

INTRODUCTION TO CHARTER CITIES

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Executive Summary

We are living through the final period of urbanization in human history, with approximately 78 million new residents being added to cities annually. These new urban residents are concentrated in countries in the Global South, which often lack the critical infrastructure and effective governance needed to accommodate rapid urban expansion. The choices made today about how new urban spaces are constructed and governed will have significant economic and social impacts for generations to come. As such, it is crucial to get governance “right” *before* new urban spaces are filled, after which point change becomes not only more difficult, but also much more costly.

Charter cities—new cities with new rules—are one of the best tools to ensure urbanization brings about rapid and sustained economic development. Governance is a key determinant of economic performance. By improving governance through deep regulatory and administrative reforms, charter cities can create a competitive business environment that enables the entrepreneurship and investment needed to spur sustained economic growth.

Building a new city on greenfield land allows charter cities to establish a streamlined and high-capacity administration largely autonomous from the pre-existing political institutions of the host country. Such high capacity will in turn allow the charter city administration to provide both the rule of law and the public goods necessary to support well-functioning markets—differentiating it from the low state capacity that pervades the Global South. Through this blank slate approach to governance reform, charter cities can overcome the political barriers that commonly stifle reform efforts in pre-existing jurisdictions.

The purpose of this paper is to provide an introduction to charter cities, as well as to outline how to begin to think about their implementation. The paper begins by giving an overview of the challenges that charter cities can help solve, namely urbanization and governance. Next, it presents the historical context that motivates the work of the Charter Cities Institute. It then provides details on existing new city developments that the Charter Cities Institute has been working with directly. Lastly, it outlines six key aspects of a charter city: the city’s governance structure, policies, site selection, urban planning, anchor tenant selection, and steps to mitigate the risk of expropriation.

Charter cities are a powerful tool for development whose time has come. We hope that this comprehensive introduction will spark a revitalized interest in charter cities within the international development community and help bridge the gap between this community and new city developers. The Charter Cities Institute stands ready to continue building the ecosystem for charter cities and to provide technical assistance to charter city projects.

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Introduction

We are living through the final period of urbanization in human history. While urbanization has significantly slowed in the Global North, urbanization continues apace in much of the Global South.¹ The new urban residents concentrated overwhelmingly in the Global South often lack effective governance and infrastructure. The choices made about how new urban spaces are constructed and governed will have ramifications for generations to come. As such, it is essential to “get things right” now, before such new urban spaces are filled and change becomes significantly more difficult. We believe charter cities—new cities with a special jurisdiction to create a new governance system focused on enabling economic development—are an important tool in ensuring those participating in the final wave of urbanization have the opportunity to improve their lives and the lives of their children.

While there are upsides to such rapid urbanization—such as more jobs, higher incomes, heightened productivity, and increased economic growth—there are also potential downsides that include increased congestion and crime, the spread of contagious disease, and the proliferation of slums. As a result, supporting the advantages of urbanization while working to minimize its challenges is among the most pressing public policy imperatives of the 21st century. Building charter cities is one of the most promising policy tools available to ensure that urbanization brings about economic development, rather than continued poverty.

Governance is the most important determinant of long-term economic outcomes.² Unfortunately, poor governance has led to persistent poverty in much of the Global South.³ In many countries, the cost in fees, time, and bribes to register a business or secure permits functionally prohibits entrepreneurship in the formal sector. For example, according to the World Bank Ease of Doing Business Index, it takes on average 36 percent of per capita income just to legally register a business in sub-Saharan Africa.⁴

While economists largely agree on the importance of institutions for economic growth, reforms that change long-run growth rates are rarely implemented for public choice reasons.⁵ⁱ In existing jurisdictions, would-be improvements in governance are too often stifled by entrenched interests and ineffective bureaucracies.⁶ By creating a special jurisdiction in a new city built on greenfield land, charter cities avoid these public choice problems that often stymie reforms in existing jurisdictions without radically changing the rents enjoyed by elites in existing cities. Greenfield sites therefore allow for deeper institutional change than would otherwise be politically feasible.

A city is the optimal unit for implementing reforms that can generate sustained economic growth. Villages are too small to lead to meaningful impact, and nationwide reforms can be politically difficult to adopt and eliminate choice for individuals.⁷ Cities, on the other hand, are large enough to fully exploit the benefits from economies of scale and from density. And while a charter city would initially be small, initial investments from large employers can create a critical mass of people to justify additional investment in and migration to the charter city, creating a virtuous cycle of growth.

Singapore, Shenzhen, Hong Kong, and Dubai demonstrate how it is possible for cities to transform poverty-stricken places into world-class cities within two or three generations. Charter cities learn from these successes. Successful charter cities will generate tremendous amounts of wealth and lift millions of people out of poverty over the coming decades.

i Public choice theory applies economic theory to political behavior. It models public officials as rationally self-interested actors, rather than as purely benevolent functionaries. For additional information, see: <https://www.econlib.org/library/Enc/PublicChoice.html>.



*Hong Kong in the mid-1800s.*⁸



*Hong Kong in 2017.*⁹

The defining feature of charter cities is the special jurisdiction for improving governance. Ideally, the host country delegates all authority to the city government except for criminal law, international treaties, and the constitution, allowing the charter city to start with a legal and administrative blank slate. The charter city would still be bound, for example, to the terms of any international investment treaties signed by the host country, and would be prohibited from adopting any laws in violation of the constitutional rights of its residents. In practice, the decentralization of certain authority might be politically sensitive and will ultimately depend on the country.

The legal and administrative blank slate allows the charter city to develop a governance system from scratch. Benchmarking to global best practices enables the charter city to quickly become an excellent destination not just for foreign and domestic investment, but also for the average resident to more easily start a business or find employment. The legal framework includes simple, low-cost business registration, tax administration, labor law, and dispute resolution, among others.ⁱⁱ

Complementary to on-paper regulatory reform is the creation of an effective administrative structure. Developing administrative capacityⁱⁱⁱ is a key component of economic development. Administrative capacity refers to the ability of the government to effectively raise revenue, implement policies, and provide public goods that work to support the functioning of markets.¹⁰ Without effective administration, the best laws remain just words on paper. The literature on “pockets of effectiveness” in public-sector bureaucracies in low-income countries has shown that even within a suboptimal institutional context, effective governance is achievable.¹¹

Nobel laureate Paul Romer first introduced the concept of charter cities in a 2009 TED Talk.¹² In Romer’s model, a charter city would be administered by a third-party “guarantor” country that is already considered well-governed, like Canada or Denmark. Romer worked on two charter city projects in Madagascar and Honduras that ultimately were never developed, although Honduras’ charter city law is still in place.¹³

The Charter Cities Institute, founded in 2017, has led a revival of interest in charter cities. While we support the core of Romer’s model, a new city with new rules, we reject the guarantor country approach as neither desirable nor politically feasible. The Charter Cities Institute instead advocates a model whereby a new city developer enters into a public-private partnership with the host country. The developer works with the host country to develop a special jurisdiction, which remains under the sovereignty of the host country.

The Charter Cities Institute takes an incremental approach. The first generation of charter cities will probably not have the full range of desirable authority. Nevertheless, they can serve as proof of concept to develop the skills, financial instruments, knowledge, and social acceptance necessary for the second generation of cities.

Poor governance and rising urbanization with only limited economic growth threatens to undermine the future

ii The Charter Cities Institute has developed a set of Reference Guides for charter city developers and administrators that includes a Governance Handbook with a step-by-step guide on establishing the necessary administrative structures and implementing policies for each necessary area of the legal framework: <https://www.chartercitiesinstitute.org/category/reference-guides>.

iii We use the term “administrative capacity” here instead of “state capacity” as charter cities are not states.

of development for much of the Global South, especially in its cities. Charter cities present an opportunity to ignite long-run and inclusive economic growth, while also providing a model of regulatory reform and administrative capacity-building for host country governments to follow. While nothing is a cure-all for all development challenges in every country, there is enormous potential for charter cities to raise millions out of poverty.¹⁴

Urbanization and Governance

Rapid urbanization is a defining issue of the 21st century. The world is projected to add 2.5 billion more urban residents between 2018 and 2050, with two-thirds of that increase concentrated in Africa and India.¹⁵ This equates to around 78 million new urban residents per year.¹⁶ In Africa alone, the UN forecasts that the population of city dwellers will almost triple by 2050.¹⁷

Demographic changes and urbanization are creating daunting challenges for cities in the Global South that struggle with governance. By 2100, the three largest cities in the world will be Lagos (88 million), Kinshasa (84 million), and Dar es Salaam (74 million). India's Mumbai, Delhi, and Kolkata also make the list of the ten largest projected cities in the world.¹⁸ India alone is facing an infrastructure financing gap of over \$500 billion over the next 20 years.¹⁹ The African Development Bank estimates that Africa has a \$68-108 billion infrastructure financing gap annually.²⁰ Growing megacities throughout the Global South must rapidly improve both their governance and their economic potential or face ever-growing deficits in infrastructure, public services, housing, job creation, and other areas that will make poverty inescapable for their tens of millions of residents.

Throughout human history, rapid urbanization has taken place only *after* a base level of transportation infrastructure had been built and *after* large increases in agricultural productivity created labor and food surpluses that could support a growing urban population. Countries that have urbanized with production-based economies tend to see a higher quality of life—such as fewer slums and lower poverty rates—than those whose economies are based more on natural resources and non-tradable services. Typically, when people move to cities, they take advantage of the larger labor market, become more productive, and lift themselves out of poverty. Unfortunately, this trend is breaking down in some regions.

