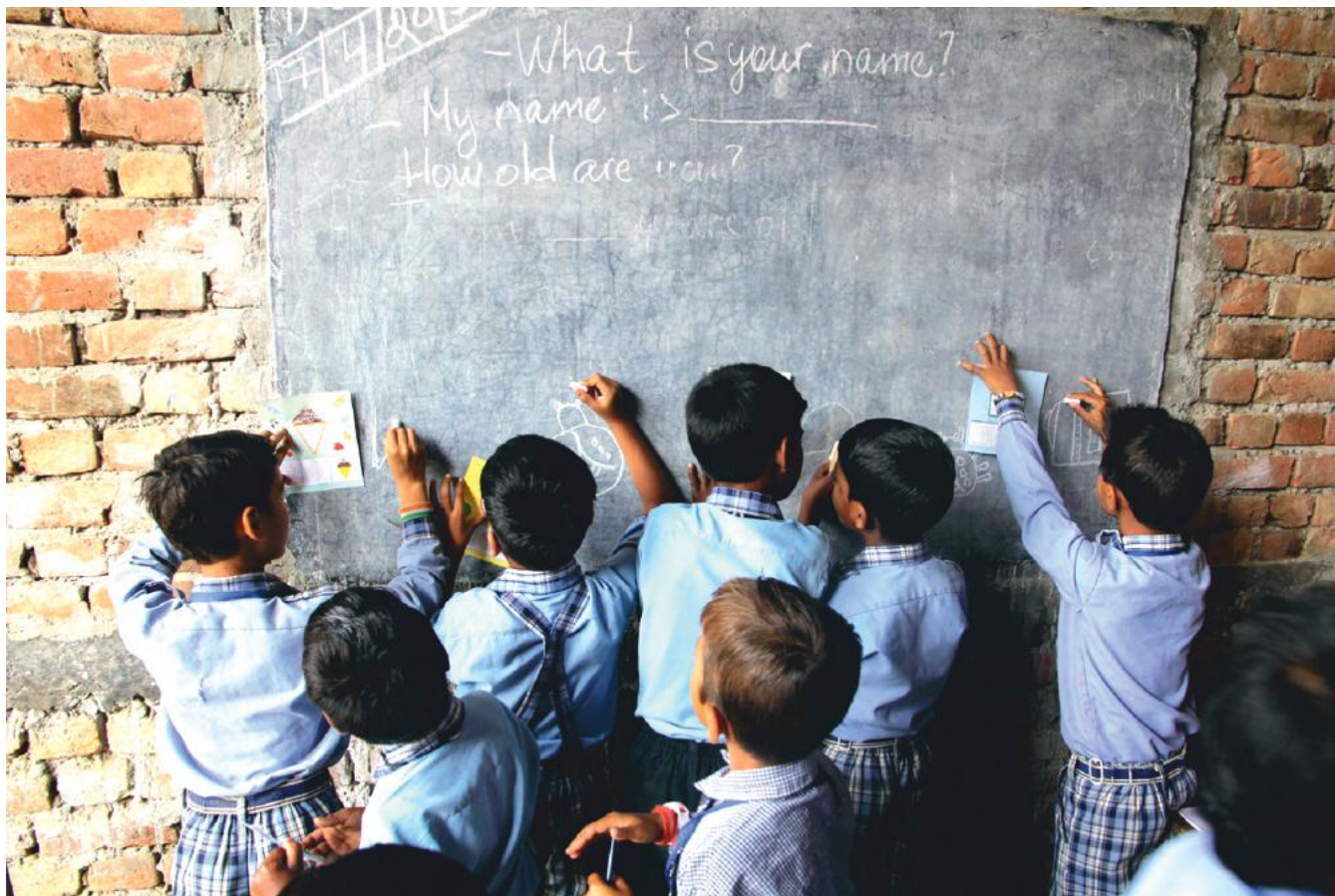
learn to read. Children that cannot read by age 10 or by the end of primary school are significantly less likely to develop effective reading skills later in life, limiting their future economic opportunities.⁸

Literacy is an important first step in the educational program for children in a charter city. Combined with an understanding of mathematics, the children that grow up in a charter city will be prepared to take more complex jobs that they otherwise may never have been able to access in the host country. An effective primary education system will prepare students to enter a vocational or technical program and succeed or to continue pursuing an academic education and attend a university.

The metrics by which to measure the effective outcomes of the education system are similar to those of equitable access. The baseline measure is simply if students going through the education

system are meeting objectives for literacy and numeracy. Beyond this, employment outcomes for students that have gone through the charter city education system can be measured through both employment data and surveys. If students report being able to secure quality employment or have successfully started businesses after completing primary school, this would suggest that the system

is effectively preparing students. Similarly, if many students attend university after completing secondary school, this also suggests that the system is adequately preparing students. Data provided by the World Bank's human capital index can provide a holistic benchmark that incorporates both health and education metrics when assessing the performance of these systems in a charter city.⁹



IV. IN PRACTICE

This section discusses the key components of an education system that a charter city should include. This includes (1) a comparison of recent research on public and low-fee private schools, as well as the intended goals for (2) primary, (3) secondary, and (4) tertiary education in a charter city.

1. Public vs. Private Education

There remains much academic debate about the equity and performance considerations of low-fee private schools relative to public schools.¹⁰ For this reason, rather than make a specific recommendation about the kind of schools a charter city should employ, an overview of current research on the subject is presented, and the final decision is left to

individual charter city administrations.

Day Ashley et al. (2014) provides a valuable overview of the state of research comparing public and private schools. In general, the review finds that private schools tend to perform better than public schools, although there are significant limitations and complications associated with this conclusion. It is often difficult to determine a student's socioeconomic background and other factors that can have a significant impact on their performance, independent of whether the school is public or private. There are also significant concerns about gender equity in access to private schools, with girls realizing lower access than boys.¹¹

Regarding teachers, there is relatively strong evidence that teachers are better in private schools than in public schools. Teacher attendance, teaching activity, and use of effective teaching approaches are all reportedly higher in private schools, in part because of greater teacher accountability to their employer. At the same time, private school teachers are frequently less formally qualified, have lower salaries, and weaker job security, all of which play a role in teacher performance. Lower teacher salaries in private schools are associated with lower costs of operations.¹²

Since 2014 additional research has largely drawn similar conclusions about low-cost private schools to that of Day Ashley et al. (2014).¹³ It is worth noting, however, that Tooley and Longfield (2015) offer a strong critique of Day Ashley et al. (2014), finding much more positive results for low-cost private schools from a review of the same set of studies.¹⁴

Day Ashley et al. (2020) offers a particularly useful

analysis of several distinct models of private school provision in India, including low-cost private schools and voucher programs. This paper found similar results as the Day Ashley et al. (2014) review regarding both teacher and student performance, that low-cost private schools outperformed public schools. However, similar concerns regarding teacher training and job security also applied. On the voucher model, the review found that such programs were effectively able to remove or reduce financial barriers to private school attendance for children in low-income families, although learning outcomes were largely unchanged. Vouchers may be a viable option for reducing the cost of delivering education, although the earlier caveat about teacher compensation applies.¹⁵

Given the state of knowledge on how best to provide education in low-income countries, there are several options available to charter cities. The charter city could simply choose to rely on the existing national or local education system for its needs, eliminating the financial and administrative responsibility for education from the city entirely. However, given the fiscal constraints, limited state capacity, and abysmal state of learning outcomes in virtually all low-income countries and most lower-middle-income countries, the children of a charter city are likely better served if the city is in some capacity involved directly in education.¹⁶

Becoming involved in education leaves a charter city with two options: direct provision of public education or subsidized private education. The former imposes greater fiscal costs and administrative responsibility on the charter city but also guarantees equitable access for children residing in the charter city. The latter offers lower fiscal costs and administrative responsibility but requires greater oversight to ensure that vouchers

offered are well-targeted and sufficient in value to guarantee equitable access. Based on the previous discussion of the evidence on low-cost private schools, there is some reason to believe that education may be of a higher quality under the private voucher model, but this outcome is far from a certainty. If the charter city chooses to pursue a voucher model, the poorest students should be fully subsidized, and the voucher can be gradually phased out based on family income level to a point at which paying for school does not induce financial hardship. Such a system will allow for the lowest-income residents of a charter city to

still access education without subsidizing the families capable of paying for education without assistance. A voucher system that fully subsidizes primary school is the most important consideration, as children must become proficient in reading and mathematics to be able to succeed in secondary school and future careers. The voucher payment for education should be delivered through the universal cash transfer platform discussed in the “Social Protection” chapter of the handbook.

BOX 36

Universal Voucher Program, Chile

Since 1981 Chile has had a relatively competitive and decentralized market for primary and secondary education, based on a universal voucher program. By one estimate, the program led to 0.6 percentage point higher primary school graduation rates, 3.6 percentage point higher secondary school graduation rates, 3.1 percentage point higher college attendance rates, and 1.8 percentage point higher four-year college completion.¹⁷ The program delivered higher quality primary schooling, decreased costs of school attendance, and reduced income inequality. Educational attainment gains between poor and non-poor students were similar as well. Today, Chile's education system outperforms the rest of Latin America, and its reading results are comparable to that of the United States, Western Europe, and China.¹⁸ A 2017 review of several studies on the Chilean universal voucher program tended to find small positive effects on student performance, although these results are far from definitive.¹⁹

2. Primary Education

Primary education must focus on getting children into school and then developing reading and mathematics proficiency. Over half of children globally are estimated to lack minimum proficiency in reading and mathematics. Two-thirds of these children attended school and still did not become proficient, either because they dropped out or simply did not learn basic skills. The other third of children were never in school. Even though school enrollment has been rising, reading and mathematics proficiency remains low.²⁰

In sub-Saharan Africa, nearly 90% of children have not achieved minimum proficiency in reading and mathematics. In Central and Southern Asia, approximately 80% of children are not proficient in reading or mathematics.²¹ For charter cities to provide a pathway out of poverty, children must attend school and actually develop reading and mathematics skills while they are there. Over time as the city becomes wealthier, the focus of education can broaden to a wider exploration of subjects like in higher-income countries; however, addressing failures to ensure basic literacy and numeracy must be the main priority at the outset.

In addition to a strong focus on reading and mathematics, primary schools in a charter city will also need to tackle the problem of teacher absenteeism and teacher quality. Teacher absenteeism, especially in primary schools, has been a noted problem in developing countries. Throughout much of sub-Saharan Africa, more than 15%—and in some cases more than one-fourth—of teachers were absent during random school visits. When adding in teachers that are present at the school but not in the classroom, the figure rises to in excess of 40 or 50% of teachers.²²

Private schools have been found to have lower rates of teacher absenteeism, which charter cities could potentially take advantage of via a voucher-based system.²³ Low teacher absenteeism should be an important part of the charter city's contracts with private education providers to ensure that primary school students do not miss vital instruction.

Large-scale experimental evidence suggests that teacher pay for performance schemes can have a positive impact on both student performance and teacher absenteeism. A randomized study of 300 schools in rural Andhra Pradesh found that students in schools with teacher incentive programs scored .27 and .17 standard deviations higher on math and language tests than students in schools without an incentive program. Pay for performance can also attract better teachers and reduce teacher absenteeism.²⁴

3. Secondary Education

At the secondary level, education becomes more complex. By this stage, all students should be proficient in reading and mathematics so that they can either begin vocational or technical training or

continue on a more academic path. This split-path approach recognizes that most of the students in a charter city will find jobs that do not require an advanced academic education or will start their own business. However, high-achieving students should be eligible to continue an academic secondary education to prepare for an eventual university education.

The vocational or technical education path should be equipped to prepare students for a wide variety of career opportunities while continuing to build on reading, mathematics, and other skill development that begins in primary school. These schools should offer traditional vocational training options that prepare students for manufacturing and service sector jobs like construction management, carpentry, welding, electrical work, certain medical and dental positions, cooking, mechanic work, and others. Experimental evidence about the effects of vocational training from Uganda suggests that the benefits of such training are longer-lasting than the benefits of an apprenticeship, in part because vocational training certifies skills to potential employers.²⁵

At the same time, these technical programs should also be prepared to train students in careers that can take advantage of the growing remote work environment like software development and graphic design.²⁶ By offering both traditional and forward-thinking vocational and technical training programs, a charter city will prepare its young adults to not just enter the current workforce but to build a more dynamic and complex economy through the necessary industrial and skills upgrading.



