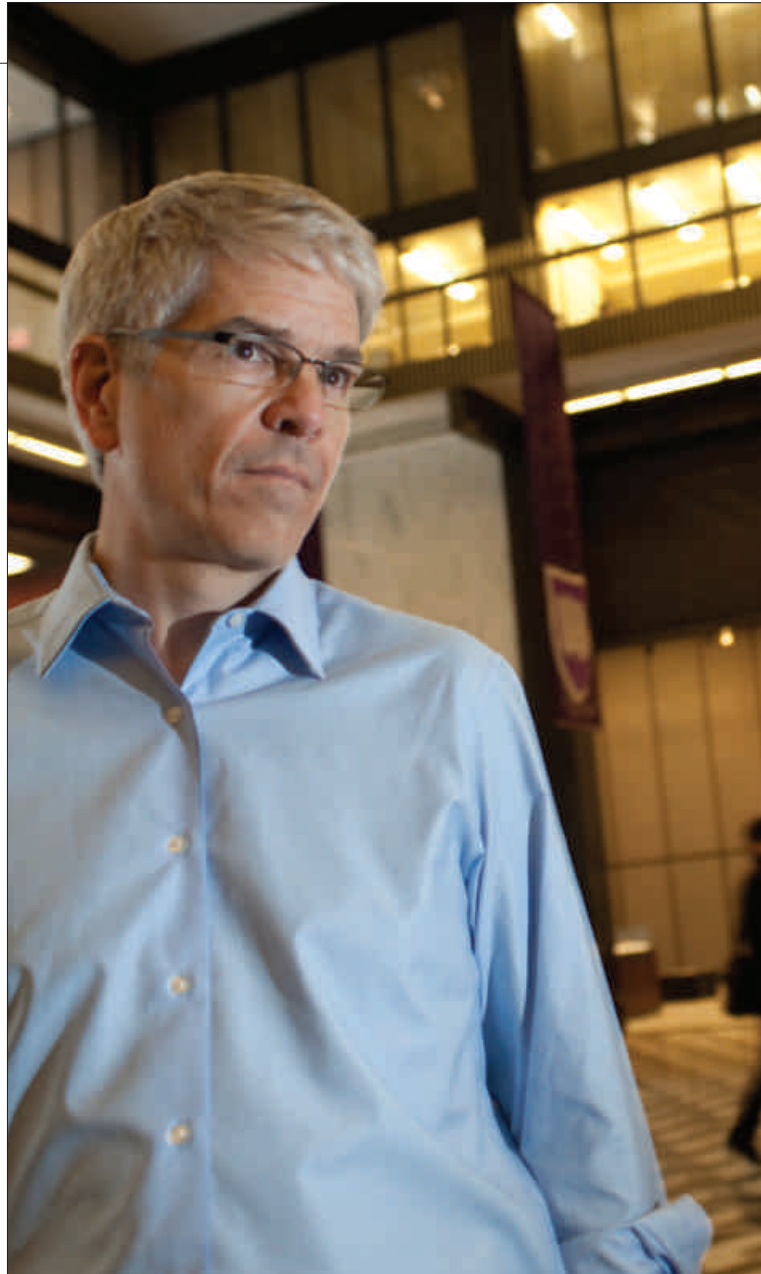


PAUL ROMER

His novel approaches to urban form and governance have taken him around the world and most recently led to his appointment as Professor of Economics and Director of the Urban System Project at New York University's Stern School of Business. Paul Romer talked with PREA about the win-win outcomes of his charter cities concept.



How did you first become interested in the political and economic structures and governance of cities?

I had a housekeeper who worked for me when I was on the faculty at the University of Chicago. She lived in Cabrini Green with her two young kids. She used to hide her money in her socks before going home because people would try to take her money. Her story raised a real question for me about why we couldn't create communities in the United States where the working poor, like this woman, could live where they could be safe and their kids wouldn't be exposed to crime. Her experiences led me to think about how we could undertake social reforms to deal with systems that leave the poor with grim choices.

What is a charter city?