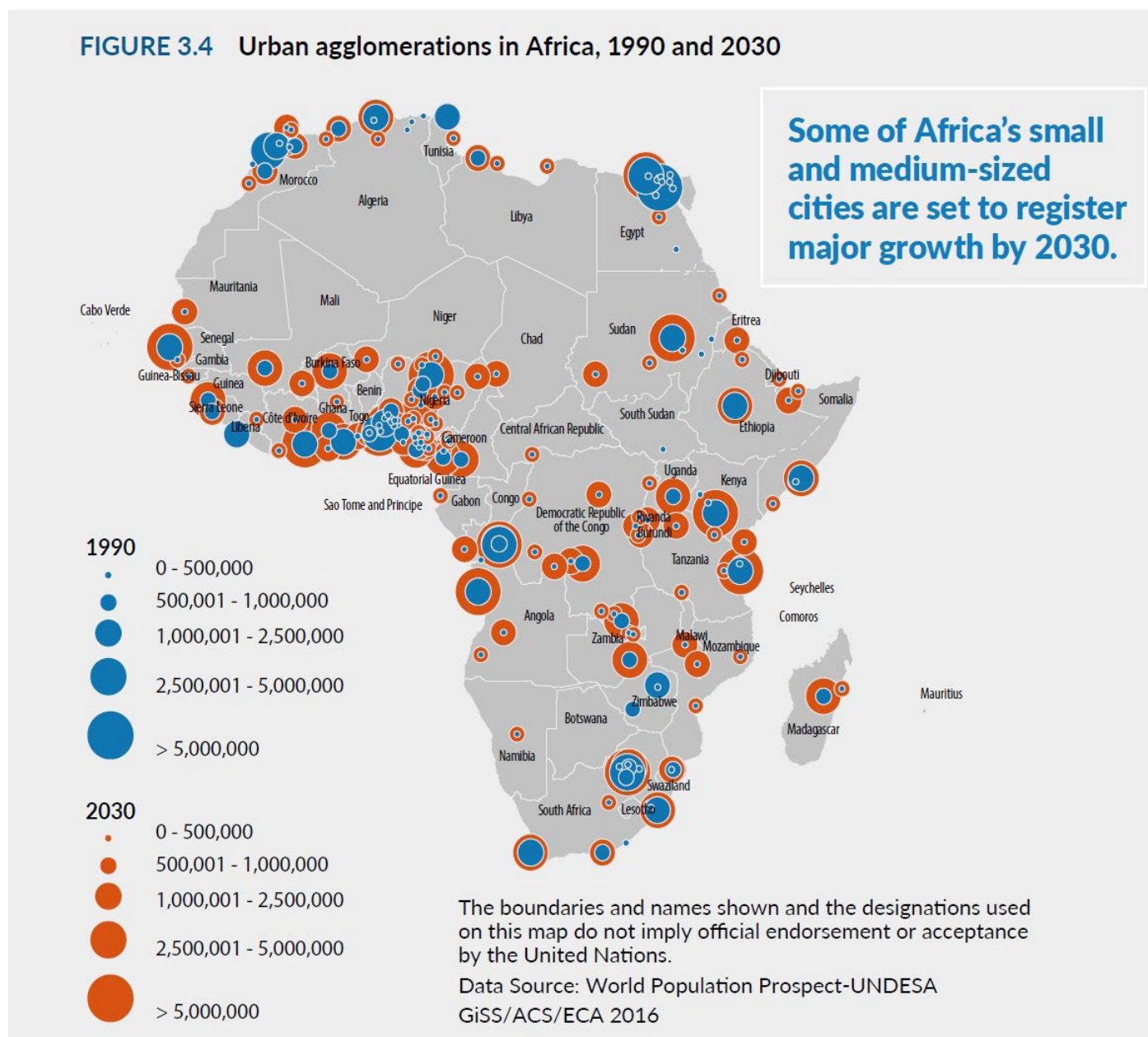
Urbanization in the Global South is occurring at significantly lower levels of income, productivity, and infrastructure development than was the case when now-developed nations urbanized in the 18th, 19th, and 20th centuries.²¹ Urbanization in the Global North was accompanied by industrialization, unlike urbanization today in the Global South.²²

Since the 1970s, sub-Saharan Africa has generated the second-highest share of GDP from resource rents of any world region, averaging about 10 percent per year.²³ Meanwhile, manufacturing as a share of GDP in sub-Saharan Africa *declined* from a steady 16.5 percent in the 1980s to a floor of 9.3 percent by 2011.²⁴ Manufacturing in Africa has started growing modestly over the past decade, but it remains the least industrialized world region. The industries that do exist in sub-Saharan Africa have struggled to improve their productivity.²⁵ This challenge exists in part because labor costs are higher in Africa than in East and Southern Asia.²⁶ As a result, Africa struggles to step up what is traditionally the first rung of economic development, labor-intensive manufacturing, although Ethiopia and Rwanda are notable exceptions.²⁷

A crucial reason sub-Saharan Africa is under-industrialized is its quality of governance. Starting, operating, and growing a business is far more difficult in low-income countries than in most high-income countries. From registering a business and getting electricity to paying taxes and enforcing contracts, each point of contact with the government necessary to operate in the formal economy is expensive and time-consuming. Both poor policy choices and poor administration contribute to lackluster business environments in which only a small share of activities can take place in the formal sector.²⁸ This traps much of the labor force in small, unproductive

informal firms that contribute little to economic growth.²⁹

Governance, however, means more than just the business environment; it also refers to decision-making regarding infrastructure and urbanization. In order to maximize the benefits from agglomeration and minimize the potential downsides of density (the spread of contagious diseases, crime, congestion, air pollution, overwhelmed public services, and ever-growing slums among others), urbanization needs to be well managed.³⁰ Developing effective governance beforehand is essential, as path dependence can be hard to change.



Africa's urban population is expanding rapidly.³¹

Managing urbanization in the face of rapidly growing population projections requires a government with the capacity to plan adequately for the impending urban expansion, to coordinate the policy response between many different government agencies, to ensure that implementation aligns with the plan, and to monitor and evaluate progress and adjust accordingly as facts on the ground shift. Most governments in the Global South lack such capacity. Colonial legacies, politics, and other factors have hindered the development of the institutions conducive to state capacity development throughout the Global South.³²

In addition to mass urbanization, the 21st century is also experiencing mass migration. Nearly 272 million people were living outside their country of origin in 2019.³³ Approximately 15 percent of the world's adults, over 750 million people, would permanently move to another country if given the opportunity.³⁴ This number is likely to rise with climate change.³⁵ Although the largest destinations are Europe and North America, migration

within the Global South is also on the rise.

However, the barriers to international migration are high, especially for those in poor countries. Restrictions on labor mobility cost the global economy tens of trillions of dollars, the estimated value lost to locking people into low productivity economies.³⁶ The recent rise in nationalism and nativism suggests that mass migration is not a politically feasible solution for global poverty alleviation over the coming decades. New solutions beyond immigration liberalization will be needed to unlock the potential of the world's poor. Charter cities are a particularly promising solution.

Charter cities can help the Global South turn rising urbanization from a challenge into an opportunity. Supporting infrastructure and other public goods for the rapidly growing urban population is necessary. Charter cities can demonstrate the potential of pro-market reform and good governance, helping to lift tens of millions of people out of poverty.³⁷

Historical Context for Charter Cities

Planned Cities

Most cities are the result of human action but not human design. An economic rationale, like new opportunities for employment, investment, and innovation, compels people to live in an area. Over time, the population grows, the economic base diversifies, and the settlement turns into a town and then a city. However, some cities are planned: the result of human design. Planned cities have a long history. From Alexandria to Abuja, people have sometimes decided to build new cities that otherwise might not have emerged organically. Some of these cities are successes, while others less so. While charter cities can draw inspiration from all cities, planned cities offer especially practical lessons. Four major cities—St. Petersburg, Dubai, Singapore, and Brasilia—showcase the variety in both development strategies and in actual outcomes observed for planned cities around the world.

St. Petersburg

The founding of St. Petersburg began in 1703. Tsar Peter the Great sought to modernize Russia by building a city inspired by Amsterdam, at the time the wealthiest city in the world, as well as a cultural and intellectual capital. The canals of St. Petersburg are a 300-year-old reminder of that inspiration. In 1719, Peter the Great moved the capital from Moscow to St. Petersburg, which also provided Russia with a new Baltic Sea port.³⁸

When building a city, governments face fewer budgetary constraints than private companies. Peter the Great was able to put the resources of the Russian government behind St. Petersburg, although this effort unfortunately included the forced labor of 40,000 serfs.³⁹ Architects and builders from all over Europe were brought in to construct centers of education and culture, as well as shops and housing, for the Russian elite to enjoy. By 1720, 40,000 people lived in the city.⁴⁰



A map of St. Petersburg from 1744.