The schools offering vocational and technical training can partner with businesses operating in or near the charter city to provide experiential learning and apprenticeship opportunities, which in turn will create a degree of economic certainty for students that enjoy their trade and establish a strong relationship with a potential employer. Students working in careers that can be done remotely may be able to tap into the growing number of international tech firms establishing a presence in lower-income regions like sub-Saharan Africa.²⁷

The academic track should continue much like a traditional education aimed at preparing students for a university education. Throughout both primary and secondary education, regular standardized testing that is aligned with the standardized testing used by the country—as well

as internationally— can provide a useful tool for measuring student performance relative to both the host and other countries. This testing can also provide a signal of the value added by additional years of education, which can help students, families, and schools better plan for the educational and occupational futures.

The voucher system identified in the primary school section should continue for secondary schooling. However, opportunities may arise for students engaging in apprenticeships to earn income which diminishes the need for a voucher, so a phase out may be necessary. The same conditions regarding teacher absenteeism and pay for performance schemes also apply to secondary schools.

BOX 37**Voucher Program, Colombia**

Colombia has also successfully implemented vouchers for private schooling. A lottery was used to distribute vouchers that partially covered the cost of private secondary school, provided the student maintained academic progress. Lottery winners were 10% more likely to have finished eighth grade and scored 0.2 standard deviations higher on achievement tests. The program is estimated to have increased secondary school completion rates by 15 to 20%. The voucher program was also found to likely raise the lottery winners' wages well beyond the tuition costs accrued by families and the government.²⁸

Colombia's voucher program for poor children also increased secondary school graduation rates by five to seven percentage points, increased eighth-grade completion rates by 10%, and increased scores on standardized testing.²⁹ Although Colombia is not as strong of a performer as Chile, it performs above average in Latin America and is comparable to a number of middle- and upper-middle-income countries throughout the world.³⁰

4. Tertiary Education

Universities and other institutions of higher education should be permitted and encouraged to establish campuses in charter cities. However, at the outset the city government should not take on the expense of establishing such an institution directly, as this is a costly and resource-intensive expense for an already burdened charter city administration. Nor should the city government impose any unduly onerous requirements or restrictions on institutions that wish to establish

themselves within the city.

Academic secondary schools in charter cities should seek out relationships and partnerships with high-quality universities in the host country and region for the benefit of their students. At the same time, these universities can be key sources of talent for businesses operating in a charter city. Such symbiotic relationships should be encouraged.

¹ Our World in Data (2020). "Average learning outcomes vs GDP per capita, 2015." Available at: <https://ourworldindata.org/grapher/learning-outcomes-vs-gdp-per-capita?time=2015>.

² World Bank (2020d). "Education (Overview)." World Bank Group: Washington, DC. Available at: <https://www.worldbank.org/en/topic/education/overview>.

³ Epstein, M.J. & Yuthas, K. (2012). "Redefining Education in the Developing World." Stanford Social Innovation Review. Available at: https://ssir.org/articles/entry/redefining_education_in_the_developing_world.

⁴ UNDESA (2020a). "Goal 4: Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all." Sustainable Development Goals, United Nations Department of Economic and Social Affairs: New York. Available at: <https://sdgs.un.org/goals/goal4>.

⁵ Psacharopoulos, G. & Patrinos, H.A. (2018). "Returns to Investment in Education: A Decennial Review of the Global Literature." World Bank Policy Research Working Paper 8402, World Bank Group: Washington, DC. Available at: <http://documents1.worldbank.org/curated/en/442521523465644318/pdf/WPS8402.pdf>.

⁶ Wils, A., Bonnet, G., & Brossard, M. (2015). "The Investment Case of Education and Equity." UNICEF: New York. Available at: https://www.unicef.org/publications/files/Investment_Case_for_Education_and_Equity_FINAL.pdf.

⁷ Although we do not discuss this topic here, the charter city should aim to provide a greater number of programs designed specifically for children with disabilities as the resources to do so become available. This will be an important component of ensuring equitable access to education for all children.

⁸ World Bank (2019). "Learning Poverty." World Bank Group: Washington, DC. Available at: <https://www.worldbank.org/en/topic/education/brief/learning-poverty>.

⁹ World Bank (2020e). "The Human Capital Index 2020 Update: Human Capital in the Time of COVID-19." World Bank Group, Washington, DC. Available at: <https://openknowledge.worldbank.org/handle/10986/34432>.

¹⁰ Ashley, L.D. et al., (2014). "The role and impact of private schools in developing countries." Department for International Development, Education Rigorous Literature Review, DFID: London. Available at: <https://www.birmingham.ac.uk/research/activity/education/projects/the-role-and-impact-of-private-schools-in-developing-countries.aspx>.

¹¹ Ashley, L.D. et al., (2014).

¹² Ashley, L.D. et al., (2014).

¹³ Akmal, M., Crawford, L., and Hares S. (2019). "Low-Cost Private Schools: What Have We Learned in the Five Years Since the DFID Rigorous Review." Center for Global Development. Available at: <https://www.cgdev.org/blog/low-cost-private-schools-what-have-we-learned-five-years-dfid-rigorous-review>.

¹⁴ Tooley, J. and Longfield, D. (2015). "The Role and Impact of Private Schools in Developing Countries: A Response to the DFID-Commissioned 'Rigorous Literature Review'." Pearson, London. Available at: https://eprints.ncl.ac.uk/file_store/production/208667/DEA1EDE1-4499-49D6-A971-C0128AB3F19C.pdf.

¹⁵ Day Ashley, L., Skinner, R., Meyer, A., and Perry, T. (2020). "Private Education and Disadvantaged Children in India: A Literature Review of Three Models of Private School Provision." Save the Children International, London. Available at: <https://resourcecentre.savethechildren.net/library/private-education-and-disadvantaged-children-india-literature-review-three-models-private>.

¹⁶ Differences in state capacity may help explain the mixed results of the literature on public and private education. Higher-capacity states can likely provide public education that is of a comparable quality to private education, while lower-capacity states may struggle to do so. Note the discussion of this literature and the related private education enrollment figures in the 2018 World Development Report (p. 176). Available at: <https://www.worldbank.org/en/publication/wdr2018>; Our World in Data. "Average learning outcomes vs GDP per capita, 2015." Available at: <https://ourworldindata.org/grapher/learning-outcomes-vs-gdp-per-capita>.

¹⁷ Bravo, D., Mukhopadhyay, S., & Todd, P.E. (2010). "Effects of School Reform on Education and Labor Market Performance: Evidence from Chile's Universal Voucher System." *Quant Economics*, 1(1): pp. 47-95.

¹⁸ Roser, M., Nagdy, M., & Ortiz-Ospina, E. (2013). "Results from the PISA study." Our World in Data: Oxford. Available at: <https://ourworldindata.org/quality-of-education#results-from-the-pisa-study>.

¹⁹ Monazza, A., Rawal, S., and Saeed, S. (2017). "Public-Private Partnerships in Education in Developing Countries: A Rigorous Review of the Evidence." Ark Education Partnerships Group. Available at: <https://arkonline.org/ppp-review>.

²⁰ UN (2019). "Quality Education." Sustainable Development Goals, United Nations: New York. Available at: <https://unstats.un.org/sdgs/report/2019/goal-04/>.

²¹ Ibid.

²² Roser, M. (2017). "Absent Teachers." Our World in Data: Oxford. Available at: <https://ourworldindata.org/teachers-and-professors#absent-teachers>.

²³ Lee, M., Goodman, C., Dandapani, N., & Kekahio, W. (2015). "Review of International Research on Factors Underlying Teacher Absenteeism." Institute of Education Sciences: Washington, DC. Available at: <https://files.eric.ed.gov/fulltext/ED555740.pdf>.

²⁴ Muralidharan, K., & Sundararaman, V. (2011). "Teacher Performance Pay: Experimental Evidence from India." *Journal of Political Economy*, 119(1): pp. 39-77.

²⁵ Alfonsi, L. et al. (2019). "Tackling Youth Unemployment: Evidence from a Labor Market Experiment in Uganda." Private Enterprise Development in Low-Income Countries Research Paper. Available at: https://pedl.cepr.org/sites/default/files/AlfonsiBandieraBassiBurgessRasulSulaimanVitali_Training.pdf.

²⁶ Lunden, I. (2020). "Andela, Which Builds Engineering Teams Tapping African Talent, Goes Fully Remote and Opens to the Wider Continent." TechCrunch. Available at: <https://techcrunch.com/2020/07/01/andela-which-builds-remote-engineering-teams-tapping-african-talent-goes-fully-remote-and-opens-to-the-wider-continent/>.

²⁷ Salaudeen, A. (2019). "Why Tech Giants like Google and Microsoft are Investing in Africa." Marketplace Africa. Available at: <https://www.cnn.com/2019/05/17/africa/tech-giants-in-africa-intl/index.html>.

²⁸ Angrist, J., Bettinger, E., & Kremer, M. (2006). "Long-Term Educational Consequences of Secondary School Vouchers: Evidence from Administrative Records in Colombia." *American Economic Review*, 96(3): pp. 847-62.

²⁹ Ibid.

³⁰ Roser, M., Nagdy, M., & Ortiz-Ospina, E. (2013).

8.2 HEALTHCARE

I. KEY TAKEAWAYS

- ✓ Developing a functional health system, and in particular a functional health finance system, rests on the ability of the system operator to adequately (1) finance service delivery, (2) pool risks, and (3) strategically purchase services and supplies.
- ✓ For structural reasons elaborated in the chapter, charter cities cannot adequately meet these three critical elements of health finance, and therefore cannot feasibly develop their own independent health systems.
- ✓ Rather than pursue the development of an independent health system, charter cities must instead negotiate with national and/or local governments to provide services within the charter city and to provide charter city representatives with a seat in health policymaking and purchasing forums.



II. INTRODUCTION

Throughout the Global South there exists a vicious cycle where poverty contributes to poor health

outcomes, and poor health outcomes exacerbate poverty. Although substantial health progress has been made throughout the Global South in recent decades because of socio-economic development

and health promotion initiatives, much work remains to be done to continue the trend of improved health and to reduce the inequity of health outcomes between high-income and low-income countries and between population categories within countries.¹ To achieve these objectives, Sustainable Development Goal 3.8 calls on countries to achieve universal health coverage for essential services that is safe, effective, quality, and affordable.²

Building a health system that can make progress toward the achievement of universal health coverage rests on the development of a robust health financing system. Health financing systems are undergirded by three key elements: revenue collection, pooling, and purchasing. First, revenue for health financing can be collected through taxation, compulsory or voluntary insurance contributions, direct out-of-pocket payments, and donations. Taxes or insurance contributions are needed for the prepayment of services, which allows for risk pooling, the second element of health finance. A sufficiently large and diverse participant pool is needed to ensure that risk—and therefore cost—is spread across all members of the pool, rather than specifically on those in the most need of medical services. In the absence of adequate risk pooling, a health insurance scheme is extremely vulnerable to collapse if the healthy share of the pool declines significantly. Third, the purchasing of medical supplies and services must be done in sufficient quantity to ensure that the provision of medical care is cost-effective and efficient.³

A charter city would be required to generate sufficient revenue, possess a large and diversified risk pool, and be able to engage in bulk-level strategic purchasing to develop an independently operated health system. However, there are structural elements to a charter city that functionally

prohibit it from achieving its objectives in each of the three key areas of health finance.

For much of the life of a charter city, especially early in its development, the population of the city will be insufficient to support the large and diverse risk pool needed to prevent any insurance system from collapsing, especially in the event of a shock such as COVID-19. Community-based health insurance—voluntary pooling of funds organized at the local level to provide health services—has worked to varying degrees as a mechanism to provide healthcare in some countries in the absence of a robust and universal single-payer or public/private insurance system.⁴ While community-based health insurance at first glance appears like a potentially viable model for charter cities to overcome pooling and financing obstacles, this is not the case.