You specify in advance the rules that will govern all social interaction in some new greenfield location. These rules are specified in a charter in the sense of the charter that William Penn wrote for Pennsylvania. Just as Penn did, you write a charter and say that this is how things will be governed in the new community. Then you ask who wants to move in and live under these rules. The idea in trying to reform rules this way is that you can make changes that would be extremely controversial and provoke potentially violent resistance if you tried to do them within existing communities. But in a new community, only the people who want the new rules will move there; so that kind of resistance isn't provoked. In the founding of Pennsylvania, the key new social rule was freedom of conscience or religion—the origins of the separation of church and state. Remember that at the time, this rule was extremely controversial.

How would you incorporate safety into the concept of charter cities?

Let me go back to this story about my housekeeper. One question I wondered about was this: Could we have a different kind of city in the United States where we have different laws about such things as tenants' rights. Tenants' rights law, which gives renters strong protections against arbitrary eviction, might work OK in some communities, but it was clearly making safe public housing impossible for a

single woman with two kids. The problem was that the Cabrini Green managers couldn't evict some of the troublemakers in this housing project. I thought about creating choices for people. Could we have a community that people could opt into who wanted to live in a city that had weak tenants' rights? People could then choose to live in housing complexes where the managers had a lot of discretion and could use that discretion to make them much safer places to live—by evicting people who did not behave well. If different cities had different rules, we could offer the choice without forcing it on anyone. Thinking very specifically about strategies for dealing with crime first got me thinking about different communities with different systems of rules.

Doesn't insisting on a greenfield site and opt-in limit the applicability of this approach? What can you offer for existing cities?

Let me use an analogy between cities and businesses. When you think about reform in an industry such as retail, you can either change existing organizations, or you can have new entrants, new start-ups, that do things differently. The right answer in industry is to have both processes. Cities should also have both those processes operating. Going back to my crime example—I was thinking about crime in Chicago at a time before crime rates had fallen as much as they have in the last 20 years. Clearly, existing cities can change in ways that make things better, just as existing companies can reform themselves the way, say, IBM has. But that said, when we look at business, we see that a lot of innovation comes from the start-ups. Both strategies should be used to keep progress going.

Who are the major stakeholders in forming charter cities, populating them, and governing them?

Think of three different roles national governments could play in establishing a charter city. One is the role I call the host; somebody has to put up the unoccupied land that could host a new city. The second role is the source, a country from which the residents in the new city will come. The third role is the guarantor. When the charter is announced, someone also has to make a credible commitment that this charter



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will be enforced and will have the force of law. Those roles could be allocated among different countries in a variety of ways. The idea that is easiest to grasp is to think of a developing country as the host, think of that country and the surrounding region as the source, and think of a developed country or a coalition of developed countries as the guarantor. Hong Kong was an example; China was the host and the source, and Great Britain was the guarantor. In the developing world, where charter cities could be the most effective way forward, having partner governments could be a very good way to bring some credibility to the guarantees in the charter. This would be quite important for reassuring potential investors.

Potentially, could there be several guarantor countries, separate from the source and host countries?

Yes. Honduras announced that it wants to be a host and that it and its neighbors will be the source. The new city Honduras is contemplating will be open to people from other countries in the region. Officials from Honduras are in discussions with partner governments to help bring credibility to the charter, precisely because they think that is the best way to encourage the investment that will be needed to make this project succeed. They are open to having several partner governments participate in offering those guarantees and possibly separating the roles that different guarantor governments could play.

To what extent might geopolitical tensions complicate the formulation and operation of charter cities, especially in cases where host, source, and guarantor countries are not the same?

One has to be attentive to existing legal arrangements. For example, Honduras has made commitments to free trade in CAFTA, the trade bloc to which it belongs. Those agreements will be binding on any new city that grows up within its national borders, so the new city will have to follow the law. Some other aspects of the law could be different within a city like this. If Honduras delegates to another country or in effect asks another country to enforce some parts of the law that might be different there, it would be making a long-term commitment that things could be dif-

ferent in that zone compared to the rest of the country. For example, the new city might elect to use British law to govern commercial law or law surrounding investments in infrastructure rather than the existing law in Honduras. It might do that to make the new city a more attractive place to invest. Once the city makes that commitment and people invest on that basis, it will need to stick to that commitment. It might do this by signing treaties with others committing to this long-term arrangement.

The concept of a charter city has as its basis self-selection of its residents and the firms that move there. Is there a brain-drain effect on the regions outside that city? If the skilled workers and businesses with certain attributes move to the city, are there winners and losers?