In many ways, St. Petersburg was successful: Cultural and academic ideas from the West, like those of the French Revolution, began to flourish in St. Petersburg as they did in Amsterdam. The city continued to grow throughout the 19th century and began to industrialize, while also remaining the intellectual frontier of Russia. By 1880, over 150,000 industrial workers lived in a slum belt around the edge of the city, while the core remained for the Russian elite. Pressure against tsarist rule grew, culminating in three revolutions largely based in St. Petersburg between 1905 and 1917 that at first chipped away at and eventually ended the monarchy, replacing it with the totalitarian Soviet Union.⁴¹

St. Petersburg endured a difficult 20th century. Stalin's purges, the Nazi siege, and the chaotic collapse of the USSR all were trying times for the city. The capital was moved to Moscow in 1918, which certainly had an impact on the city's economy. Today, St. Petersburg's challenges are far less drastic. The city struggles with congestion problems resulting from Soviet-era urban planning failures resulting from the absence of land markets. Despite being Russia's gateway to liberal Europe, illiberal political attitudes remain strong in St. Petersburg.⁴² Peter's dream of a "Western" city has a mixed legacy. It is the fourth most populous city in Europe and historically has helped introduce new ideas to the traditional Russian orthodoxy. However, some of those ideas were quite disastrous, and Russia remains distanced from the European community. St. Petersburg shows that a heavily-planned city created for the elite is unlikely to live up to the utopian dream of its creator.

Dubai

From 630 AD to the 1930s, the population of the contemporary United Arab Emirates never surpassed 80,000 people.⁴³ Today, over 3.3 million people live in Dubai alone.⁴⁴ Dubai's meteoric rise over the past 60 years from small village to global city serves as a testament to the value of future-oriented thinking in the creation of cities.

Following several years of small-scale military action, the British toppled the ruling trading empire in the area in 1819 and would control the modern UAE until 1971. In 1819, the British also established contact with Dubai, then just a 1,000-person village. In 1833, the Maktoum family gained control of Dubai and allied themselves with the British. Since the 1833 takeover by the Maktoums, Dubai has enjoyed great stability relative to the rest of the region, with no sheikhs overthrown or assassinated in that time. This predictability and stability in leadership has been a key factor in the long-term success of Dubai as a commercial center.⁴⁵

In 1958, Sheikh Rashid became the official ruler of Dubai, although he had unofficially been in charge for the previous two decades under his father's regime. The start of Sheikh Rashid's reign stands as an inflection point in the development of Dubai. Starting in the 1960s, a wave of modernization programs intended to secure a successful future for Dubai were led by Sheikh Rashid. A new port was dredged, greatly expanding the cargo capacity and improving the attractiveness of Dubai as a shipping destination. At the same time, an electricity-generating station was constructed, providing light and comforts like air conditioners and refrigerators. By 1968, every building was provided with running water.

The early development of Sheikh Rashid came before the discovery of oil in 1966. Oil revenues were used to finance early infrastructure development. Dubai's sentiment is best captured by Sheikh Rashid's well-known quote, "My grandfather rode a camel, my father rode a camel, I drive a Mercedes, my son drives a Land Rover, his son will drive a Land Rover, but his son will ride a camel."⁴⁶ Today, oil accounts for only a small percentage of Dubai's budget, in unlike many of its neighbors.

Sheikh Rashid's rapid modernization of Dubai made the Emirate increasingly attractive for international business, and the city continued to grow. In 1960, 60,000 people lived within two square miles. By 1980, 276,000 people lived in Dubai, which had grown to 32 square miles. Dubai continued to diversify its economy, rather than doubling down on oil like many of its neighbors. The Jebel Ali port was constructed, along with a drydock and other infrastructure projects. Other diversification efforts included the promotion of tourism and the establishment of Emirates airlines.⁴⁷ Dubai has also emerged as a top global financial hub. In 2004, the Dubai International Financial Centre (DIFC) was introduced as a free zone with its own English common law-based commercial court.⁴⁸

The DIFC stands as one of the most successful purpose-built institutions. The DIFC Courts effectively imported British common law and court procedures, along with British, Singaporean, and other foreign judges. Originally set up to handle cases for firms registered within the DIFC, the Courts eventually began hearing cases for parties outside of the DIFC but within the Emirate of Dubai that chose to opt in, rather than use the regular Dubai courts. The DIFC Courts even began to hear cases from the rest of the United Arab Emirates, and they became an international arbitration destination for parties based abroad, competing with the most widely used commercial courts in London, Singapore, and elsewhere.⁴⁹

For over a century, Dubai's rulers have looked to the future when assessing economic strategy, although the roots of this culture go back further. In the 1880s, Iran began introducing new taxes at its ports. Dubai's leadership recognized the arbitrage opportunity and made Dubai a free port in 1901. Traders throughout the region flocked to the city, home to 10,000 by 1908. Dubai has repeatedly made itself the beneficiary of poor Iranian policymaking and political upheaval, receiving additional waves of entrepreneurs in the 1970s and academics and liberals in the 1980s in response to import tariff increases and the 1979 Revolution.⁵⁰

While many of Dubai's neighbors built their economies around fossil fuels, Dubai diversified. Dubai has looked outward to the world and made itself not just an attractive place to do business, but also to live, with almost 90 percent residents being of foreign origin.⁵¹ Dubai's transformation from a poor tribal village to a wealthy global

city in just over a century demonstrates the potential of forward-thinking leadership and open engagement with the world. The city faces new challenges today and will need to continue to innovate to succeed moving forward.⁵²



Dubai's growth has been extremely rapid (2017).⁵³

Singapore

Modern Singapore was founded in 1819 as a British trading post, and then as a colony. It was established as a free port, attracting traders from throughout Southeast Asia. By 1860, the population of the island had risen from just 1,000 at the time of the British arrival to over 80,000.⁵⁴ When Singapore achieved self-governance in 1959, it was a city-state of 2,000,000 with a per capita income of \$3,500 (inflation-adjusted).⁵⁵ Today, with a population of over 5.6 million and an average per capita income of \$64,000 USD, Singapore is among the world's wealthiest cities.⁵⁶ Singapore's rapid rise to prosperity is a case study of the impact of good governance on long-term prosperity.

Singapore's first Prime Minister, Lee Kuan Yew, recognized that Singapore would need to industrialize, and that long-term growth based on a free port would be limited. Tourism had been growing, but this too would be limited. To encourage industrialization, Lee began to visit American CEOs abroad to bolster their confidence to invest in a young, untested market. Labor-intensive manufacturing exploded in Singapore in the 1970s, and its exports began to include more complex products like electronics by the 1980s. To attract investment, Singapore allowed the British Privy Council to serve as its appeals court until the late 1980s. In addition to a vibrant manufacturing sector, Singapore also established itself as a financial center. Singapore's financial reputation was built up slowly over 20 years, and by the 1990s, it was a major global finance hub.⁵⁷

Singapore under Lee also made major investments in the city itself, particularly in public housing. Starting in the 1960s, the government developed hundreds of thousands of units of housing that were sold to the public at affordable prices.⁵⁸ Today, around 80 percent of Singaporeans live in government-built housing, in dense, mixed-income communities, with access to public services like transportation and education.⁵⁹

The government's support for housing helped develop a sense of investment in the long-term success of Singapore. The government also invested in quality healthcare and pension programs to further bolster public support for the pro-market policies that would be needed to compete with jurisdictions like Hong Kong. These programs continue to enjoy widespread public support and participation.⁶⁰

Lee and Singapore's early leaders stressed the need to keep the Singaporean government free of corruption. Government officials were paid competitive wages to reduce their incentives for engaging in corruption. The culture of excellence developed for Singapore's public officials has contributed massively to the country's reputation for stellar governance.⁶¹

Singapore's excellent governance has enabled it to successfully implement policies that improve the quality of life in the city, like congestion pricing. In 1975, Singapore introduced the Area License Scheme, which required the purchase of a special pass to drive in the city core, along with higher parking charges and more parking enforcement. Congestion fell by 20 percent, and the public supported the program. This system was replaced in 1998 with electronic congestion pricing that now responds to real-time traffic conditions. Traffic has remained low in downtown Singapore, and public transit usage has increased.⁶² Singapore's traffic management schemes have proven to be among the most effective in the world, a demonstration of the government's ability to execute on plans that improve the functionality of Singapore as city.

Singapore's rise from dire poverty to wealth within two generations is a success story built not just by pro-market policies, but also by high-quality governance. Singapore works as an economy and as a city because its government has been able to credibly commit to courses of policy action, and then effectively execute on those policies, like its housing and traffic control programs.

Brasilia

If Singapore is representative of the effects of urban planning that takes markets into account, Brasilia is representative of the opposite. Built between 1956 and 1960 as a new capital for Brazil, Brasilia was designed to look like an airplane from above, with government offices as the cockpit and residential areas as the wings.⁶³



Brasilia as viewed from Google Earth, the airplane or bird shape can be seen clearly (2020).

Brasilia was built without consideration for market forces. No land values or measures of demand for particular types of land use or planning were considered.⁶⁴ Instead, Brasilia was designed at the whims of urban planners Lucia Costa and Oscar Niemayer, inspired by the ideas of French architect Le Corbusier.⁶⁵

By the very nature of Brasilia's airplane design, much of the population lives far away from the city center. Brasilia's population density *increases* with distance from the city center, rather than decreases.⁶⁶ The poor have largely been relegated to satellite cities far from central Brasilia, where the Brazilian government is concentrated.