Most notably, Rwanda has enjoyed great success with its community-based health insurance program. However, Rwanda's community-based health insurance program is part of a larger, highly centralized health system organized at the national level, rather than operating as a collection of purely local units.⁵ But Rwanda is the exception, rather than the rule, concerning the success of community-based health insurance. Most schemes offer limited access to the poor, cannot effectively scale, and are susceptible to fluctuations in risk.⁶

Charter cities will similarly face difficulty financing an independent health system. In virtually every country, health spending as a share of total government expenditure is not a trivial share of total government expenditure. Most countries in the Global South spend between five and 18% of total government expenditure on health, with a few countries even approaching 20%.⁷ Most of these countries, despite their

significant expenditure on health, have not come close to achieving universal health coverage or a high standard of care. Given that a charter city will have many competing priorities early in its development and as it grows—in addition to its limited risk pooling potential and relatively small tax base—financing an independent health system is simply untenable.⁸

Furthermore, a charter city health system would experience great difficulty engaging in the strategic purchase of medical supplies and services at a reasonable cost, given its small order sizes. Health purchasing is organized in most low- and middle-income countries at the nationwide level, or state level in some cases; for this reason many international purchasing consortiums like Gavi, The Global Fund, and others only engage partners at the national level.⁹ A charter city with an independent health system would find itself unable to secure the supplies necessary to meet the demands of some of the most common disease burdens in the Global South, including HIV, tuberculosis, and malaria.

III. IN PRACTICE

Given the constraints on the ability of a charter city to pursue the development of its own health system highlighted in the introduction, this chapter breaks from others in the handbook and recommends that charter cities utilize the existing health system infrastructure in the host country. In some countries, the health system is administered or centrally organized by the national government (Ghana, Rwanda, and Thailand), while in other countries this power is devolved to varying degrees to state governments (Nigeria and India). In either case the most feasible approach for a charter city to provide healthcare to its residents is by utilizing the system in place in

the host country.

Although charter cities will need to rely on existing health infrastructure, they need not passively do so. While negotiating with the host country government—and state or other local government units if applicable—over the powers devolved to the charter city and the rights and obligations of all parties involved in the development of the city, charter city administrations can request that the government pledge to establish new health infrastructure in the city as it grows.

These pledges to build delivery points for health services can be benchmarked to specific population targets. As an example, the first clinic could be required once the city hits a population of 500 people. Over time these pledges can scale to larger and more complex facilities like hospitals. The charter city administration, to entice the national or state government to accept such an agreement and to later help implement it, can pledge financial support toward building the physical infrastructure necessary to deliver health services.

Charter city administrations can also request representation with the boards and agencies making health system decisions, including on policy and purchasing. There is precedent for free zones and other special jurisdictions to participate in international negotiations alongside institutions of their national governments. For example, the Dominican Association of Free Zones (ADOZONA), a private and not-for-profit association that represents free zones and free zone companies, is a participant in Dominican trade policy negotiations.¹⁰ This principle could be adopted from the trade sector to the health sector, and charter city representatives can urge the host government to support cost-effective health interventions when making policy and purchasing medical supplies

and services.

By negotiating for the development of health delivery centers based on specified metrics and for charter city representation in health policymaking and purchasing settings, a charter city can most effectively utilize the health infrastructure of the host country to provide services for its population without bearing the full financial and administrative burdens required of an effective health system.

Depending on the extent to which local government units enjoy devolved authority in providing health services, a charter city could (in

the long term) consider building out its own equivalent health system. If in the host country states bear the primary responsibility for delivering health services, a charter city that generates tax revenues and a population comparable to that of a state could seek recognition as a state-equivalent unit and establish its own health system within the existing national health system framework. However, because this scenario is highly dependent on local context and assumptions about the growth of a charter city well beyond its initial development, this possibility is not explored in greater detail in the chapter.



¹ Ortiz-Ospina, E. and Roser, M. (2016). "Global Health." Our World in Data. Available at: <https://ourworldindata.org/health-meta>.

² UNDESA. (2020b). "Goal 3: Ensure healthy lives and promote well-being for all at all ages." Available at: <https://sdgs.un.org/goals/goal3>.

³ World Health Organization. (2010). "Health Systems Financing: The Path to Universal Coverage." The World Health Report. Available at: <https://www.who.int/whr/2010/en/>.

⁴ World Health Organization. (2020). "Community-based health insurance." Available at: <https://www.who.int/news-room/fact-sheets/detail/community-based-health-insurance-2020>.

⁵ Chuhan-Pole, P. & Angwafo, M. (2011). “Yes Africa Can: Success Stories from a Dynamic Continent.” World Bank Group: Washington, DC. Available at: <https://openknowledge.worldbank.org/handle/10986/2335>.

⁶ World Health Organization. (2020). “Community-based health insurance.” Available at: <https://www.who.int/news-room/fact-sheets/detail/community-based-health-insurance-2020>.

⁷ Our World in Data. (2014). “Health spending as a share of total government expenditure, 2014.” Available at: <https://ourworldindata.org/grapher/health-expenditure-government-expenditure?stackMode=absolute®ion=World>.

⁸ Individual insurance contributions are an alternative to a tax financing, however, given that such contributions would need to be mandated given the limited population size, this financing approach is functionally equivalent to imposing a health tax.

⁹ Gavi. (2020). “Eligibility.” Available at: <https://www.gavi.org/types-support/sustainability/eligibility>; The Global Fund. (2020). “Eligibility List 2020.” Available at: https://www.theglobalfund.org/media/9016/core_eligiblecountries2020_list_en.pdf.

¹⁰ World Bank. (2015b). “How to Sustain Export Dynamism by Reducing Duality in the Dominican Republic.” Available at: <https://openknowledge.worldbank.org/handle/10986/21685>.

8.3 SOCIAL PROTECTION

I. KEY TAKEAWAYS

- ✓ By introducing social protection for several critical areas, the charter city can help generate significant improvement in the lives of its least well-off residents.
- ✓ This chapter covers the five key areas of social protection a charter city should strive to implement: (1) child benefits, (2) retirement benefits, (3) unemployment benefits, (4) disability benefits, and (5) crisis support. These benefits can do a great deal to support individuals and families at critical stages in the life cycle when extra help is needed, or the ability to work is limited.
- ✓ The simplest and most effective mechanism to deliver these benefits is through a single cash transfer program, along with additional supporting programs as needed. Such a universal cash transfer system has several benefits. First, the charter city administration can easily distribute benefits without having to worry about excluding those most in need. Second, the city administration still has the ability to tax back transfers from those not in need. Third, a cash transfer system would lead to significant savings on administrative costs.



II. INTRODUCTION

Social protection refers to the systems used to help individuals and families invest in their children's

health and education, assist the elderly, and manage shocks like unemployment or COVID-19.¹

By introducing social protection for several critical

areas, the government of a charter city can help generate significant improvement in the lives of its least well-off residents. The first key area concerns support for children. Transfers to families with young and adolescent children can generate significant short- and long-run benefits in health, education, and other measures of development.²

A second important area is support for the elderly. The world population is aging, including in low-income countries, highlighting the need for adequate old-age support systems. While old-age pension systems in high-income countries have achieved near-universal coverage, pension systems in low-income countries see only a small fraction of the elderly population covered. There are also significant differences across countries in terms of the adequacy of benefits paid out to beneficiaries.³ While people beyond working age are unlikely to be among the first movers to a charter city, such a population will emerge, and the city must be prepared to provide support on top of what families are able to provide.

A third critical area covers those that are unable to work because of a disability and those left unemployed. Workplace injury and significant health problems, as well as pregnancy, can leave otherwise able people unable to work or in a situation where it would be best if they did not work. While there is a role to play for family and other networks to support those that cannot work, there is also a role for social protection to bolster that support to ensure that no individual is left destitute.

Similarly, the firm-level or macroeconomic conditions that can generate unemployment are typically outside of an individual worker's control, and there is a role for the charter city administration to play in supporting that individual while they

search for new employment. There may also be a role to play for the charter city to help address *seasonal* poverty in nearby rural areas (as well as its own labor matching issues) by providing small travel subsidies to farming families in need of work between planting and harvesting seasons, creating a channel for entrepreneurial talent to reach the city, greater buy-in from the surrounding communities, and increased economic linkages with the host country.⁴

Beyond these three areas, there is a need to consider the response to major events that disrupt normal economic and social life, such as a pandemic or natural disaster. While a charter city has at best a limited capacity to prevent such events from impacting its residents, it can take steps to build resilience and ensure that a sufficient level of financial support will be in place for its population when such events do inevitably occur.

There is also the critical question of finance. Social protection and insurance programs are financed in a variety of ways throughout the world. Some are supported through a combination of individual, employer, and public contributions, while others are funded by tax revenues. Given the limited resources of a charter city and the prospect of a rapidly growing population, funding mechanisms that include savings or contributions by individuals will play an important role in ensuring that while social protection is offered, it does not consume the city budget and is sustainable over the long run.

In sum, social protection represents a network of interrelated supporting programs to improve wellbeing across the population. Policy and policy implementation in areas such as labor, health, education, and the environment are all connected to the demand for social protection and to the

various benefits and programs that need to be offered. (See these individual chapters within this handbook for additional details.) Although higher economic growth can reduce the overall demand for social protection, there will always be a need to support individuals and families that cannot fully meet their own needs. Effective implementation and administration of social protection programs can ensure that those most in need get the support they require to maintain a minimum standard of living.

The recommendations made in this chapter of the handbook should be phased in over time, potentially as supplements to existing national or regional social protection programs. At the outset of a charter city development, it is unlikely that the city will have the resources to fully, or even

partially, implement the recommendations. More specifically, social insurance schemes like unemployment insurance are likely beyond the reach of a charter city because such programs require significant risk pooling to function. Existing host country benefit programs can be utilized and supplemented until the city's tax revenue streams are sufficient to support large transfer programs and the population is sufficient to introduce social insurance programs.

III. VALUES AND GOALS

Social protection in a charter city should be focused on three key values: (1) **simplicity**, (2) **cost-effectiveness**, and (3) **integration across policy areas**.

Table 17. Summary of Values and Goals for Social Protection

Value	Meaning of the Value	Measurable Goals
Simplicity	<ul style="list-style-type: none"> —Programs should be easily understood by beneficiaries. —Programs should impose minimal administrative burdens. 	<ul style="list-style-type: none"> —Share of population covered by each program —Total number of programs. —Administrative costs as a share of the program cost.
Cost-effectiveness	<ul style="list-style-type: none"> —Policies should target the highest possible benefits per spending. —Fill in the gaps in the broader system of social protection that are generated by informal employment or that are not adequately addressed by employment, labor, community, or other interpersonal social networks and relationships. 	<ul style="list-style-type: none"> —Benchmark to evidence from randomized control trials (RCTs) and other available evidence. —Pursue policies that generate significant positive externalities.
Integration across policy areas	<ul style="list-style-type: none"> —Social insurance and social assistance programs are part of a larger comprehensive strategy. —Labor, education, health, environmental, and other policy areas all have implications for social welfare. 	<ul style="list-style-type: none"> —Cooperation across agencies in policy planning and implementation. —Policies and regulations account for the multidimensional nature of effects.

IV. IN PRACTICE

This section discusses the key areas that need to be included in a charter city's social protection program, including support for children, the elderly, the unemployed, the disabled, and major crises. This section also discusses one platform for delivering these benefits, a universal cash transfer program that city residents are automatically enrolled in.

It should be noted that, depending on the agreement reached between a charter city and the

host country, social protection programs in the host country could still be fully applicable in the charter city, which may reduce the need for the city to develop its own social protection systems. In this scenario, there may be more of a supplementary role to play for the city's social protection systems, rather than acting as the primary source of social protection. Insurance-based supports, like unemployment and pension programs, are best implemented above the municipal level because a larger population diversifies risks and strengthens the system.