You have to think about different geographic scales. Central America suffers now from a substantial brain drain toward the parts of the world that have vibrant, successful cities. So if you could get a vibrant, successful city of ten million in Central America, there would actually be a net reduction in the brain drain from the region. Frankly, the area is suffering brain drain of both skilled and unskilled workers, who take enormous risks to travel to the United States right now. Moving somewhere nearby rather than leaving the region would be a huge benefit for the region and for those people. Within the region, there will be places that end up with few people, just as there are in the United States—think of rural Nebraska—and that is OK. We should be concerned about the well-being of the people, not the well-being of the places.

What are the primary benefits of developing charter cities, not just for the people who will occupy them but for the rest of the world?

Look at the raw numbers; the enormity of what the world faces is overwhelming. Billions of people are going to move into cities in this century. Think about how to solve challenges at that scale—such as how to feed 6.3 billion people every day to avoid mass starvation. That ultimately happens because of what economists call mutually beneficial exchange. Ev-

everybody does things mostly out of self-interest but, it turns out, this leads to good outcomes, such as feeding everybody. To get good outcomes from self-interest, however, you need some kind of structure of rules. So the idea with charter cities is this—if we can create the right rules, we can help bring about this massive switch to urbanization around the world. All participants will share the benefits. People who move to cities will get the benefit of modern life in the city, and the investors who finance the infrastructure in these cities will get high returns on their investment. It is a true opportunity for a win-win solution, but it does take establishing the rules in the charter to protect all the parties.

The charter city concept also comes at an unusual and potentially fortuitous time in the global economy because the macroeconomic challenge the world faces right now is an insufficiency of investment demand. The rich countries all want to save more, and we know the only way for everybody to save more is if the world invests more. That means investment in physical objects such as machines, buildings, roads, and power plants. The world as a whole has to invest more if everybody wants to save. Here's another way to say that: If we are going to produce less in consumption goods, such as restaurant meals, we have to produce more durable things that will produce income in the future. But producing durable things means building machines, building factories, building roads. The problem right now is that the world doesn't know where to put this investment. It doesn't know where the high returns on investment will be, but the answer is staring us in the face. We know where trillions of dollars of very high return investments could take place—in building the infrastructure that will create the successful, livable, productive, modern cities to which billions of people are going to move.

You emphasized the importance of flexibility in the rules governing charter cities. Why is flexibility important, and what are the pitfalls if rules are too rigid and unchangeable?

A general problem that humans face is that we have norms about right and wrong, which are a very im-

portant source of the rules that govern our lives. Rules are partly laws and partly norms. What happens is that the world changes, but norms tend to stay fixed. The challenge is how to periodically update norms about right and wrong and update laws to take advantage of the new reality we face. Many developing countries still have norms and laws that made sense when people lived in rural settings in very small villages, but they are not adapted to the modern world of an anonymous city with 10 or 20 million people. We know those large cities can convey enormous benefits, but people have to switch from traditional norms that are based on things such as family association, reputation, and relationships with very small, closed groups to the more modern norms of anonymous exchange and adherence to the legal terms of a deal. In dense, urban settings, people also have to be more considerate of other people.

What kinds of densities do you anticipate for charter cities?

Density is kind of an outcome of a market process; it is not something you want to try to control as if you were doing central planning. That said, you still have to make some predictions about a likely density. A good rule of thumb that many people use around the world is that a piece of land can hold about 10,000 people per square kilometer. I have encouraged officials in Honduras to think about 1,000 square kilometers, which could translate into ten million people. Cities around the world have variations, from central Paris, which has 20,000 people per square kilometer, to suburban Atlanta, which has many fewer per square kilometer.

There is a great deal of unpopulated arable land available on a global basis, possibly for charter cities. Could there be other elements important to urban growth, such as access to ports and waterways, that might limit the actual quantity of land suitable for development of charter cities?

Yes. In a region where there is some surrounding political instability, it would be important for a city to be located on a coast where a port could be located; this would provide an additional guarantee to



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investors. The developers of a city would like to be able to say to investors that, no matter how much instability there might be in the surrounding region, this city will thrive, just as Hong Kong thrived even when the surrounding land in mainland China was going through the Cultural Revolution. A port is important because if a city is landlocked and has neighbors with hostile governments or militant or terrorist groups, its road and rail access to the rest of the world could be cut off. An isolated city that can't trade with the rest of the world won't be successful. But looking ahead, charter cities could be located inland. There are cities in the United States that don't rely on ships and waterways for trade with the rest of the world but still have lots of trade through trucks and trains. For cities where the surrounding land is in the hands of a stable government, the need for a coastline goes away.