Planned for 500,000 people with limited room for expansion, over 2.5 million now live in the city. While there has been growth in sectors other than the Brazilian government, extensive sprawl combined with poor public transportation makes accessing these jobs difficult for the poor.⁶⁷

Brasilia's planners expected the car to be the primary mode of transportation, and so public transportation options in the city are limited.⁶⁸ Brasilia has commute times that are comparable to larger and poorer Brazilian cities and that are longer than many of the world's major cities.⁶⁹ Cities are effectively labor markets—a functional city makes it cost little in time and money to access a variety of jobs. On this margin, Brasilia fails as a functional city.⁷⁰

Brasilia struggles, relative to other Brazilian cities, simply as a place where people want to live. The politicians that work in Brasilia tend to travel to Rio de Janeiro, Sao Paulo, and other cities for entertainment rather than spend more time there.⁷¹ While some purpose-built capitals like Washington, D.C., and Abuja, Nigeria, are regarded by some as success stories, Brasilia exemplifies the limits of planning new cities without accounting for the market forces that shape them.⁷²

Special Economic Zones

In addition to new city developments, charter cities draw inspiration from special economic zones (SEZs). Modern SEZs were first introduced in the 1960s, and today there are over 5,400 worldwide. SEZs typically cover a limited geographic area, provide some level of infrastructure support, and offer fiscal and regulatory incentives. These often include tax breaks, access to land, easier permitting and licensing, relaxed labor and environmental standards, and other incentives. Many operate as their own customs territories, with reduced or eliminated tariffs and duties.⁷³

Many factors contribute to the success or failure of a SEZ, and these factors have important implications for the success or failure of a charter city. Chief among these factors are the location, regulatory environment, and support for the SEZ provided by the developer and government. Successful SEZs are in areas that offer easy access to existing markets. Zones whose primary attraction is regulatory incentives typically perform better than those whose primary attraction is tax incentives.⁷⁴ Zones with a flexible regulatory regime that allows for a variety of activities also tend to perform better than those highly focused on a single activity.

Another key best practice for SEZs is that they are part of a broader development strategy, under which the government and the zone developer can coordinate effectively. At the same time, the hierarchy of zone administration should be clear, and the distribution of veto powers over administrative and regulatory action should be significantly constrained as to avoid problems of hold-up and complexity.⁷⁵ Ultimately, it is the broader business environment and governance of the SEZ regime that determines its fate, rather than any particular incentive.⁷⁶ These institutional arrangements and relationships with other government entities are similarly crucial for charter cities.

When implemented successfully, SEZs not only attract significant investment, but also generate beneficial spillovers. SEZs that attract investment help generate economic activity nearby, as local firms can do business with SEZ firms and often encourage nearby (mostly informal) firms to register formally. SEZs can also create knowledge and technological spillovers that lead to greater economic development outside of the zone. An SEZ that attracts significant foreign business can help create new linkages with firms outside of the zone, leading to greater integration into global markets and value chains.⁷⁷

SEZ performance, in terms of attracting investment and creating jobs, has been mixed. SEZs have been adopted widely throughout Asia and have generally been successful there, as well as in Latin America. However, Indian and African SEZ regimes have proven less successful.

African SEZs have struggled to provide a more competitive economic environment than what is available outside of the zones. It often takes longer for customs clearance within a zone than outside of a zone, and power outages lead to significant production downtime. Zone infrastructure is often inadequate, zone developers tend to lack experience, and zone regulatory frameworks are outdated or do not exist. African SEZs have generally not been adopted as part of a larger national development strategy and have not been granted the necessary support from governments to attract the hoped-for level of investment.⁷⁸ However, some African zones have proven to be relatively successful, like the Hawassa Industrial Park in Ethiopia.⁷⁹



A PVH textile manufacturing facility within Hawassa Industrial Park during a visit by Kenyan President Uhuru Kenyatta and Ethiopian Prime Minister Dr. Abiy Ahmed (2019).⁸⁰

Charter cities adopt the lessons of successful SEZs and apply them on a much broader scale. While SEZs improve a few parts of the existing law at the margins, the legal framework for charter cities starts as a blank slate. This allows charter cities to introduce a set of reforms that more extensively cover all areas of the law that impact the business environment and everyday life, including labor, taxes, business registration, and dispute resolution.⁸¹

SEZs are also more limited in their geographic scope, as well as in their target industries. They are often organized as industrial parks, with a specific focus on one or just a handful of activities, like textile manufacturing or electronics assembly. This can be a useful method of economic development if implemented well; however, the economic impact is limited.⁸² As noted in the introduction, a city is the smallest unit able to generate sustained economic growth, and industrial parks are significantly smaller. With the exception of China, special economic zones have generally not led to sustained economic growth, even in countries where they have been implemented successfully.

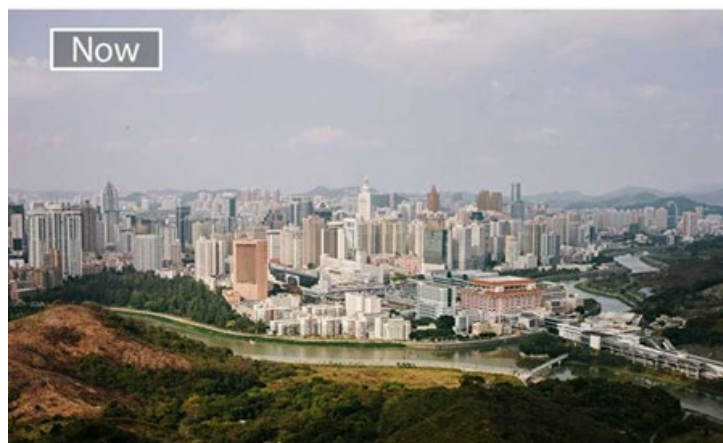
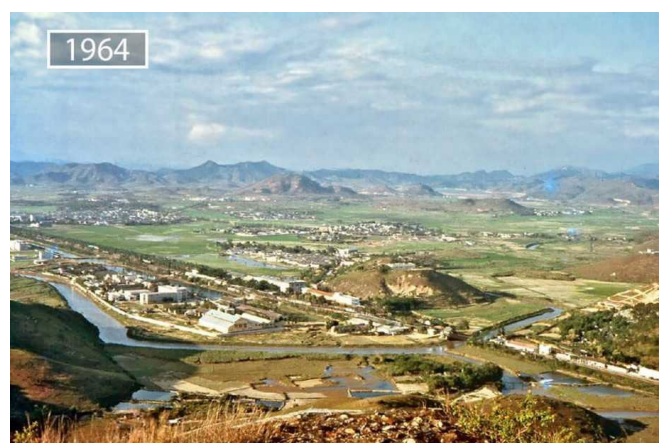
Charter cities focus on a much larger, expandable geographic area. Cities tend to grow over time and incorporate new communities into their governance structure, rather than remain a fixed entity like an industrial park.⁸³ SEZs can be expanded through legislative action, while a charter city ideally possesses the ability to incorporate

additional territory without requiring host country approval for each expansion. Charter cities also aim for a wide variety of industries, not just one or a few. Because a charter city is a city, it needs services, retail, transportation, communication, and other sectors in addition to a base in manufacturing, to adequately serve the population. Allowing for growth and diversity in economic activity ensures that charter cities can remain dynamic as the national and world economies changes. This more holistic approach to economic development minimizes the risk of focusing the bulk of economic activity on a single industry.⁸⁴

Special economic zones	Charter cities
<i>Limited governance reforms</i> – Typically focused on tax incentives, infrastructure, and a one-stop shop	<i>Deep governance reforms</i> – Touching all aspects of the business environment, including registering a business, dispute resolution, labor law, taxes, etc.
<i>Small geographic area</i> – Often encompassing a small geographic area, such as an industrial park, which limits growth potential	<i>Large/expandable geographic area</i> – Big enough for a city to encourage industry diversification and urban expansion
<i>Single industry</i> – Often targeting a single industry, such as textile or electronics manufacturing	<i>Multi-industry and residential</i> – Attracts multiple industries, including manufacturing and services, ensuring a broad economic base
<i>Limited administrative autonomy</i> – Administrative unit is not flexible and cannot respond to changing conditions	<i>Administrative autonomy</i> – New administrative body with legislative authority allows the charter city to respond more quickly to changing conditions

Chinese Growth

The World Bank estimates that China has lifted 850 million people out of poverty since 1978.⁸⁵ This was accomplished through urbanization combined with special economic zones. First areas around Hong Kong, including Shenzhen, were liberalized as special economic zones, allowing foreign direct investment, labor markets, and land markets. The success of Shenzhen led Beijing to allow additional coastal cities to adopt similar reforms. Eventually, those reforms spread throughout China, leading to the greatest humanitarian miracle in the post-war era.