BOX 38

Child Support Grant, South Africa

South Africa's Child Support Grant, introduced after the end of apartheid, has been hugely successful at improving the lives of poor children. The grant initially sent monthly payments of ZAR100 to the poorest 30% of children under the age of seven, conditional on participation in development programs and immunization status.⁵

After a limited initial enrollment, the grant program was significantly expanded. Children above the age of seven were included, and the government increased the eligible household income to 10 times the value of the grant. Immunization conditions were also eliminated as not all children had access to the necessary documentation. As of 2012 over 11 million children were enrolled in the grant program, and monthly payments were increased to ZAR280.⁶

The grant has had wide-ranging positive effects on the health and development of poor children. Children whose families received the grant saw better nutrition, more schooling, and less labor force participation. Families were able to use grant payments for health services, transport, medicine, education, and higher quality food, all of which support the development of their children. Adolescents that received the grant as children were also less likely to use drugs or alcohol or to become pregnant. Both early and risky sexual behavior were also reduced, lessening the likelihood of contracting HIV. In addition to these health benefits, families were also able to borrow against future payments in the event of unanticipated expenses, allowing the grant to operate as an insurance scheme.⁷

1. Universal Cash Transfers

Any targeted benefits established as component pieces of a social protection system require both a recipient identification and a delivery mechanism. A benefit program intended to support low-income children, for example, must determine

what families have children and of those families, which have household incomes at or below the eligibility threshold. There is then a question of whether benefits are delivered in-kind, in-cash, or through some other mechanism, as well as the conditionality of the benefits.

Given that most countries in the Global South cannot collect regular income data because of their large informal economies and limited administrative capacity, they must rely on proxy means-testing measures that attempt to estimate which households should be eligible for transfers. Although the administrative costs of means-testing are not so high as to be prohibitive, errors in the testing methodology can exclude recipients from receiving transfers they should qualify for.⁸ Means-testing also places an explicit burden on the applicant to gather all the necessary information while also creating opportunities for corruption. In terms of benefit delivery, a growing body of research suggests that cash transfers are one of the most effective anti-poverty tools, much more so than in-kind transfers.⁹

By establishing a *universal* cash transfer as the standard platform for social protection, a charter city can avoid the above-mentioned problems associated with targeting (mainly excluding by measurement error residents in need of assistance). A cash transfer gives recipients a choice in how to spend their money and can be used as a platform on which to provide additional cash for children, the elderly, or other designated groups. The element of choice is key; recipients know best what they need and tend to spend their cash payments on useful goods and services like food, health, and education, rather than frivolous or harmful products like alcohol and tobacco.¹⁰ Fears about declining labor force participation resulting from cash transfers are likewise unfounded.¹¹

Under a universal cash transfer system, some individuals that would not receive benefits under a means-tested system will receive payments. However, the money could be taxed back from those that do not need the transfer through a small income tax. This latter group almost certainly

works in the formal economy, which would be large in a charter city to begin with, thereby making taxing back this cash transfer a straightforward exercise. Residents could also be given the option to forgo receiving the payment, eliminating the need to tax it back later. The wage rate for a person in formal employment would be known *ex ante*, which would also allow for a pre-emptive denial of the transfer.

By structuring social protection around a single cash transfer program, the city government can adjust benefit levels as resources permit. When resources are more limited, transfers could be introduced at a low level and scaled up over time as revenues and administrative capacity grows. At the same time, rising administrative capacity allows for the possibility of more specifically targeted programs, should that be the objective of the charter city administration.

In terms of payment delivery, transfers can be made through banks or non-bank financial service institutions. Direct transfers to beneficiaries' bank accounts, when possible, are the simplest and most easily monitored way to deliver transfers. With the use of biometric ID cards, banks and other institutions can also facilitate over-the-counter transfers if an individual does not have a bank account.¹² Kenya's highly successful M-PESA mobile banking system offers a model for how increasingly utilized technology like mobile phones can be used to help deliver benefits, even when banking infrastructure is limited.¹³

2. Child Benefits

Transfer programs targeting the health, education, and well-being of children have been introduced successfully throughout the world in a variety of ways. Some programs impose conditions on factors

such as school attendance rates or completion of vaccinations like Brazil's *Bolsa Familia*, while other programs like Mongolia's Child Money Program are universal in nature.¹⁴

Regardless of the structure of the child benefit scheme introduced, such programs have played a critical role in improving outcomes for children. Transfer programs related to children have resulted in increases in height-for-age and weight-for-age (a function of better nutrition), decreased disease infection rates, improved mental health, decreased incidence of low birth weights, increased schooling, and decreased child labor.¹⁵ In high-income countries, universal child allowance programs have led to significant reductions in the incidence of child poverty.¹⁶

A charter city should introduce a child benefit paid on top of the base cash transfer on a per-child basis. Government resources available over time

and across charter cities will vary, making it difficult to suggest a specific spending target for a child transfer, but 0.5 to 3.5% of GDP represents the standard family benefit spending range among OECD countries.¹⁷ Although for a charter city, any payments will likely fall on the lower end of that distribution, any support that can be offered to families on a universal basis represents a major success for social protection.

Child benefits can also be structured around the age of the children. Parents with young children will require the greatest assistance, while teenagers that are of legal working age demand less support. Better nutrition, healthcare, and educational opportunities at a young age can have significant positive effects on a child's long-term health and economic outcomes, and so the distribution of payments should heavily prioritize this group of beneficiaries.



BOX 39

Cash Transfers Can be Extraordinarily Effective at Reducing Poverty, Kenya

In response to the AIDS crisis that left many Kenyan children without one or both of their parents, the Kenyan government and UNICEF introduced a cash transfer program. After a successful initial pilot program, over 15,000 households were receiving monthly transfers of KES1,500 by 2008, leading to improvement in child health. By 2012, the program was expanded to cover over 280,000 children in 134,000 households. At the same time, experiments with conditioning the transfers were attempted but found to be ineffective.¹⁸

The transfer program was credited with a 36% reduction in absolute poverty, an increase in food and health expenditures, and more diverse diets. The likelihood of early sexual behavior was reduced by over 30%, along with a significant reduction in risky sexual behavior that could result in contracting HIV. The likelihood of pregnancy also fell, and significant improvements in mental health were reported.¹⁹

3. Old-Age Benefits

In addition to support for the young, there is a role to play for social protection in supporting the elderly. Through a combination of contributory savings and tax-financed transfers, a charter city can help ensure that its elderly population avoids poverty after retirement. Although families often support their elderly relatives in some capacity, the charter city administration can help ease this burden and aid those without the benefit of a family to supply needed care. It is also important to note that any transfers to the elderly will need to be at a supplemental level to any existing old-age benefit programs in the country and not introduced as a standalone old-age pension program because of the aforementioned difficulties with risk pooling in a charter city.

In addition to direct support paid to the elderly through the cash transfer platform, a charter city can introduce a mandatory savings program, as has been implemented in numerous countries.²⁰ Each individual working in the charter city can be provided an individual savings account, to which they must contribute a fixed percentage. By making contributions mandatory but not allowing withdrawals, individuals can build up sizeable

retirement savings without leaving a massive pension burden on city finances. Employers could also be required to contribute to these savings accounts, although this does come with the trade-off of making each employee hired more expensive.

Beyond just accruing savings, individual retirement accounts can be invested to generate returns for account holders. A fiduciary duty can be imposed on fund management to help ensure that savings are not invested in assets that might otherwise be considered too risky. In addition to traditional investments, pension funds could also be invested in socially useful city development projects, which can generate both monetary and non-monetary benefits for account holders.

Even with a lifetime of mandatory savings, low-income workers may not have an adequate amount of savings to fully support themselves in retirement. The city administration can provide supplementary cash transfers to those with limited savings. Base level of support can be provided to pensioners up to a certain savings level, at which point the additional transfers could be phased out. So long as the city administration can view what each individual has saved in their retirement

account, means testing for such a program can be accomplished with minimal administrative overhead.

4. *Unemployment Benefits*

Unemployment benefits are another key component of a social protection system. When a worker loses their employment through no fault of their own, unemployment benefits can help that individual support themselves and their family until new work can be found. For the same pooling reasons as old-age pensions, unemployment is another area where the charter city has a supplemental role to play rather than as the principal provider of benefits.

Eligibility requirements for unemployment benefits should be set so that the benefits system cannot be abused. Workers fired for just cause, breach of duties, illegal activity, and other such criteria should not be eligible for unemployment benefits; however, these workers should be eligible for a rapid appeals process that can examine the circumstances of their termination within one month of denial for benefits. Workers that freely leave their jobs should likewise be ineligible for unemployment benefits. A base period of time spent at a job should be set to determine if benefits

are available. This period should be between three and six months to account for the nature of short-term work and not exclude the population most vulnerable to unemployment.²¹

Unemployment benefits are typically paid as a share of the worker's former compensation, up to some maximum level. A minimum level set equal to the minimum wage can ensure that all unemployed workers meet a basic standard of living. In terms of the duration of benefits, at least three months is an appropriate minimum. These standards are common for national unemployment schemes, so a lower benefit level and a shorter duration of the benefit are more feasible. Workers should be given support, but unemployment benefits must not become a long-term replacement for employment.²²

Both workers and employers can be required to contribute a small percentage of monthly compensation to finance unemployment payments. General fund revenues may also be used to support unemployment benefit payments. Drawing funds from all employers and all workers will help to pool risk, implicitly benefitting those at higher risk of unemployment, although this pooling will likely be insufficient to support anything beyond a low level of benefits.²³

BOX 40

Mandatory and Privately Managed Pensions, Chile

Under the Pinochet dictatorship, Chile moved from a pay-as-you-go pension system to a privately managed, mandatory contribution program. All formal sector workers were required to contribute 10% of earnings, and a minimum benefit payment was guaranteed for workers that provided 20 years of contributions. Although the financing difficulties of the previous pension system may have been eased, this new program still left many without adequate coverage, especially those in the informal sector.²⁴

In 2008 the system was reformed to include a solidarity pension program, which is a non-contributory program that is withdrawn as one's private savings increase. The top two quintiles of earners are not eligible for the solidarity benefit. An auction mechanism was also introduced to govern private fund management and reduce the administrative overhead of the program.²⁵

In 2015 a commission was established to identify further reforms, including ways to boost income replacement levels, which were far below the expected 70%. Proposed reforms to help address shortcomings included increasing solidarity benefits for those with little private savings by 20% and expanding those benefits to the bottom 80% of pensioners. A new employer contribution of 4% has also been proposed to fund both the individual and solidarity accounts, among other administrative changes.²⁶

Although Chile's private pension system was an important factor in the country's impressive growth relative to its peers, the system continues to face significant political and financing challenges. Its deep unpopularity shows that any privately managed pension system with forced savings must respond to the concerns of pensioners and provide a base level of support for those likely to receive less than adequate benefits in retirement.²⁷

5. Disability Benefits

Disabilities, temporary or permanent, can severely limit the extent to which a person can work or even prevent that person from working entirely. Because of their limited capacity to work, individuals with disabilities in a charter city should be entitled to receive a transfer to ensure that they can support themselves and avoid falling into poverty.

To provide disability benefits the charter city will require an authority that can assess an individual's claimed disability. This authority must be able to assess both the degree of disability as well as the duration of the disability. These determinations can be used to calculate the value and duration of the benefits to be paid. For example, South Africa's disability benefits system pays 75% of the individual's last monthly earnings (up to a cap) in the event of total permanent disability but pays varying percentages for partial disabilities based on the assessed degree of that disability.²⁸

Depending on what programs are already in place at the national level, the importance of developing a disability benefits system may vary. A reasonably effective national disability benefits program may preclude the need for a small supplement by the charter city.

6. Crisis Support

Major events that disrupt ordinary social and economic life, like pandemics and natural disasters, can quickly leave families without a reliable source of income for some time. It is important to develop a robust social protection regime that can provide aid in the event of shocks that threaten the ability of families to meet their needs. While cash transfers cannot be the sole response to such disruptions, as during normal times they may induce families and individuals to take greater economic risks, they can allow a charter city to build resilience in critical moments by providing additional support to families in need.

Cash transfers have become a mainstay of the global response to the COVID-19 pandemic. When work is scarce or must be restricted in the name of public health, providing an alternative income stream to people can help them weather the economic hardship without losing valuable assets like a home or being forced to take on high levels of debt.²⁹

Cash transfers, which were already in place in Kenya before the pandemic, have been an important component of that country's COVID-19 response. Kenya's basic income program has

proven helpful in improving food security, as well as physical and mental health, during the crisis. Additionally, Kenya's basic income has allowed for

greater social distancing, as well as lower hospital utilization among non-COVID-19 patients.³⁰

¹ World Bank (2020f). "Social Protection (Overview)." World Bank Group: Washington, DC. Available at:

<https://www.worldbank.org/en/topic/socialprotection/overview>.

² Collins, O. (2015). "Social Cash Transfers and Children's Outcomes: A Review of Evidence from Africa." UNICEF: New York. Available at: https://www.unicef.org/esaro/Social_Cash_Transfer_Publication_ESARO_December_2015.pdf.