The University of North Carolina's John Kasarda has popularized the term "aerotropolis," which refers to cities intimately tied to aviation, economically and geographically. Do you envision most or all charter cities as aerotropolises?

That term is used in two senses. One is that an airport actually forms the center of a city. Very few charter cities will actually make that choice. Much economic theory and practice suggests that the center of a city should be the business district with the tall buildings, and you wouldn't want to use that very valuable land for something land intensive like an airport. In general, successful cities have very dense centers and then less-dense areas away from the center. Most of the time, airports are located there with good transportation links from the center.

On the other hand, any successful city must have good connections to the global network of air travelers. This pushes us in the direction of anticipating cities that are larger than we used to anticipate. In Honduras, for example, officials could have thought about building a city of a million people, which already sounds pretty ambitious. But is this going to be a place where the major corporations will want to base their employees, where high-tech start-ups will want to open, where universities will want to grow

up? Many firms and employees are very sensitive to air transport links. They want to be within an hour's drive of a major hub airport, an airport where they can get direct flights to the other major hubs in the world. The more people who live in a city, the more likely it is that the city is going to have direct flights, that it is going to become a hub. I strongly encouraged the people of Honduras to think of a charter city of ten million rather than a million because such a city has a very good chance of becoming a major hub airport in Central America.

New cities should be big enough to have a major hub airport and should be located on coasts. Airports and seaports should be in close proximity so that firms that can locate near both of them have the best of both worlds in terms of transport.

Will cities lacking proximity to hub airports languish significantly in the coming decade?

There is a risk that we will see that. I'll give you an example. My first job was in Rochester, NY, which at one time was a major industrial city and a major corporate center; both Kodak and Xerox started in Rochester. Cities the size of Rochester are increasingly going to have difficulty competing with a city like New York because getting in and out of New York, both for people and for goods, is easier than getting in and out of Rochester. For Honduras, the issue is partly about mobility of the people but also about the transition from, say, garment assembly—the country ships garments to the United States—to iPad assembly. A successful city has to have a hub airport because iPads travel on airplanes, not ships.

A number of environmental concerns, including climate change, have heightened interest in the role that cities can play in mitigating environmental impacts. Do you envision some guiding principles that can enhance ecological profiles of charter cities? What are the special opportunities and challenges, particularly related to the use of uninhabited land?

First, the mere fact of having people move from rural settlement to urban settlement is good for the planet and the environment. It significantly reduces the hu-

man footprint on Earth. Part of the reason it is good is that as people shift from economic activities that exploit the natural resources of the land, they shift into the manufacturing services, knowledge-based productive activities, which offer more income and make much smaller demands on the environment. Consider a country like Indonesia. If Indonesia could build dozens of cities that offered people the opportunity to get jobs and education and to start connecting to the modern world that, say, Hong Kong offered in the 1950s and '60s, then Indonesians wouldn't devote so much of their human and natural resources to harvesting timber, clearing land, and exposing peat to grow palm trees for oil. Indonesia, a substantial emitter of carbon right now, would emit far less if Indonesians moved to cities.

In a new city, the charter might say that all electricity generation must use renewables or zero carbon. It's easier to do something different in a greenfield than to go back and retrofit an existing system. Some people are hoping that all new charter cities will, for example, rely only on extremely low carbon waste-generated electricity or use no liquid fuels to power vehicles. The problem with those hopes is that they impose the cost of reducing carbon emissions on the world's poor. It's a little bit like people in the United States and Europe saying, "We don't want to incur any additional cost to reduce our carbon emissions, so let's force the poor people of the developing world to pay more for their electricity." That is morally unjustifiable and the world's poor simply will not agree. There is a potential deal that could be done. Officials from a European country or the US might make this offer to a developing country: Rather than spending money to retrofit our electrical systems, we will subsidize you for adopting low carbon waste-generated electricity technologies.

You've worked with many governments and other organizations in the development of charter cities, such as the government of Honduras. What can you tell us about those experiences? Did anything come up that was unexpected in working with those organizations and governments?