Shenzhen's growth from a collection of villages to major metropolis (2017).⁸⁶

China urbanized at an unprecedented pace. In 1980, only 19 percent of the population lived in urban areas. Today, over 60 percent of China's population lives in cities.⁸⁷ This remarkable growth has been accompanied by the ascent of hundreds of millions of people from extreme poverty as Chinese industrialization took off, starting in the 1980s.⁸⁸

Shenzhen was one of the first four special economic zones authorized in 1980. Starting as a handful of fishing villages with a population of around 100,000, in 40 years it became a metropolis of 20 million residents. Today, Shenzhen is quite wealthy, even by global standards. Shenzhen's metro system, for example, opened in 2004 at 178 kilometers. By 2015, annual ridership was approaching one billion passengers.⁸⁹ Ridership has continued to grow, and the system is now over 300 kilometers, making it one of the most extensive in the world.⁹⁰

It is important to note how Shenzhen and subsequent SEZs differ from the typical SEZ discussed in the previous section. First, the Shenzhen SEZ was large, totaling over 320 square kilometers. Second, there was a sweeping devolution of authority to the SEZ. For example, labor law was not dictated to Shenzhen from Beijing. Instead, labor law was discovered in Shenzhen through a process of trial and error which, when proven successful, provided the basis for national reforms. With deep governance reforms, local autonomy, many industries, and city scale, Shenzhen more closely resembles our definition of a charter city than an SEZ. Today, nearly every major Chinese city has some type of special economic zone status.⁹¹

A variety of reforms were piloted here starting in 1980, which later spread throughout China. China's first commercial land market was introduced in the Shenzhen SEZ, along with subsequent housing reforms. Price controls on capital goods were relaxed, and market mechanisms were introduced for the purchase of daily goods. China's first labor market and wage reforms were introduced here as well. Foreign banks were permitted to establish branches in Shenzhen in 1982, and a stock exchange was opened in 1987. Several state-owned enterprises were also transitioned into joint-stock enterprises and allowed domestic and foreign investment in former SOEs. Most of the reforms piloted in Shenzhen were led by local officials, who were given great autonomy to experiment with policy.⁹²

After the first four SEZs introduced in 1980 proved successful, more reform zones were established throughout China. From 1984 to 1988, 14 industrial parks were introduced, although these were smaller in size than the original four SEZs. By 2010, 69 of these industrial parks had been created throughout China. 54 high-tech research and development zones were introduced between 1988 and 2010. Prior to China's entry into the World Trade Organization, 15 free trade zones had been established and have since been linked to nearby ports. 61 export processing zones have been established since 2000 to develop export-oriented industries.⁹³

Current Projects

New cities are not just a historical phenomenon. On the contrary, there are hundreds of new city projects at various stages of development around the world.⁹⁴ The Charter Cities Institute has been working with two such projects, Enyimba Economic City in Nigeria and Nkwashi in Zambia.

Enyimba Economic City (hereafter Enyimba), which won the Charter Cities Institute's 2019 Business Plan Contest, is a new city in Abia State, Nigeria, being built for 1.5 million people on over 95 square kilometers. The project is privately led, although the Federal Government of Nigeria and the Abia State government both have equity stakes in the project. Enyimba is being developed as a regional hub for manufacturing and trade. It has an inland port and truck trailer park which will be connected by rail to a deep seaport in Onne, Nigeria. Other planned sectors of interest include healthcare and education.

Reliable electricity is a major problem for Nigerian businesses, and so the city will have its own 540-megawatt powerplant, later to be upgraded to 1008 megawatts, among other infrastructure. Enyimba has status as a Free Trade Zone (FTZ) under the Nigerian Export Processing Zones Authority Act with its own governance, one stop shop, investment regime, and tax incentives. The Charter Cities Institute is helping revise and finalize draft regulations to govern Enyimba, which will be submitted to the Nigerian Export Processing Zones Authority after the COVID-19 crisis has passed.⁹⁵

Nkwashi is a satellite city development outside of Lusaka, Zambia, planned for 100,000 residents on 12 square kilometers being developed by Thebe Investment Management. Rather than manufacturing, this project focuses on creating service and knowledge-sector jobs. The centerpiece of Nkwashi is a new university that will focus on training students in coding and other STEM fields. Construction is already underway, and the first residents are expected to move in this year.⁹⁶ In addition to working with the Nkwashi team, the Charter Cities Institute signed a memorandum of understanding with the Zambia Development Agency to conduct a review of and make recommendations to improve Zambia's Multi-Facility Economic Zone regime.⁹⁷

The Charter Cities Institute plans to partner long-term with these new city developments and work to support their efforts beyond helping them set up their governing framework. The next several years will see significant growth for charter city projects, and the Charter Cities Institute stands ready to continue partnering with new projects.



A rendering of the proposed business park for Nkwashi (2014).⁹⁸

Six Key Factors for Successful Charter Cities

As the discussion of new cities, special economic zones, and Chinese development illustrate, charter cities are complex projects. Developing them requires identifying the key decisions and the framework within which to approach those decisions. The Charter Cities Institute has identified six criteria which are crucial to the success of charter cities; governance, policies, site selection, urban planning, the anchor tenant, and reducing the risk of expropriation.

Governance

Charter cities have a special jurisdiction. The decision-making process of the special jurisdiction is a key factor in the success of a charter city. As previously mentioned, Paul Romer advocated for a high-income country to govern the city. Under the Romer model, the governance process would be the procedure established by the high-income country. The Charter Cities Institute instead advocates for a public-private partnership between a real estate developer and the host country. The real estate developer has a long-term interest in the success of the city because of the increase in land values that comes from more economic activity.

The details of the public-private partnership will be negotiated by the host country and the real estate developer. Over the past few decades, many countries have grown accustomed to contracting with the private sector to perform functions like building and maintaining roads and ports or providing services like water and electricity. Several governments now have specific departments solely dedicated to Build-Operate-Transfer and other such agreements. Furthermore, governments now fully realize the value of utilizing private capital to provide public goods and services, which can ease the financial and administrative pressure on the government to provide these basic services.⁹⁹

However, based on our experience, we expect the city to be governed by a city council with seats appointed by the city developer, the host government, and potentially other third parties. The Councilors would then appoint a city manager who would be responsible for the development of the city and day-to-day operations.^{iv}

The Charter Cities Institute believes that empowering the city developer in the governance process is important for the success of the city. Just as a key part of Shenzhen's success was the broad devolution of power to local officials, it is integral to the success of a charter city for the city developer to have broad authority. The developer generates revenue from leasing or selling the land in a charter city, while the city government generates revenue from fees and taxes imposed. Because the city developer owns the land, they are incentivized to support an effective administration and economic liberalization and provide public goods in order to increase economic activity. This is because a city that effectively attracts investment and residents will see land values rise substantially over time.

^{iv} The Charter Cities Institute details this relationship in our Model Charter: www.chartercitiesinstitute.org/post/model-charter.

Shopping malls offer a useful analogy for understanding this governance arrangement. Malls offer public goods like security, bathrooms, and lighting without directly charging for them, instead benefitting from a share of sales by stores in the mall.¹⁰⁰ Master-planned communities like Irvine, California, have taken this approach, providing public goods like roads and attracting universities, to increase the value of their land.¹⁰¹ Charter cities similar allow the developer to provide the public good of a capable government and open business environment.

There are some advantages to limiting political influence over policymaking, exemplified well by the case of central banks. Historically, countries with more independent central banks have seen less inflation.¹⁰² Charter cities apply this governance model over a limited geographic area, albeit with greater governance authority.

A developer-governed city is unlikely to be sustainable over the long run as it lacks democratic legitimacy. As the population of the city grows, there will be more demand from residents for greater political voice. There is limited precedent for how to handle the transition from developer governance to democracy. If authority is transferred too early, it may be difficult to attract and retain the investment necessary for the city to become successful. Transferring authority too late risks undermining public trust in the city's governance.

One model to learn from is homeowners' associations. The standard model for homeowners' associations is for the developer to have three votes for every unsold property, giving them decision-making rights until 75 percent of the property has been sold.¹⁰³ While this model isn't workable in a city, as there aren't a fixed number of units, it can serve as an inspiration for a transfer of city governance from the developer to the residents.

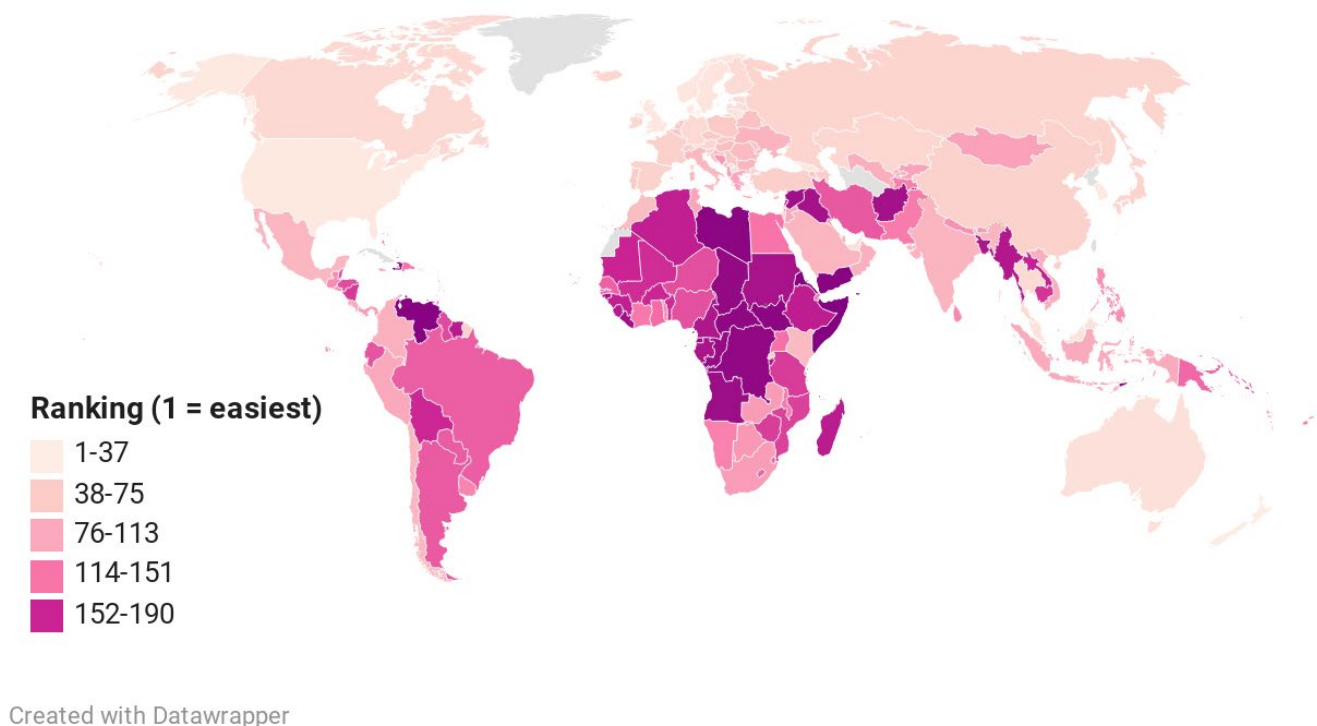
The framework of Hong Kong's Legislative Council is another instructive model that increasingly distributes power to city residents over time. In its current form, 35 of the Council's 70 seats are elected by universal suffrage. 30 seats are "functional constituencies" which represent various social and economic sectors that elect their representation. The final five seats are elected by voters ineligible to vote in functional constituencies. Under the "Basic Law" establishing Hong Kong as a special administrative region of China, the ultimate aim of the governance system is universal suffrage.¹⁰⁴ Although there are grave doubts about the willingness of the Chinese government to adhere the letter and spirit of the Basic Law in light of the passage of a restrictive new national security law, Hong Kong nevertheless represents a model to learn from.¹⁰⁵