³ Yang, W. et al., (2018). "Promoting Inclusion Through Social Protection: Report on the World Social Situation 2018." UNDESA: New York. Available at: <https://www.un.org/development/desa/dspd/wp-content/uploads/sites/22/2018/06/rwss2018-full-advanced-copy.pdf>.

⁴ Evidence Action (2018). "No Lean Season." Available at: <https://www.evidenceaction.org/beta-no-lean-season/>.

⁵ Glassman, A. & Temin, M., eds. (2016a). "A Step Up for the Children Apartheid Left Behind: South Africa's Child Support Grant," in *Millions Saved: New Cases of Proven Success in Global Health*. Center for Global Development: Washington, DC. Available at: https://www.cgdev.org/sites/default/files/Millions_Saved_excerpt.pdf.

⁶ Ibid.

⁷ Ibid.

⁸ Hanna, R., & Olken, B.A (2018). "Universal Basic Incomes versus Targeted Transfers: Anti-Poverty Programs in Developing Countries." *Journal of Economic Perspectives*. 32(4): pp. 201-226; Brown, C., Ravallion, M., & van de Walle, D. (2018). "A Poor Means Test? Econometric Targeting in Africa," *Journal of Development Economics*. 134: pp. 109-24.

⁹ Blattman, C. (2017). "Bill Gates wants to give the poor chickens. What they need is cash." Vox. Available at: <https://www.vox.com/the-big-idea/2017/3/14/14914996/bill-gates-chickens-cash-africa-poor-development>; GiveDirectly (2020). "Research on Cash Transfers (Overview of the Evidence)." Available at: <https://www.givedirectly.org/research-on-cash-transfers/>.

¹⁰ Evans, D. & Popova, A. (2017). "Cash Transfers and Temptation Goods." *Economic Development and Cultural Change*. 65(2): pp. 189-221.

¹¹ Salehi-Isfahani, D. & Mostafavi-Dehzoeei, M.H. (2018). "Cash Transfers and Labor Supply: Evidence from a Large-Scale Program in Iran." *Journal of Development Economics*. 135: pp. 349-67.

¹² OECD (2019a). "Implementing social protection strategies: Lessons from the EU-SPS Programme." OECD: Paris. Available at: https://www.oecd.org/dev/inclusivesocietiesanddevelopment/Lessons_learned_Implementing_social_protection_strategies.pdf.

¹³ Ndung'u, N. (2017). "M-Pesa – a success story of digital financial inclusion." University of Oxford Blavatnik School of Government Practitioner's Insight. Available at: <https://www.bsg.ox.ac.uk/sites/default/files/2018-06/2017-07-M-Pesa-Practitioners-Insight.pdf>.

¹⁴ Hellman, A.G. (2015). "How does Bolsa Familia Work? Best Practices in the Implementation of Conditional Cash Transfer Programs in Latin America and the Caribbean." Inter-American Development Bank Technical Note No. IDB-TN-856, Inter-American Development Bank: Washington, DC. Available at: <https://publications.iadb.org/publications/english/document/How-Does-Bolsa-Familia-Work-Best-Practices-in-the-Implementation-of-Conditional-Cash-Transfer-Programs-in-Latin-America-and-the-Caribbean.pdf>;

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¹⁵ GiveDirectly (2020). Available at: <https://www.givedirectly.org/research-on-cash-transfers/>.

¹⁶ Matthews, D. (2017). "Child poverty in the US is a disgrace. Experts are embracing this simple plan to cut it." Vox. Available at: <https://www.vox.com/policy-and-politics/2017/4/27/15388696/child-benefit-universal-cash-tax-credit-allowance>.

¹⁷ OECD (2020). "Family Benefits Public Spending (Indicator)." OECD: Paris. Available at: <https://data.oecd.org/socialexp/family-benefits-public-spending.htm>.

¹⁸ Glassman, A. & Temin, M., eds. (2016b). "Giving Vulnerable Children a Fair Shot: Kenya's Social Cash Transfer Program," in *Millions Saved: New Cases of Proven Success in Global Health*. Center for Global Development: Washington, DC. Available at: https://www.cgdev.org/sites/default/files/Millions_Saved_excerpt.pdf.

¹⁹ Ibid.

²⁰ John, D.C. & Levine, R. (2009). "National Retirement Savings Systems in Australia, Chile, New Zealand, and the United Kingdom: Lessons for the United States." Retirement Security Project Paper No. 2009-1, Brookings: Washington, DC. Available at: https://www.brookings.edu/wp-content/uploads/2016/06/07_retirement_savings_john.pdf.

²¹ Kuddo, A., Robalino, D., & Weber, M. (2015). "Balancing Regulations to Promote Jobs: From Employment Contracts to Unemployment Benefits." World Bank Group: Washington, DC. Available at:

<http://documents1.worldbank.org/curated/fr/636721468187738877/pdf/101596-REPLACEMENT-WP-PUBLIC-12-9-15-Box394816B-Balancing-regulations-to-promote-jobs-FINAL-web-version.pdf>.

²² Ibid.

²³ Ibid.

²⁴ Barr, N. & Diamond, P. (2016). "Reforming Pensions in Chile." *Polityka Społeczna*. 1: pp. 4-9.

²⁵ Ibid.

²⁶ Ibid.

²⁷ Margolis, M. (2020). "Covid-19 May Destroy Chile's Iconic Pension System." Bloomberg. Available at: <https://www.bloomberg.com/opinion/articles/2020-07-21/covid-19-may-destroy-chile-s-iconic-pension-system>.

²⁸ SSA (2017). "Social Security Programs Throughout the World: South Africa." Social Security Administration Office of Retirement and Disability Policy: Woodlawn, MD. Available at: <https://www.ssa.gov/policy/docs/progdesc/ssptw/2016-2017/africa/south-africa.html>.

²⁹ Maizland, L. (2020). "Why Countries Are Giving People Cash Amid the Pandemic." Council on Foreign Relations: Washington, DC. Available at: <https://www.cfr.org/in-brief/why-countries-are-giving-people-cash-amid-pandemic>.

³⁰ Banerjee, B. et al., (2020). "Effects of a Universal Basic Income During the Pandemic." Unpublished Working Paper. Available at: https://econweb.ucsd.edu/~pniehaus/papers/ubi_covid.pdf.

8.4 ENVIRONMENT AND ENERGY

I. KEY TAKEAWAYS

- ✓ On the one hand, the natural environments of many successful cities can be pull factors, enticing people and businesses to a city. On the other, a polluted, unsafe, and over-exploited environment or an unreliable and overwhelmed energy grid are frequent downsides of density in the Global South, discouraging firms and residents from locating in the city.
- ✓ To attract economic activity a charter city must strike a delicate balance, safeguarding the environment and delivering reliable power, but avoiding overzealous regulation that often hamstrings firms (especially SMEs) while providing little or none of the promised environmental benefits.
- ✓ Charter city policymakers should prioritize two main values: (1) efficiency, as determined by credible cost-benefit analyses, and (2) public health and safety.
- ✓ This chapter reviews four key decisions that charter city administrations must make when establishing environmental and energy regulations and their associated regulatory agencies: (1) policy and standards, (2) environmental and social impact assessments (ESIA) vs. risk management, (3) monitoring and evaluation and enforcement, and (4) administering and financing the city agencies.

II. INTRODUCTION

The enactment and enforcement of effective environmental and energy policies in a charter city are important for several reasons:

First, without appropriate environmental and energy standards in place, it becomes significantly harder for charter city developers to attract quality businesses and residents to the city. For example, according to the Air Quality Life Index, the average New Delhi resident would live a full nine years longer in the absence of that city's staggering amounts of air pollution.¹ Such egregiously low environmental and air quality discourages those businesses and residents with alternative location options from moving to New Delhi. With effective standards in place *before* tenants start to move to the city, charter city developers can better avoid these disadvantages and become more attractive to potential investors, businesses, and residents. Indeed, UNIDO's eco-industrial park framework

asserts that their recommended environmental policies can help lower firm operating costs, decrease business risks, bolster firm and worker productivity, and improve the resilience and security of needed supplies of resources/inputs.²

Second, increasingly financing—especially public and multilateral financing—is contingent on meeting particular baseline environmental and energy standards.³ This fact is especially true when it comes to financing large infrastructure projects, which often involve development finance institutions (DFIs) like the African Development Bank, Asian Development Bank, World Bank, and/or International Finance Corporation (IFC). Moreover, many of the world's largest private financial institutions are signatories to the Equator Principles, which set out a framework for the assessment and mitigation of environmental and social risks.⁴

Third, an estimated 71%–76% of CO₂ emissions



The average New Delhi resident would live a full nine years longer in the absence of that city's astonishing levels of air pollution.

from final energy use come from cities.⁵ Therefore, as urbanization rates increase across the Global South, especially in sub-Saharan Africa and South Asia, cities will come to play an even more outsized role than they already do in responding to climate change.

While the above factors must be recognized, it must also be recognized that many environmental and energy regulations miss the mark. Not only are many ineffective at achieving the outcomes they seek to deliver, but they also impose high compliance costs on firms. This actively discourages investment and business formation, and it also makes it near impossible for small and medium enterprises to comply as they have much lower capacity than larger firms, which incentivizes continued SME informality. Instead, environmental and energy regulations should be subject to basic cost-benefit analyses to ensure their outcomes justify the costs imposed.

For example, in many countries in the Global South, Environmental and Social Impact Assessments (ESIAs) are often prohibitively expensive and time-consuming for businesses, but the environmental benefits derived from ESIAs are frequently minimal due to myriad gaps and inefficiencies in the overall ESIA process and the general lack of enforcement.⁶ This chapter proposes an alternative approach to ESIAs based on risk management policies. (These risk management policies are also discussed in the “Customs” chapter of this handbook.)

III. VALUES AND GOALS⁷

Effective environmental and energy policies should be motivated by two main values: (1) **efficiency** and (2) **health and safety** of the city residents, businesses, and the broader public.

Table 17. Summary of Values and Goals for Environment and Energy

Value	Meaning of the Value	Measurable Goals
Efficiency	<p>—Efficiency means that environmental and energy policies aim to maximize potential benefits and minimize projected costs. Only when the benefits of a policy outweigh its costs should it be pursued.⁸</p> <p>—Where a policy passes a cost-benefit analysis (CBA) this value then aims for efficiency of resource use.</p>	<p>—The costs of environmental and energy regulations in terms of lost economic activity and compliance costs (for both firms and the city administration) should be tracked over time.</p> <p>—The benefits—in terms of reduced emissions and pollutants, improved health and safety, increased biodiversity, and prevention of environmental degradation—should also be tracked over time.</p>
Public Health and Safety	<p>—This value aims at ensuring environmental and energy practices do not threaten the health or the physical safety of residents within the charter city.</p> <p>—This value mainly deals with toxic/chemical/hazardous materials, waste disposal, and air pollution but should be applied broadly.</p>	<p>—For toxic or chemical materials, the goal should be that all firms in the charter city appropriately handle, store, transport, and dispose of toxic and hazardous materials.</p> <p>—For air pollution the proportion of firms in the charter city that have pollution prevention and emission reduction strategies to reduce the intensity and mass flow of pollution/emission release should be tracked (in countries where the national government does poorly, this metric should aim to go <i>beyond</i> national legislation).</p> <p>—Another air pollution metric to monitor is the proportion of largest polluters in the charter city that have a risk management framework in place that: (a) identifies the aspects which have an impact on the environment and (b) assigns a level of significance to each environmental aspect.</p> <p>—A metric to monitor for wastewater is the proportion of industrial wastewater generated by firms/the city administration that is treated to appropriate environmental standards.</p>

First, **efficiency** should be prioritized in the formulation and implementation of environmental and energy policies in a charter city. This means that all such policies should pass through a cost-benefit analysis (CBA), and only if the estimated environmental benefits are greater than the projected costs in terms of lost economic activity, should the policy be pursued.