The political systems in developing countries are

generally less stable than in richer countries, so I've encountered political instability. I had some conversations, for example, with a former government in Madagascar that were encouraging, but for unrelated reasons, the president was overthrown in a coup. Honduras had a constitutional crisis around the behavior of the previous president, who was removed from the country by the Honduran military. I started talking to the new democratically elected government after it took power. The government officials' willingness to try something new with the charter city partly reflects their understanding that their political system is a little bit unpredictable. They can't be sure whether they might have a president who is suspected of wrongdoing. In a way, the instability makes them more willing to take bold steps that other countries could conceivably benefit from.

Who owns the land in a charter city?

The beauty of the charter is that you can set things up in many different ways. One that deserves serious consideration is an arrangement in which the governing entity or the development authority for the city actually owns the land. Then what you could have is private ownership of the structures and leases of the land. This kind of arrangement could have some important advantages as a way of financing the operation of the government. Land that is now empty and worth nothing can become as valuable as the land in a city if a government takes certain kinds of actions: It provides a police force, a judicial system, the basics of public health, some education opportunity. If the government creates the value in the land, it could use that value to finance the investments it makes. This kind of arrangement creates incentives for governments to do the right things and take the right steps.

It sounds analogous to the concept behind tax-increment financing, on an even larger scale. As you mentioned, there is also some precedent for that sort of arrangement in existing cities.

Both Hong Kong and Singapore started in circumstances in which the government controlled the land and earned substantial revenue from the control of that land. Singapore developed the first non-oil sov-



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foreign wealth fund from the sale of land, and the fund is apparently quite large. It is a novel form of public finance that could have significant advantages.

In that sort of arrangement, what role could institutional real estate investors play?

There is a role for the coordinating function that a land developer plays. The governing authority might have responsibility for things such as policing and the judicial system, but large parts of the city could be leased to or put under the control of a developer. There is also the role of investors in the infrastructure. For example, the government might put out a tender saying it is willing to let a private firm build and operate an airport and collect landing fees as a way to earn a return on investment in the airport. This could probably be done with many types of infrastructure, even more than the types we ordinarily think about. The airport, the seaport, the power system, the water system could all be privately financed with returns captured in fee income that firms collect over time. Such arrangements could conceivably even extend to something like a road network if a firm used sensors to establish road usage and then charged for the usage.

These arrangements will take a legal system that is strong in two senses. It has to protect the investment of foreign investors so they earn the returns for many decades based on their investments. On the other hand, the investors that win the right to build the airport or the seaport based on an initial round of competition make certain commitments about how they will price things over time. The local government has to make sure that investors stick to those commitments. Unfortunately, in many PPP-like arrangements, where the private sector provides something that traditionally has been provided by the public sector, the firm that wins the contract overpromises and then breaks its promise as soon as it becomes the monopoly supplier. One of the paradoxes is that you have to have a very strong government to let the private sector do all the things the

private sector can do. I describe that kind of government as strong but narrow.

Can you give us an idea of the magnitude of investment involved?

Roughly speaking, three to five billion people will move into cities in this century. Put numbers on the capital per person, physical capital, and infrastructure per person, and three to five billion people translates very quickly into trillions of dollars of investment. In some ways, it is the investment opportunity not just of a lifetime but of all human history. It is truly an enormous opportunity and challenge. Lots of individuals, private funds, and sovereign funds have said they want to invest in infrastructure. So far, almost all the spending has been to purchase existing infrastructure. It hasn't led to investment in the sense of producing new things, because the places where new investment would be most valuable have high political risk. But if we can use a mechanism like the charter city to get rid of the political risk, then we can unleash the mutually beneficial exchange I was talking about and unleash it in very large magnitudes. In any venture like this, the people who get in early and learn how things work will do better than those who come in after things get commoditized, so to speak. The very large-scale investors should be looking around the world and asking what it would take to remove political risk from our calculations and then where we could go to create huge value with new investment projects.

A lot of intellectual and political energy has been devoted to trying to remove conventional barriers to trade, but political risk associated with infrastructure investment is much more harmful and costly than the barriers to trade that persist around the world today. We should devote much less attention to conventional trade, tariff, and quota barriers and pay much more attention to political risk because this impediment is really hurting the whole world.

Thank you for taking the time to talk to us. ■