Policies

While governance refers to the political structure and decision-making process for the charter city, policies refer to the specific details of legislation enacted by the city government. Charter cities are not sovereign; however, the Charter Cities Institute recommends delegating a wide range of authority to the city to maximize its chances for success. In an ideal setting, a charter city would have authority over all areas of the law, except for criminal law, constitutional law, and international treaties. This would mean a charter city would have authority over business and land registration, taxes, dispute resolution, banking and finance, immigration, customs, environmental policy, energy policy, health policy, labor policy, social welfare, education, housing and building, administrative procedure, and private law.

Therefore, charter cities have close to a blank slate within which to create a legal system. The goal of the policies is to increase sustainable economic growth, which in practice means improving the business environment. Among other things, it should be quick and easy to register a business, pay taxes, hire as well as fire people, and resolve a dispute. Not only must the laws be written, but administrative authorities must be established to enforce those laws.

Ease of Doing Business Rankings (2019)



The Global South still struggles with its business environment relative to the Global North.¹⁰⁶

Because there currently is no single source of the best practices which a charter city developer can adopt, the Charter Cities Institute is developing such a document, the “Charter Cities Governance Handbook.”^v Our process in developing the Governance Handbook is twofold. First, we review the best practices for the relevant sub-section, such as labor law. If Singapore and Hong Kong have the best labor law, we need to be careful to ensure we adapt it to the income level of a charter city. We also reach out to various subject-area experts, both academics and practitioners, to get a better understanding of how things work on the ground. Two key areas a charter city would have authority over are labor law and tax administration.

Authority over labor law would allow a charter city to adopt its own minimum wage and job security requirements, for example. In some countries, the minimum wage may be so high that it discourages employment and encourages informality, and so a lower minimum wage would be appropriate. In other countries, the minimum wage may not be so high as to inhibit employment growth. The same can be said regarding labor market flexibility. In some cases, labor immobility may inhibit new firm formation or the movement of workers from low-productivity to high-productivity jobs, while in other countries this may be less of a problem.¹⁰⁷ In general, labor law in a charter city will be written to generate employment that is accessible to as many people as possible.

A charter city would also have its own authority over tax policy and administration. For much of the Global South, sufficient revenue mobilization to provide public goods and services is a struggle.¹⁰⁸ At the same time, compliance with tax law is often difficult and extremely time-consuming for those businesses and individuals that do actually pay taxes.¹⁰⁹ Charter cities aim to simplify tax compliance while generating the revenue needed to provide services and enter into a revenue-sharing agreement with the host country.^{vi} By being transparent

^v When published, the Governance Handbook will be available in the Reference Guides section of the Charter Cities Institute website: <https://www.chartercitiesinstitute.org/category/reference-guides>.

^{vi} The purpose of the revenue sharing agreement is further explained in the section on appropriation risk.

about revenue usage, charging a single tax per tax base, and digitizing as much of the process as possible, charter cities can improve on their tax collection performance relative to the host country. Simplifying and digitizing the process also reduces opportunities for corruption.¹¹⁰ A simple tax code and a competent tax administration in a charter city can make investment and entrepreneurship within the formal sector far more feasible than it would be in the host country.

Under the proposed governing framework, a charter city would be able to change its labor law, tax law, or any other regulatory area without seeking permission from the national or local government. As the population of the city grows over time, and as the city becomes wealthier, the law will need to change too. The appropriate labor, tax, and other regulations for a city of 100,000 with an average income of \$2,000 per year will likely differ from a city of 1,000,000 with a per capita income of \$12,000, and a charter city has the power to make those changes when appropriate.

Site Selection

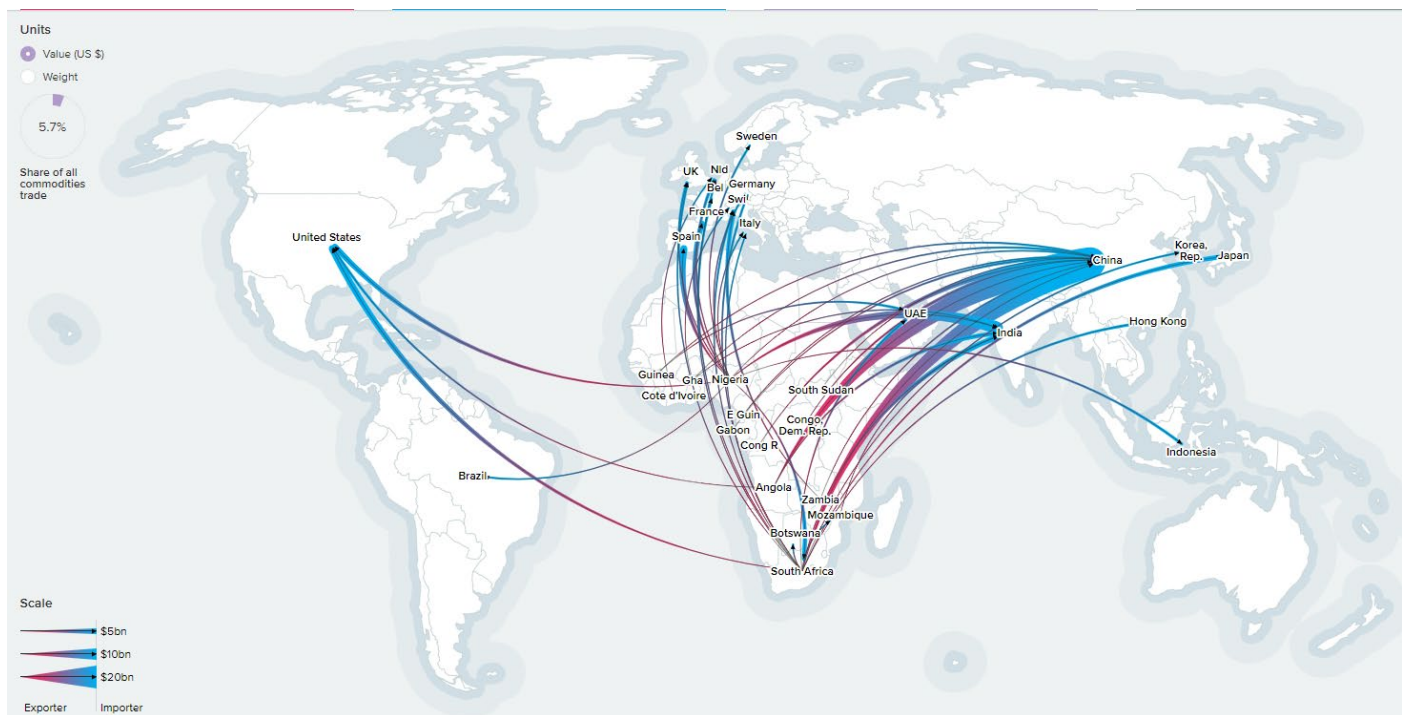
Purposeful site selection is crucial for the success of any real estate project, even more so when the project is an entirely new city. A new legal framework and administrative entity will have little impact if the city is built in a location that is unattractive to potential residents and businesses. The two key considerations of site selection are urbanization rates and trade routes.

High urbanization rates in a potential host country or broader region signal a demand for cities and a perception that economic opportunity can be found there.¹¹¹ However, existing cities in the developing world are struggling to provide the infrastructure necessary to support a rapidly growing population. In Africa alone, the estimated infrastructure gap is upwards of \$170 billion.¹¹² New cities can ease the infrastructure pressures faced by existing cities and provide new options for those looking to relocate.