When a policy has passed a CBA, the value of

efficiency then also entails the efficient use of resources within the city, particularly when it comes to two integral resources—energy and water. In terms of energy, reviews of the performance of special economic zones, industrial parks, and cities across the Global South suggest that one of the major factors inhibiting business formation and sustained economic growth is the unreliability of power.⁹ In terms of water, production is oftentimes initiated in zones or industrial parks without

adequate information as to whether the local water table can handle such production.¹⁰ Relatedly, even if the water tables can sufficiently bear a given production level, the wastewater that is generated is typically not effectively dealt with. Not only does this result in inefficiency, but it could also lead to potential health problems for charter city residents. These problems around both energy and water are further exacerbated if a charter city focuses on energy- and water-intensive sectors like textiles or other industrial manufacturing. As such, appropriate measures and precautions around efficient energy and water use should be enacted.

A factor that could help improve the efficient use of energy and water is that provision of these resources be privatized. Private provision has been the norm in the vast majority of now-industrialized countries between the nineteenth and mid-twentieth centuries when these countries had lower levels of both income and state capacity, similar to much of the Global South today. For example, private water provision involved England, France, Holland, and the United States all granting clear water rights to water supply companies, and these companies then charging user fees to citizens (clients).¹¹ In contrast, other important environmental concerns—most relevantly for this chapter, air quality and waste disposal—are more pure public goods and will therefore require more attention from charter city policymakers and regulators.

Second, the **health and safety** of the residents and firms in the charter city must be a paramount consideration when formulating environmental and energy policies. Three particular areas that should be of focus when it comes to environmental safety are chemical and toxic materials and their treatment/disposal; waste, including wastewater;

and air pollution. Any significant accidents when it comes to chemical or toxic waste or any reports of respiratory issues related to egregious air pollutants could both decrease overall productivity and reduce the attractiveness of the charter city to potential residents and firms.

The World Bank, UNIDO, and GIZ (Germany's development agency) jointly published *An International Framework for Eco-Industrial Parks* in 2017 that provides specific and internationally recognized goals that can be used to track progress around a multitude of environmental factors within industrial parks, including efficient water and energy use, and public safety around toxic/chemical materials and air quality.¹² While industrial parks are by no means synonymous with charter cities, the standards set out in the above framework are still largely applicable. If the metrics laid out in this policy framework pass a CBA, tracking these metrics over time can provide the charter city administration an understanding of its overall environmental performance and, if need be, notify the administration to intervene in order to remedy any deviations from set standards.

IV. IN PRACTICE

This section provides step-by-step guidance for the establishment of effective environmental and energy policies, as well as the associated city agency tasked with administering and enforcing these policies.

The setup and administration of an environmental and energy regulatory framework are comprised of four main parts: (1) policy and standards, (2) environmental and social impact assessments (ESIAs) vs. risk management, (3) monitoring and evaluation and enforcement, and (4) administering and financing the city agency. This section

sequentially goes over each of the above parts.

1. Policy and Standards

Charter city policymakers do not have to reinvent the wheel when it comes to policy and standards. In fact, one could argue that this space suffers from too *many* policy documents, which merely end up overburdening already time- and resource-constrained projects. Accordingly, as there are already several existing global frameworks that can be leveraged to guide policies, this section elaborates on the most widely recognized and well-respected of these frameworks below. While these frameworks can serve to inform policies in the charter city, *specific* performance standards should always be set taking economic and administrative feasibility, as well as the local context, into consideration.

First, the resource that should be most heavily consulted for more high-level policy formation is the framework published jointly by the World Bank, UNIDO, and GIZ in December 2017: *An International Framework for Eco-Industrial Parks*. This framework builds off of a myriad of past policy handbooks and reports, bringing together and summarizing the key insights and findings in one centralized document. The performance standards laid out in the document are seen as *minimum* standards and are expanded upon in Annex 1 if a particular city, industrial park, or zone desires to go beyond the minimum standards (see p. 60).¹³

Second, more granular and nuanced environmental and energy standards are maintained and provided jointly by the International Finance Corporation (IFC) and World Bank: see the *Environmental*,



For charter cities that want to differentiate themselves by offering a healthy and liveable natural environment, the International Framework for Eco-Industrial Parks (written by the World bank, UNIDO, and GIZ) provides useful standards and best practices.

Health, and Safety (EHS) Guidelines. The World Bank and IFC require that any projects they wholly or jointly finance adhere to the relevant measures or levels of the EHS Guidelines. The EHS Guidelines are formulated to be generally attainable at a reasonable cost using existing technologies. It is stipulated that if the EHS standards diverge from the regulations of the host country, projects will be required to adhere to the more stringent standard. Given that many new city projects will often be at least partly funded by development finance institutions (DFIs) or multilaterals, including the World Bank and IFC, this handbook recommends that the charter city administration utilize these existing EHS Guidelines as a source of inspiration for its

environmental and energy policy standards.

Still, over time charter city administrations should aim to stay up to date on the most recent science when formulating standards in each particular policy area instead of fully relying on other entities. Through this exercise some standards would then be set above and some below the recommended targets. For example, very recent research on air pollution indicates that it negatively impacts not just overall health but also cognition, which in turn negatively affects productivity (see Box 41). Such recent research should inform ultimate decisions when setting standards within the charter city.¹⁴

BOX 41

Air Pollution's Negative Impacts on Cognition

Most research has documented the adverse *health* impacts of air pollution, including mortality.¹⁵ However, several much more recent studies have increasingly demonstrated the negative *cognitive* effects of air pollution. These cognitive effects are often completely missing in the justifications of standards-setting bodies; for example, both the EPA and WHO air quality standards do not mention negative cognitive effects.¹⁶

Key findings from a few of these recent studies clearly illustrate this issue. First, OECD (2019) finds that an increase of PM2.5 concentration of $1\mu\text{g}/\text{m}^3$, which is only about a 10% increase at the sample mean, results in a decrease in that year's real GDP of 0.8%. Importantly, the study finds that 95% of this decrease is caused by declines in output per worker either through increased worker absence or reductions in worker productivity.¹⁷ Second, reducing the average exposure levels (more than one year) of PM10 in aging Chinese populations to the EPA standard increases verbal test scores from the median to the 63rd percentile and improves math test scores to the 58th percentile.¹⁸ Third, exposure to CO and other volatile organic compounds at conventional office building levels is correlated with reduced cognitive performance when compared to exposure levels in green office buildings.¹⁹ Several other well-identified papers show air pollution causes more mistakes in chess players, higher incidences of Alzheimer's, poorer stock market performance, and less complex verbal performance among politicians, among other negative cognitive effects.²⁰

This new line of research is important for several reasons. First, data from the World Bank finds that about half of the world's population (3.8 billion people) is exposed to PM2.5 levels of more than $45\mu\text{g}/\text{m}^3$ (mean annual exposure).²¹ For context, the WHO's target for PM2.5, in terms of average annual exposure levels, is $10\mu\text{g}/\text{m}^3$ (over four times less).²² Second, because cognition is a key factor in overall productivity, innovation, and human capital, impairing cognition has significant economic costs, including lower rates of overall economic growth. Third, despite the mounting evidence, many EPA and WHO scientists still find these arguments controversial because, they say, it's difficult to prove causation due largely to PM2.5

involving many different kinds of pollution (everything from toxic soot to tiny droplets of water condensed around a sulfate ion), among other reasons.²³ Not only is the evidence cited well-identified and quite statistically convincing, but given the sheer economic costs involved, this excuse—causation is tricky to pin down—is not a reasonable rationale for inaction.



Many recent studies have shown the significant adverse effects of air pollution on various cognitive abilities.

In addition to the most up-to-date science, policies and standards—whether for energy use, water, waste, chemical/toxic materials, air quality, and other realms—should be formulated with an eye to pragmatism and viability, as well. Even if a given standard is optimal from an environmental science standpoint, the standard is useless if it's impossible for firms and residents to actually implement or for regulators to actually enforce. This point further emphasizes the importance of using credible cost-benefit analyses in guiding policy development. (See Values and Goals above.) One way to improve overall viability is to, wherever possible, implement interim targets with

associated timelines that allow for a phased approach in reaching the ultimate target. Such a phased approach recognizes that there are very real economic costs in making a transition toward full compliance with new standards. For example, the WHO's air pollution guidelines include *three* interim targets before reaching the ultimate recommended standard.²⁴

Lastly, another consideration from international frameworks that should be taken into account is international treaty obligations. The World Bank, UNIDO, and GIZ (2017) framework lays out the international environmental standards and

protocols to which the host country may be a signatory (p. 33).²⁵ Given that charter cities are not sovereign and thus are party to their host country's international treaties, charter city administrations should verify which of these international standards apply and work with the relevant host country authorities to remain in compliance.

2. *Environmental and Social Impact Assessments (ESIAs) vs. Risk Management*

ESIAs typically extend across most phases of infrastructure and construction projects: the pre-construction and planning phase (site selection, financing, relocation of pre-existing community members, etc.), the construction phase (land preparation, site clearing, physical build-out, etc.), and the operational phase (maintenance and ongoing project activities). In essence, ESIAs evaluate the environmental and human risks to particular projects and suggest an action plan that can mitigate these risks. Broadly, charter cities will face two main scenarios when it comes to ESIAs: (1) the new city project is funded largely or partly by development finance institutions (DFIs), and (2) the new city project is *not* funded by DFIs.

—**DFI funded projects.** Many DFIs provide their own ESIA requirements that any project the DFI works with must meet. In these instances, the charter city may have little choice but to adhere to the relevant ESIA requirements laid out by DFI guidelines (links provided in the endnote at the end of the chapter).²⁶

The mitigation plan that is typically part of, or results from, the ESIA includes the following five main elements among others: (1) establishing how environmental and social factors are to be measured, (2)

clearly defining duties and responsibilities across project stakeholders, implementation timelines, and specific budgets, (3) outlining the engagement plan with locally displaced or affected communities, (4) elaborating on any required capacity building necessary in order to effectively implement the mitigation plan, and (5) enumerating monitoring and evaluation methods, as well as compliance with any applicable statutory requirements.

—**Non-DFI funded projects.** For projects and buildouts *not* involving DFIs or multilateral funding with their own prescribed ESIA requirements, the charter city administration will need to formulate its own policy to appropriately manage environmental and social risks.

This handbook focuses on this second scenario—non-DFI funded projects—as it allows somewhat more flexibility in approaching how to both enable rapid city growth at the same time as managing environmental and social risks. In this scenario, this handbook emphasizes the need for charter city officials to avoid the knowledge problem, which was discussed in more detail in the chapter “Tax Policy and Administration.” In short, regulators do not possess perfect *ex ante* knowledge. It follows that the preferred course of action for charter city agencies should be to *observe* a problem first and *then* work to fix it. An agency should not try to fix a problem that it doesn't know will exist.

Many ESIA processes violate this rule of thumb, often falling victim to the knowledge problem. This is especially true in low- and middle-income countries with a limited administrative capacity to effectively carry out ESIAs. Even in high-income

countries, government agencies often have trouble completing ESIAs in a manner that (1) is low-cost and (2) does not overly delay much-needed projects, and (3) actually achieves their stated

environmental objectives.²⁷ For example, see Box 42 on the misguided decision to subject 5G installations across the US to environmental review.

BOX 42

ESIA Problems: Subjecting 5G Broadband Rollout to Environmental Review in the US

Over time some ESIA procedures naturally become outdated as a result of technological innovations and other changes. The United States provides an illustrative case with the rollout of the small cell networks required for 5G wireless broadband.

Prior generations of broadband needed large installations of very tall cell towers—rightly subject to environmental review. Conversely, 5G rollout only needs relatively tiny cells about the size of a shoebox installed onto already existing buildings. What's more, an effective rollout of 5G broadband would call for *hundreds of thousands* of these small cells in the span of a few years.

Despite the minimal footprint of new 5G installations, they were still subject to environmental review, significantly increasing costs and delaying timelines for no discernible environmental benefits simply because of the antiquated rules in place.



The rollout of compact, small, and environmentally benign 5G broadband units was mistakenly subject to environmental review in the US, significantly increasing both the costs and time of the rollout.

A review of many Ethiopian industrial parks demonstrates that despite costly and time-consuming ESIA, many reviews still fail to achieve their desired environmental benefits. Below are some of the most common challenges this report found with ESIA:²⁸

- The final ESIA report is **delayed** by the consultants, oftentimes meaning the project start date occurs *before* the ESIA report is finalized.
- ESIA consultants **lack competence and capacity**.
- Once the ESIA report is completed, its **approval is delayed** by the appropriate agency.
- The local city or municipal administration **fails to cooperate** effectively and/or to provide required data in a timely manner.
- Project affected people (PAPs) are **not compensated in a timely manner**.
- The mitigation plan that results from the ESIA is not implemented or enforced, such that much of the **suggested mitigation activities do not take place**.
- There is a **lack of capacity** when it comes to practical expertise on appropriate mitigation techniques and technologies.