Cities are built where there is an economic rationale to build them, often related to trade. A well-placed port or rail hub, for example, can serve as a distribution center for the surrounding region, like Chicago did for the American Midwest. Increasing trade with neighbors, regional blocs, and partners overseas, as well as between regions of the host country, can help identify the best possible location for a charter city. Rising trade flows across some land borders may identify locations where integrating a new city into trade between two existing economic hubs is relatively seamless. However, as global trade flows shrink amid rising uncertainty, charter cities also provide better opportunities for production intended for domestic consumption, rather than export abroad.¹¹³

New trade agreements coming into effect can serve as an indicator of where future trade flows may increase. Trade between African nations and regional economic integration within the continent is likely to grow in the coming decades as the African Continental Free Trade Agreement comes into effect. The agreement has created a massive single market with major reductions in tariff and non-tariff barriers to trade in goods and services, as well as progress toward the free movement of labor and capital.¹¹⁴

As labor and other costs in Asia rise and as pressure to diversify supply chains away from China rises, manufacturers are increasingly looking to establish their operations elsewhere, including Africa. Ethiopia has already begun to capture garment manufacturing operations typically seen in Southeast Asia, prompting conversations about the country becoming the “China of Africa.”¹¹⁶ However, labor costs elsewhere in Africa are higher than in Ethiopia because of resource extraction rents, high food import costs, and other factors, which offers a challenge to the continent’s nascent industrialization to overcome.¹¹⁷ Kenya is the major supplier for East Africa in a variety of sectors, including textiles, pharmaceuticals, and motor vehicles.¹¹⁸ Freight volumes at ports in East and South Africa have been on the rise, although many existing ports are struggling to reduce congestion and develop supporting infrastructure.¹¹⁹ An increase in private-sector port operation, and in some cases port ownership, has proven useful for improving performance in West Africa, relative to other regions.¹²⁰



This map shows African export flows. The dominance of trade with China is clear (2020).¹¹⁵

Ports are a key source of employment and economic spillovers in coastal cities, and with improvements in port capacity, hinterland linkages, and other considerations, they can continue to be an engine for regional and overseas trade. By 2100, a projected 80 percent of the world's nearly 11 billion people will live in Africa or Asia, highlighting the need to continually build out economic infrastructure in these regions, including ports.¹²¹ In countries whose expected trade flows are primarily overseas, charter cities would do well to develop new ports or be located near existing ports that perform well.

Developers must be mindful of the contents of these trade flows and identify new opportunities. Many developing economies focus on resource extraction but send the raw materials abroad for processing. Charter cities present an opportunity for these economies to begin performing more domestic downstream processing of extracted materials, rather than sending them abroad for processing. For example, Nigerian billionaire Aliko Dangote is constructing a massive oil refinery in the Lekki Free Zone just outside of Lagos that is slated to begin operations in 2021.¹²² Rising labor costs in China and elsewhere in light industries like textiles presents an opportunity for less developed economies to capture some of that production. Integrating into and moving up global value chains presents an opportunity for developing economies to grow and diversify.¹²³

In order to enact the reforms needed to enable the economic development described above, charter cities should be built on greenfield land. Because greenfield land is undeveloped, setting up a new jurisdiction does not force anyone to live under it involuntarily, nor are there any entrenched special interests that may work to block economic and political reforms. This allows a charter city to overcome the collective action problems that make major reform at the national or city level difficult.¹²⁴

Another consideration is whether to build on true greenfield land, or to develop a satellite city in the growth path of an existing city. Satellite cities can continually tap the labor market of the existing city, as well as their infrastructure, decreasing the investment required. The challenge of building a satellite city is that the closer it is to the parent city, the higher the land prices will be, the more fragmented land ownership will be, and the more political interests there will be to contend with.

After accounting for urbanization rates, trade flows, and greenfield or satellite development, a reasonable question remains: are there any good locations for a charter city left? There are thousands of cities around the world, surely the best locations have all been taken. However, Paul Romer points out that the cities home to over three billion people only cover about three percent of the world's arable land. Given that billions more are

going to move to cities in the coming decades, it seems entirely reasonable that space remains in the Global South to accommodate some of them in new cities.¹²⁵

Anchor Tenant Selection

Whether to build a satellite city or a greenfield city illustrates one of the primary challenges facing charter cities; how to attract the initial residents. While satellite cities can piggyback off the labor market of existing urban areas, a greenfield city needs to attract a critical mass of residents to justify building supermarkets, schools, entertainment, and the modern necessities of life. As such, no one wants to be the first person to move to a charter city because none of those amenities will be available. The anchor tenant solves this problem.

An anchor tenant is a large employer that creates the critical mass of workers and residents to overcome the first mover challenge. The term anchor tenant comes from real estate, and it typically refers to a large tenant in a shopping mall, often a department store or retail chain. The anchor tenant in a shopping mall is charged lower rent per square foot because they drive foot traffic that leads to higher spending in other parts of the mall.

An anchor tenant in a charter city would work similarly. It would be the business to attract the initial residents and jumpstart economic activity. The workers from the anchor tenant would create a critical mass of residents, justifying investments in supermarkets, schools, entertainment, and housing. The anchor tenant would also help justify the initial infrastructure investments from the developer. The extent to which a city is a greenfield or a satellite development will partially determine the immediate investment needed in education, entertainment, and other amenities. Satellite charter cities will be able to rely, at least initially, on the parent city to provide some of these goods and services, while greenfield developments will require a larger upfront investment.

The long-term effects of the anchor tenant are as important, if not more so, as the immediate effects of solving the first-mover challenge. The anchor tenant sets the stage for the type of industry which will power the charter city's growth. The employees of the anchor tenant are also the core talent pool of the charter city. Picking the right anchor tenant can therefore set the stage for long-term success, while picking the wrong anchor tenant can hamstring the growth of a charter city.

There are several criteria with which to evaluate a potential anchor tenant. First, does the industry of the anchor tenant create positive regional spillover effects? An industry with positive regional spillover effects can create a lot of employment, increase productivity, and move up the value chain as the human capital in the region develops. An industry without positive regional spillover effects still creates value but does not help create a virtuous cycle towards ever greater levels of development.

Resource extraction is an example of an industry which does not have positive regional spillover effects. While resource extraction does create value, it rarely serves to jumpstart larger economic growth. Typically, resource extraction requires small populations of both high-wage labor to manage the extraction, as well as lower-wage labor to work directly with the extractive process. This rarely spills over into broader development, as the skills associated with resource extraction are rarely useful outside of resource extraction. Economies based on resource extraction tend to see pockets of wealth amid broader poverty, the result of the resource curse and Dutch disease.¹²⁶

Manufacturing, on the other hand, has positive regional spillover effects. Employment, skills training, and financing are all transferable within manufacturing, allowing for potentially rapid moves up the value chain. The linkages necessary for effective manufacturing hubs ensure integration into the regional economy and larger employment than just the anchor tenant. Shenzhen, for example, has developed from textile manufacturing to advanced electronics in just 40 years.¹²⁷ This makes the trend of premature deindustrialization observed throughout much of the Global South particularly worrisome, as many countries are simply not getting the

same opportunities to industrialize as did today's high-income countries.¹²⁸



The second step after picking an industry is to pick a sub-sector. Let's continue with the manufacturing example. The anchor tenant should be a company which works in a sub-sector that can be supported by the surrounding region. More specifically, this means that ensuring that the human capital, backward linkages, and forward linkages are there to support the industry.

Take textile manufacturing, for example. Textile manufacturing requires a high number of low-wage workers. Additionally, it requires certain inputs, like machines, cotton, and reliable access to electricity to be available for the factory. There also must be an accessible market for the final product. Perhaps that is a nearby factory for further processing, or perhaps the product is final and can be sold in America or Europe.

The Chinese construction equipment market offers a good example of how firms can shift over time to more complex products, as well as shift from selling to the domestic market to the export market and move up the global value chain. Firms that at one time were producing more simple machines, like wheel loaders, have started to produce more complex machines like excavators. These firms developed their manufacturing skills in a competitive domestic market and then began to export abroad. Although Chinese construction exports primarily go to Asia and Africa, they are of a high enough quality that American, European, and Japanese consumers are also now buying Chinese construction equipment.¹²⁹

Another approach is for a charter city to try to leapfrog development by skipping manufacturing and going directly into services. This approach could be optimal if the city is landlocked, making exporting expenses high, or if there is a population which could offer high-value skills with a little training. The growing remote work revolution could make charter cities that specialize in services even more attractive.^{vii,130}

vii For example, Mwiya Musokotwane, whose firm is building the Nkwashi new city development in Zambia, recently founded an online coding and design education platform called Explorer Academy that is open to students in over half a dozen African countries: <http://explorer.education/>.

There are several challenges with leapfrogging. First, there is little precedent for it. Every wealthy country in the world, with a handful of oil-rich exceptions, went through a period of industrialization. Second, the service sector can be challenging to scale, at least compared to manufacturing. Tech companies, for example, have far fewer employees than past industrial titans like General Motors. Premature deindustrialization can also stunt the development of a skilled workforce ready to fill jobs in a service-based economy. These obstacles to leapfrogging could limit the potential growth of a charter city. Nevertheless, in landlocked countries with poor infrastructure, leapfrogging might be the best option for development.

Securing the right anchor tenant(s) for a charter city will be instrumental for long-term success. Manufacturing and resource processing operations can provide employment directly to thousands of workers and indirect employment in supporting industries, services, and other areas for thousands more. It is important to note that charter cities will also need high-quality healthcare, educational, and other social services. We have chosen to focus on manufacturing because it can provide the scale of employment necessary for overcoming the first-mover challenge and in turn sets the city on a path of sustained economic development. However, this does not mean that other key sectors can be ignored by charter city developers and administrators.

Urban Planning

A good urban plan is crucial for the success of a city. A successful city is an integrated labor market. An unsuccessful city fragments the labor market, which limits beneficial agglomeration effects.

For a charter city to be successful, charter city developers must resist the urge to over-plan. Cities are not office buildings or real estate where every detail can be planned *ex ante*; they are emergent phenomena. Ultimately the market is the best determinant of land use. The developer should just provide the constraints. Specifically, the developer should establish a grid delineating public and private spaces, and after providing basic infrastructure and attracting an anchor tenant, they should step back and allow the market to work.

By allowing markets to decide what is built and where, a city can effectively take advantage of agglomeration effects—the benefits created from concentrated economic activity and a large labor market.¹³¹ Businesses with common interests will tend to locate near each other to reduce supply transportation costs, tap similar labor pools, and discover information.¹³² However, policy that specifically encourages clustering may be misguided. Instead, improving cities through investment in infrastructure and education may be sufficient to encourage industry clustering in ways that improve productivity.¹³³

Innovation and economic growth are driven by three main factors: the presence of large labor markets for workers at different skill levels, knowledge accumulation and sharing, and low transportation costs.¹³⁴ This is why firms tend to be more productive in larger cities with larger labor markets.¹³⁵ City residents want both access to employment and short commute times. If public transportation is limited or expensive, this can have an adverse effect on employment outcomes, especially for the poor. Jobs should generally be within a one-hour commute, by any means of transportation.¹³⁶ The world's busiest and most extensive metro systems are capable of providing billions of trips each year, demonstrating the high-end potential of public transportation.¹³⁷ Shorter commute times are key for employment growth.¹³⁸

Congestion in cities doesn't just affect the labor market—it also creates substantial public health problems.¹³⁹ Building cities more densely and providing viable alternatives to cars, like bus systems, can improve urban air quality.¹⁴⁰ For many countries, traffic fatalities are quite high. Expanding safer options like public transportation, as well as bike and foot infrastructure, can make commuting far less dangerous.¹⁴¹

While the physical infrastructure in a city is important, the defining feature of cities is that they empower human relationships. City developers that overemphasize planning and treat charter cities primarily as real estate projects will only create more Brasílias. Brasilia was designed without its future inhabitants in mind—it looks like an airplane when viewed from above—and as a result, it has some of the longest commute times of any city in the world.¹⁴²

New York offers a better approach to urban planning. A master plan for Manhattan, the Commissioners' Plan of 1811, was drafted to manage the expansion of New York from the southern edge of the island. The plan delineated public spaces like roads and parks, while allowing demand to fill in the rest of the grid.¹⁴³ The Commissioners were forward-thinking in the design of the grid—they knew that the city was going to continue to expand and that rectangular blocks with straight streets would make new construction both cheaper and easier to build.

By introducing the rectangular grid system, it was predictable where roads would be built and where property units would then follow, leading to the emergence of a functioning real estate market.¹⁴⁴ Small-scale entrepreneurs and investors were able to take advantage of the plan's small and easily affordable lot sizes. While anchor tenant-scale businesses are needed in a flourishing city, so too are small and medium enterprises.

Long hated by many urban planners, an appreciation of the functionality of New York's rectangular grid has emerged in recent years.¹⁴⁵ Although there are many determinants of the relative success or failure of a city, its urban planning is critical. New York became one of the world's premier cities, while Brasilia became a prime example of a city not designed with its inhabitants in mind.

Risk of Expropriation

In order for a charter city to attract the investment required to build the necessary infrastructure, the investor needs to be sure their assets are secure. This means limiting the risk that the host country expropriates the city, either by limiting its regulatory autonomy or by directly confiscating assets. The host country must be committed politically to respect the autonomy of the charter city for the project to be successful. Because a charter city is not sovereign, expropriation risk can never be fully eliminated, but there are strategies charter cities can employ to limit this risk.



An illustration of the Commissioners' plan from 1893.

The first thing the developer can do is to align their own incentives with those of the host government from the onset of the project, as a component of the public-private partnership structure. By giving the national and local government an ownership stake in the charter city and establishing a revenue-sharing agreement, it becomes in the best interest of the government not to interfere with the charter city. For a host government, seizing ownership of the land and property in a charter city risks the future stream of tax revenue that can be expected to come from a prosperous city.¹⁴⁶ An Expropriation Risk Mitigation Guide and Model Legislation developed by the Charter Cities Institute includes such a mechanism to align the incentives of host country politicians and bureaucrats with those of the charter city.^{viii}

A fraction of the tax revenue from a charter city of over one million people with an average income well into middle-income status represents an enormous opportunity for governments that typically struggle to mobilize revenue.¹⁴⁷ This is revenue that the host country does not even need to collect itself—the charter city has its own taxing authority that can work in coordination with national and local tax authorities. Production-sharing agreements, similar to the revenue-sharing mechanism we propose, under which resource-extracting firms share some level of output with the host country, have long been used as an expropriation risk mitigation tool.¹⁴⁸

Threats or acts of expropriation would frighten many potential investors and stunt the city's long-term economic prospects. However, the effects of expropriation may extend beyond the charter city's borders. Governments that engage in such behavior risk incurring negative reputational effects that can limit future investment elsewhere in the country. A government that expropriates a charter city may find it increasingly difficult to negotiate long-term contracts and secure foreign direct investment in the future.¹⁴⁹

Charter cities not only generate tax revenue for the government; they can also create strong linkages with the local economy. The most successful SEZs have integrated into local economies by creating supply chain and subcontracting relationships. For example, the Tema Free Zone in Ghana, which was established in the 1990s but was considered a failure by 2005, was revamped in part by an effort to create linkages with local investors and local firms that could supply exporters operating within the zone.¹⁵⁰ SEZs that were not planned to incorporate the local economy have proven to be far less successful.¹⁵¹ Economic integration between a charter city and the surrounding area represents a win-win for both parties: The charter city is far more likely to grow economically and attract residents, while the surrounding areas see greater investment and economic growth than it otherwise would have, generating more buy-in for the charter city project from the local community.

Disrupting this virtuous cycle accomplishes little for the host government, especially local politicians. A local politician that can claim some degree of credit for the development of a successful charter city risks political backlash from the electorate if he or she effectively kills a project that had been a major source of employment and income growth among their constituency. Charter cities generate positive economic and social spillover effects for surrounding areas, shifting the political incentives away from expropriation and isolation and toward facilitating greater cooperation.¹⁵²

Because charter cities are not sovereign, they are subject to all of the international treaties signed by the host country, including international investment agreements. Typically signed on a bilateral or regional basis, these investment agreements provide a basis for suit in international courts and enforcement of arbitral awards. Thousands of such treaties are currently in force, including in the low- and middle-income countries where charter cities would be located.¹⁵³ The existence of investment treaties increases the volume of FDI a country receives because investors believe that restitution in the event of expropriation is possible.¹⁵⁴

Although there are exceptions, states involved in international arbitration do tend to abide by arbitral awards made, subject to the terms of the relevant international agreements.¹⁵⁵ In addition to the bilateral and regional investment agreements, international arbitral agreements like UN's New York Convention have been signed by most countries.¹⁵⁶ Model international arbitration laws have also been adopted, including in low- and middle-income countries.¹⁵⁷

On top of utilizing international investment agreements to protect charter cities, project developers can seek the involvement of and source some of their funding from international organizations that can influence the

viii The Risk Mitigation Guide and Model Legislation can be found in the Reference Guides section of the Charter Cities Institute website: <https://www.chartercitiesinstitute.org/category/reference-guides>.

behavior of the host government. A charter city receiving funding or other formal support from an institution like the IMF or various development banks can call on these organizations for assistance if the city or property in it is expropriated. IMF agreements have been shown to dramatically reduce the likelihood of investment expropriation.¹⁵⁸

One final method to help protect charter cities from expropriation is to list the city on the host country's stock exchange. The land in a charter city is owned by the city developer, who could feasibly make the company publicly traded on the local stock exchange. By publicly listing the company, expropriation threatens the financial standing of not just the city developer, but hundreds or thousands of stockholders. If owned by politically powerful groups like pension funds, the stock listing could decrease political risk for the charter city, as well as provide it with capital.^{ix}

Listing a charter city on a stock exchange could also potentially provide early information about increasing risk of expropriation before this information becomes widespread. Stock prices, to some extent, reflect information that is available to participants in the market. If word begins to spread that the government may move to expropriate a charter city or business within one, this will be reflected in the stock price of the charter city before any public announcement or action is taken. While this is not a perfectly clear prediction of future action, unusual price movements can serve as an early warning sign for charter city operators and firms.

Conclusion

In this paper we clearly define the concept of charter cities and promote their potential as a significant anti-poverty policy tool. By doing so, we hope to help influence both policymakers and city developers. Our ultimate goal, however, is not merely to discuss charter cities, but to help implement them. As such, we view this paper as an important, but early step in the nascent and growing charter cities ecosystem. More work is needed.

While we believe this document to be a comprehensive introduction, there are some aspects of charter cities that were not included, including financing. The cost to build the initial infrastructure in a charter city will likely be in the hundreds of millions, if not billions, of U.S. dollars. The economic activity generated by the city can be captured via the increased value of the land. However, further development of financial models and tools for charter cities are necessary.¹⁵⁹

In addition to developing financial models, as mentioned above, developing charter cities requires the engagement of multiple stakeholders, from multilateral institutions like the World Bank and United Nations, to national governments, to local governments, and to the developers which will build the cities. We hope that this document can help clarify what charter cities are, why they matter, and help coordinate the various institutions which need to be activated in order to build dozens of charter cities.

Humanity can make a choice during its final urbanization. Poor management of the urbanization process will relegate too many new urban residents in the upcoming decades to the peripheries of urban life—subject to slums, crime, congestion, and contagion—with little hope of improving their lives. Charter cities can put in place the structures that are necessary to ensure better lives not just for these new urban residents, but for untold millions of their descendants. Charter cities should rightfully be considered as a key policy priority for economic development: an idea whose time has come.

ix This idea was suggested to the Charter Cities Institute as a potential expropriation deterrent by Mwiya Musokotwane, whose firm is building the Nkwashi new city development in Zambia.

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