The above findings broadly suggest that ESIA are very resource-intensive processes that divert both firm and governmental resources away from productive activities and into compliance efforts, often with little or no environmental benefit (thereby failing to pass a CBA). Given this ineffectiveness, this handbook suggests an alternative approach to managing environmental and social risks in charter cities.

This alternative approach takes inspiration from

recommended risk management policies commonly used by customs agencies around the world to effectively manage the risks associated with cross-border trade. As such, let's refer to this ESIA alternative as the risk management approach. In particular, this approach takes from two key risk management policies used in customs:²⁹

—**Post-clearance audits (PCAs)**. PCAs refer to when customs officials verify that customs rules and other applicable legislation and regulations have been complied with by auditing the books and accounting records of traders *after* the goods have been released—this audit typically occurs at the trader's physical premises. PCAs are seen by experts to be one of the most effective tools available to customs agencies to facilitate trade, as it permits immediate release of imported goods while ensuring risks are managed through subsequent audits and controls.³⁰ Oftentimes PCAs may require alterations to national policies or legal frameworks.

—**Authorized operators (AOs)**. AOs refer to “special or preferential customs treatment provided to reliable traders.”³¹ The concept is similar to how the heightened scrutiny involved in becoming a NEXUS member allows these pre-screened travelers expedited processing when entering the United States or Canada.³² Charter city customs branches should work with national authorities to allow AOs streamlined formalities for imports, exports, and transit transactions. Regardless of which AO benefits are provided, these benefits should be clearly listed and publicly available on the customs website. In addition to the benefits, the

selection criteria for AOs should be published, as well as procedures to attain AO status and the time by which a decision on AO status will be rendered.

It should be noted that PCA and AO programs can be seen as complementary. For example, while PCAs can uncover high-risk traders, they can also pinpoint low-risk traders that can then be funneled toward AO status and the associated streamlined, cost-saving procedures that AOs are afforded.

These two customs concepts—post-clearance audits and authorized operators—can both be applied to the management of environmental and social risks. As in customs, the ultimate aim of environmental risk management should be to focus control efforts on high-risk firms, projects, and activities in the charter city while minimizing and expediting control efforts on other low-risk entities and activities.

Firms should be able to establish themselves as authorized environmental operators (AEOs) by demonstrating reliable environmental stewardship for a specified number of past projects, activities, or operations. (These past projects shouldn't necessarily be required to have taken place within the charter city.) Charter cities can set other specific criteria around selection for AEO status as they deem fit. If firms demonstrate past reliability and prove themselves to be low-risk, AEO status—as with AO status for customs—should allow the firm to more quickly and at lower cost commence construction, begin infrastructure buildouts, or start whatever other activities the firm undertakes without the need to first go through full ESIA. In addition a firm's AEO status should also trigger post- or mid-project audits (PMPA), analogous to PCAs in customs. And these PMPAs would be *in lieu* of ESIA, normally required to be completed *before* any building or project begins.



Charter cities should focus ESIA efforts on high-risk firms, while allowing low-risk firms to quickly commence operations. This takes from the best practices of customs agencies, where border control efforts are targeted at high-risk entities, while expediting the border crossing of low-risk entities.

This risk management approach has six main benefits over ESIA:

—**Avoids the knowledge problem.** The knowledge problem inherent in ESIA is avoided. That is, the typical ESIA-based model doesn't tend to know *ex ante* which firms are low-risk and which are high-risk. Therefore, it too often lumps both low- and high-risk firms and activities together and subjects them to similarly intensive compliance efforts. In contrast, the risk management approach attempts to solve this knowledge problem by separating out low-risk firms through established selection criteria and granting these firms AEO status.

—**High-risk firms are still scrutinized.** The risk management approach still subjects high-risk firms to the type of stringent controls involved in ESIA.

—**Rapid city growth needs rapid infrastructure growth.** Because the risk management approach allows more firms to start construction and other activities more quickly, this will allow for infrastructure to be built out at a pace that can better accommodate a rapidly growing charter city.

—**In the event of ineffectiveness, can revert to the status quo.** The risk management approach should still be subject to the values and goals of this chapter: (1) efficiency as determined through cost-benefit analyses and (2) protecting public health and safety. So if this risk management approach fails to adequately safeguard environmental and

social risks, the charter city can have a mechanism to return to a more ESIA-based system.

—**Gets incentives right.** The AO program used by customs agencies has already demonstrated that firms demand the benefits that come with AO status. These firms will also go to great lengths to remain in compliance with the conditions of their AO status because being subjected to significantly slower cross-border trade affects their bottom lines and makes them less competitive. Similarly, losing AEO status by, for example, failing a PMPA would negatively impact a firm's bottom line and overall competitiveness, as it would then be subjected to more onerous environmental screening processes.

—**Demonstrated political buy-in.** As noted above, the AO and PCA programs are being implemented by customs agencies around the world. This is because these programs are part of the Trade Facilitation Agreement (TFA) that entered into force in 2017 after enough WTO member states ratified the TFA. The fact that these programs are already widely adopted by countries around the globe implies that this proposed risk management approach to mitigating environmental and social risk should have fairly broad political support. Indeed, it would be bizarre for a given country to allow this risk management approach for cross-border trade on the one hand—where illicit drug smuggling, counterfeiting, human trafficking, or arms dealing are potential risks—but on the other to *not* allow a similar approach to managing environmental

risks.

3. Monitoring and Evaluation and Enforcement

Several organizations have conceived of tools and metrics that should be used by the charter city administration to inform its M&E, enforcement, and post- or mid-project audit (PMPA) activities. The three most useful are highlighted below.

First, the World Bank and partners have come up

with a tool for M&E around environmental and climate-related issues called Climate Action for Urban Sustainability (CURB), which is a scenario planning tool that cities can use to examine various options of minimizing environmental impact without depleting municipal budgets. CURB is an Excel-based tool and can be used offline, and it is free of charge. World Bank experts can be contacted for technical support, and it was designed by a cross-disciplinary team of engineers, economists, and urban planners.³³



Many cities across the Global South lack capacity when it comes to environmental enforcement and waste management. The result is often unhealthy and unlivable cities.

Second, the Global Green Growth Institute (GGGI) provides tools and indicators that provide similar functions to CURB. GGGI also usefully links to particular projects it has helped to implement environmental M&E systems.³⁴

Third, Energy for Growth's Reliability-Adjusted Cost of Electricity (RACE) metric should be relied upon to measure energy poverty over time. Typically, energy poverty is measured simply by how many households have access to electricity (household access rate). This metric, while useful,

fails to capture the many frequent power outages that can result in significant additional costs for residents and businesses in areas with low power reliability, including much of the Global South. Not to mention, power reliability is one of the most important factors examined by businesses and firms when deciding whether to locate in a particular jurisdiction.³⁵ RACE “estimates the actual costs faced by private firms by capturing both tariffs [user fees] from the grid plus the additional costs borne by backup generators when grid power is unavailable.”³⁶ RACE can therefore not only be used to gauge the level of energy poverty, but it is also an insightful barometer of how dysfunctional the electricity system is as a whole.

4. *Administering and Financing the Regulatory Agency*

Lastly, ensuring adequate financing for the city agency (or agencies) dedicated to environmental and energy-related matters is essential to effectively carry out its functions over the long term. The aim should be to make this agency self-financing as much as possible. Yet it should be made clear that this goal of self-financing should *not* factor into setting the actual level of user fees, carbon taxes, congestion pricing, etc. These fees and taxes should all be set to maximize economic efficiency.

4.1 *Public-Private Partnerships*

Public-private partnerships (PPPs) should be used where possible. Historically, the sectors of electricity, infrastructure, water and sanitation, and others in most now-industrialized countries were heavily provided (and only lightly self-regulated) by private actors.³⁷ While this did come with some environmental consequences,

privatization was predominantly favored because the weak state capacity and ubiquitous corruption in these countries until relatively recently meant governments were unable to provide, price, and regulate these services as effectively as private actors. And yet, many governments across the Global South today—often with even weaker state capacity—attempt to publicly provide and regulate a myriad of complex and very costly goods and services.³⁸ Such state capacity is typically even *weaker* at the city level. Just as now-industrialized countries in the Global North largely avoided this premature load bearing,³⁹ charter city administrations should avoid this mistake as well, especially at the outset. Instead, they should off-load these provision and regulatory duties as much as possible via PPPs or private firms, at least until the city administration has grown sufficient capacity to perform these functions effectively. For more details on designing effective PPPs at the city level, see the World Bank's 2019 *Better Cities, Better World: A Handbook on Local Governments Self-Assessments* (p. 206).

4.2 *User Fees*

Part and parcel to increasing private participation and to the city agency being able to finance most, if not all, of its operations is the implementation of user fees. User fees have three main benefits. First, they increase operational autonomy of the service provider, as the provider derives less of its revenues from city policymakers or fiscal transfers to maintain service quality and, instead, relies more on the users themselves. Second, user fees bolster both user power and provider responsiveness; that is, without obtaining its revenues from users, providers have little incentive to respond to user needs. Third, user fees result in greater accountability from the charter city administration because an egregiously unfair change in charges,

especially if not tied to improved services, will elicit a rapid response from users. If warranted, the city administration can then quickly intervene.⁴⁰ These three benefits combine to improve the provision, pricing, and regulation of services like electricity, water and sanitation, and various other types of infrastructure development.

4.3 Carbon Tax and Congestion Pricing

Both carbon taxes and congestion pricing are discussed in the chapter “Tax Policy and Administration” of this handbook, and so more details on these taxes can be gleaned in that chapter. Before briefly reviewing their benefits here, it should be noted that these two taxes are likely to be more effective in later phases of a charter city development for two main reasons. First, even a modest carbon tax applied in the first phase of a charter city when firms are nascent and individual incomes are still low may be infeasible, and at the same time, setting a carbon tax at a level affordable to low-income individuals and SMEs is going to have very negligible impacts on emissions, if any. Second, both carbon taxes and congestion pricing schemes require a certain threshold level of administrative capacity in order to implement effectively. This capacity (as mentioned in subsection 4.1) may not be sufficient at the beginning of a charter city development. Still, it's unnecessary to wait too long; for example, Singapore was the first city in the world to implement congestion pricing and did so in 1975 when its per capita income was about US\$2,500.

—**Carbon tax.** One method to finance the city agency dedicated to the environment and/or energy is through a carbon tax. Perhaps the only policy position that the vast majority of economists agree on is that a carbon tax is the most cost-effective tool

available to decrease carbon emissions rapidly and at scale. By making carbon-intensive products and energy sources more expensive, it leverages a powerful price signal so that many buyers shift their consumption toward lower-carbon options like, for example, renewables (wind, solar, nuclear energy).⁴¹ Moreover, the carbon tax can be increased over time such that stated goals around emissions are attained, technological innovation is encouraged, and low-carbon goods and services are more quickly diffused. Some of the revenue from this tax should finance the city agency's operations, while some—especially at higher carbon tax levels—should be rebated to less well-off residents to offset the potential increases in energy prices.

Importantly, this simple carbon tax can largely replace the need for many other types of overly burdensome carbon regulations. And because price signals are far more efficient than various regulations, this policy is much more conducive to economic growth and also offers regulatory certainty to firms. For a good example of carbon tax implementation, charter city administrations should examine the Canadian province of British Columbia, which implemented a carbon tax in 2008 at US\$10 CDN per ton of CO₂. As recommended above, this has been raised over time and in April 2019 was at US\$40 CDN per ton. This model has been replicated around the world, such that by 2019 more than 70 jurisdictions responsible for an estimated 20% of global greenhouse gas emissions have implemented similar carbon pricing schemes.⁴²

—**Congestion Pricing:** Another method that should be used to finance the city agency is congestion pricing. Traffic congestion results in longer and more costly urban travel commutes, a more fragmented labor market, and large quantities of air pollution with significantly negative health and cognitive implications (see Box 40 above). Just as with carbon, these negative externalities should be priced. As congestion pricing is discussed in further detail in both the chapters, “Land Use Regulation and Building Regulation” and “Tax Policy and Administration,” it won't be repeated here. Suffice it to say charter city administrations should look to London, Stockholm, and Singapore among others, for successful implementations of congestion pricing schemes.⁴³

4.4 External Funding: Multilaterals and Donors

While self-financing should be prioritized by the city agency by using some of the above-recommended methods, it's also important to highlight external sources of funding. Because contemporary capital markets often fail to provide municipalities with sufficient and affordable financing for green urban infrastructure projects,

donors and multilateral entities have tried to supply funding to fill this gap. Several organizations and funds should be mentioned here. First, the GGGI works to help governments foster a regulatory environment more conducive to green investments. Second, the world's largest green financing initiative is the Green Climate Fund (GCF), created by the Paris Agreement on Climate Change. High-income countries are committed to providing a total of US\$100 billion per year to the GCF earmarked for green financing to low-income countries up to 2025. After 2025 this amount will be set higher. Third, the Global Environment Facility (GEF) is administered by the World Bank. Fourth, the City Climate Finance Gap Fund is a 100 million fund implemented by the European Investment Bank and the World Bank. The Gap Fund supports city governments that face obstacles to accessing finance for climate-smart urban projects.⁴⁴ Given these external funding sources will likely only increase over the next several decades, charter city administrations should attempt to secure green financing from these multilaterals and donor funds for such public investments as electric or low-emissions public transit, solar electric projects, energy-efficient buildings, low-energy street lights, and environmentally friendly water conservation projects, among others.

¹ Air Quality Life Index (2020). “India Fact Sheet.” Energy Policy Institute at the University of Chicago (EPIC): Chicago. Available at: <https://aqli.epic.uchicago.edu/reports/>.

² UNIDO (2017). “Implementation Handbook for Eco-Industrial Parks.” United Nations Industrial Development Organization: Vienna. Available at: <https://www.unido.org/our-focus/safeguarding-environment-resource-efficient-and-low-carbon-industrial-production/eco-industrial-parks>.

³ See, for example, the World Bank's Environmental and Social Standards 1 (ESS1) that overviews the assessment that projects it finances must go through. ESS1 Assessment and Management of Environmental and Social Risks and Impacts is available here: <https://www.worldbank.org/en/projects-operations/environmental-and-social-framework/brief/environmental-and-social-standards>.

⁴ For further details on the Equator Principles see here: <https://equator-principles.com/about/>.

⁵ IPCC (2014). “IPCC Fifth Assessment Report.” Intergovernmental Panel on Climate Change: Geneva. Available at: <https://www.ipcc.ch/report/ar5/syr/>.

⁶ For some common deficiencies of ESIA's see IPDC (2019). “Industrial Parks Development: Key Learnings.” Industrial Park

Development Corporation: Addis Ababa: p. 195. Available at: <https://bit.ly/2ZvMZUe>.

⁷ Note that several performance metrics around the value of Public Health & Safety are taken from World Bank, UNIDO, GIZ (2017). "An International Framework for Eco-Industrial Parks." World Bank Group: Washington, DC. Available at: <https://openknowledge.worldbank.org/handle/10986/29110>. See pp. 44-45 for the framework's comprehensive environmental performance standards. In addition to this framework, charter city projects should also see the World Bank's ESS1 guidelines here: <https://www.worldbank.org/en/projects-operations/environmental-and-social-framework/brief/environmental-and-social-standards>.

⁸ For a useful guide to conducting cost-benefit analyses (CBAs) when it comes to environmental policy, see GGGI (2018). "Green Growth Assessment & Extended Cost Benefit Analysis: A Handbook for Policy and Investment Decision Makers." GGGI: Seoul. Available here: <https://www.greengrowthknowledge.org/research/green-growth-assessment-extended-cost-benefit-analysis-handbook-policy-and-investment>. For another useful example of a CBA conducted for the city of Kigali, Rwanda see Gouldson, A. et al. (2018). "The Economics of Low Carbon Cities." International Growth Centre: Oxford. Available at: <https://www.theigc.org/project/the-economics-of-low-carbon-cities-promoting-energy-access-and-energy-efficiency-in-urban-africa/>. "The report gives prioritized lists of the most cost- and carbon-effective measures that could realistically be promoted across the housing, commercial buildings, transport, and waste sectors...."

⁹ Interview, Robbie Marwick. Farole, T. (2011). "Special Economic Zones in Africa: Comparing Performance and Learning from Global Experience." World Bank Group: Washington, DC: p. 129. Available at: <https://openknowledge.worldbank.org/handle/10986/2268>. The best metrics and indicators around energy use come from Energy for Growth and focus on cost, reliability, and scale of energy for industry, commerce, and other productive uses. See here: <https://www.energyforgrowth.org/issue/metrics-goals/>.

¹⁰ Interview, Ade Okuwoga.

¹¹ World Bank (2004). *World Development Report 2004: Making Services Work for the Poor*. World Bank Group: Washington, D.C. Available at: <https://openknowledge.worldbank.org/handle/10986/5986>. pp. 164-176. Note that, for energy, in order for privatization to lead to efficient outcomes both competition and economies of scale are typically required. These conditions are unlikely at low population levels early on in a charter city development, so an arrangement with the host country that allows charter city energy providers to sell power to citizens/firms of the host country would be advisable. Although, many countries of the Global South have a nationalized energy provider, and may therefore likely be resistant to undermining their own monopoly by permitting another energy provider in the charter city. If a host country does *not* agree to allowing a dedicated city energy provider, then at the very least strict service delivery targets that the national energy provider must meet around energy generation, transmission, and distribution should be explicitly stated in the concession agreement.

¹² World Bank, UNIDO, GIZ (2017).

¹³ World Bank, UNIDO, GIZ (2017).

¹⁴ Note that the EHS Guidelines use the WHO's standards on air quality available here: <https://www.who.int/airpollution/guidelines/en/>.

¹⁵ See, for example, Our World In Data here <https://ourworldindata.org/air-pollution>.

¹⁶ For WHO standards see <https://www.who.int/airpollution/guidelines/en/>. For EPA standards see <https://www.epa.gov/naaqs/particulate-matter-pm-air-quality-standards>.

¹⁷ OECD (2019b). "The Economic Cost of Air Pollution: Evidence from Europe." OECD: Paris. Available at: [http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=ECO/WKP\(2019\)54&docLanguage=En](http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=ECO/WKP(2019)54&docLanguage=En).

¹⁸ Zhang, X. et al. (2018). "The Impact of Exposure to Air Pollution on Cognitive Performance." PNAS 115(37): pp. 9193-9197. Available at: <https://www.pnas.org/content/115/37/9193>.

¹⁹ Allen, J. et al. (2016). "Associations of Cognitive Function Scores with Carbon Dioxide, Ventilation, and Volatile Organic Compound Exposures in Office Workers: A Controlled Exposure Study of Green and Conventional Office Environments." *Environmental Health Perspectives* 124(6). pp.805-812.

²⁰ For links to many studies on the negative cognitive effects of air pollution see <https://patrickcollison.com/pollution>.

²¹ See https://data.worldbank.org/indicator/en.atm.pm25.mc.m3?most_recent_value_desc=true.

²² In contrast, the EPA has less strict air quality standards than the WHO. For example, the EPA's primary standards for PM2.5 are 12 $\mu\text{g}/\text{m}^3$ (annual average exposure levels), and 15 $\mu\text{g}/\text{m}^3$ for secondary PM2.5. See here: <https://www.epa.gov/pm-pollution/national-ambient-air-quality-standards-naaqs-pm>.

²³ Interview, Brian Mannix.

²⁴ For WHO standards see <https://www.who.int/airpollution/guidelines/en/>.

²⁵ Stockholm Convention on Persistent Organic Pollutants; Basel Convention on the Control of Transboundary Movements of Hazardous Wasters; Vienna Convention for the Protection of the Ozone Layer; Emission Thresholds from the World Health Organization; International Convention for the Prevention of Pollution from Ships; Montreal Protocol on Substances that Deplete the Ozone Layer; Economic Commission for Europe (ECE) Water Convention on the Protection and Use of Transboundary Water Courses and Internal Lakes; Ramsar Convention of Wetlands; FAO International Code of Conduct on the Distribution and Use of Pesticides;

WHO Recommended Classifications of Pesticides by Hazard Class Ia/Ib; and Espoo Convention on Environment Impact Assessment in the Transboundary Context.

²⁶ For the World Bank's *Environmental and Social Framework (ESF)* see <https://www.worldbank.org/en/projects-operations/environmental-and-social-framework> (especially ESS1). For the African Development Bank's *Environmental and Social Assessment Procedures (ESAP)* see <https://www.afdb.org/en/news-and-events/afdb-launches-revised-version-of-its-environmental-and-social-assessment-procedures-for-2015-15013>. For the Asian Development Bank's *Environmental and Social Safeguards* see <https://www.adb.org/site/safeguards/main>. For the European Investment Bank's *Environmental and Social Standards* see <https://www.eib.org/en/publications/environmental-and-social-standards>.

²⁷ Charles Hughes, 2018. "Streamlining Infrastructure Environmental Review." *Issue Brief*. Manhattan Institute. June 18, 2018. Available at: <https://www.manhattan-institute.org/html/streamlining-infrastructure-environmental-review-11301.html>.

²⁸ Industrial Parks Development Corporation, 2019. "Industrial Parks Development: Key Learnings." IPDC: Addis Ababa, p. 195. Available at: <https://bit.ly/2ZvMZUe>.

²⁹ These are copied from the "Customs" chapter of this handbook.

³⁰ OECD (2018). "Trade Facilitation and the Global Economy." OECD: Paris: p. 40. Available at: <https://www.oecd.org/publications/trade-facilitation-and-the-global-economy-9789264277571-en.htm>.

³¹ For more on AOs see <https://www.tfafacility.org/article-7#:~:text=7.4%20Members%20are%20encouraged%20to,of%20the%20legitimate%20objectives%20pursued>.

³² See <https://www.cbp.gov/travel/trusted-traveler-programs/nexus>.

³³ For more details on the CURB tool see <https://www.worldbank.org/en/topic/urbandevelopment/brief/the-curb-tool-climate-action-for-urban-sustainability>.

³⁴ For more details on GGGI's tools and indicators see <https://gggi.org/global-program/tools-and-indicators/>.

³⁵ Farole, T. (2011).

³⁶ For more details on Energy for Growth's RACE metric see <https://www.energyforgrowth.org/report/the-reliability-adjusted-cost-of-electricity-race-a-new-metric-for-the-fight-against-energy-poverty/>.

³⁷ For example, the early provision and regulation of water and sanitation services in England, the Netherlands, the United States, and France were carried out by the private sector until well into the 20th century (World Bank, 2004: p. 167).

³⁸ World Bank (2004): pp. 165-68.

³⁹ The term 'premature load bearing' implies "putting too much weight on a structure before it is able to support it," which, "not only does not accomplish the task at hand, it sets progress back," (p. 54) in Andrew, M., Pritchett, P., & Woolcock, M. (2017). *Building State Capability: Evidence, Analysis, Action*. Oxford University Press: Oxford.

⁴⁰ World Bank (2004): p. 170.

⁴¹ See this open letter by dozens of Nobel Prize winning economists, former Fed chairs, former Treasury secretaries, and others all advocating for a carbon tax: <https://www.wsj.com/articles/economists-statement-on-carbon-dividends-11547682910>.

⁴² See <https://www2.gov.bc.ca/gov/content/environment/climate-change/planning-and-action/carbon-tax>.

⁴³ Emily Provonsha and Nickolas Sifuentes, "Road Pricing in London, Stockholm, and Singapore: A Way Forward for New York City," Tri-State Transportation Campaign, 2017, <http://www.tstc.org/reports/A-WAY-FORWARD-FOR-NEW-YORK-CITY-2017.pdf>.

⁴⁴ For the GGGI see <https://gggi.org/global-program/investment-services/>. For the GCF see <https://www.greenclimate.fund/sectors>. For the GEF see <https://www.thegef.org/about/funding>. For the Gap Fund see <https://www.worldbank.org/en/news/press-release/2020/09/23/city-climate-finance-gap-fund-launches-to-support-climate-smart-urban-development>.

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