

**Imagine There's No Country: Three Questions
about a New Charter City in Honduras**

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June 2012

www.cgdev.org/content/publications/detail/1426274



ABSTRACT

Paul Romer has an out-of-the-box vision to promote global development without aid or charity—what Sebastian Mallaby in *The Atlantic* called “the politically incorrect guide to ending poverty.” His proposal, in a nutshell, is to build more Hong Kongs: places where third-world immigrants and first-world governance can meet on neutral territory. But as Honduras launches the first trial of Romer’s charter city model, a number of core challenges remain.

The genius of the model is that it provides a politically feasible way to capitalize on one of the most effective (yet underexploited) policy tools for reducing global poverty: immigration. For the time being, as long as rich countries with strong institutions and good economic opportunities—Romer often cites Canada—don’t want more Honduran or Haitian immigrants, charter cities with Canadian-style governance provide a second-best solution.

But for all of its attractions, the charter city model – and the Honduran plan in particular – still faces significant challenges before it can muster the kind of widespread support from potential partners it needs to succeed. What follows are three big questions we think supporters of the new Honduran city need to address, and two ways to do so.

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Imagine There's No Country: Three Questions about a New Charter City in Honduras

Paul Romer has an out-of-the-box vision to promote global development without aid or charity—what Sebastian Mallaby in *The Atlantic* called “the politically incorrect guide to ending poverty.”¹ His proposal, in a nutshell, is to build more Hong Kongs: places where third-world immigrants and first-world governance can meet on neutral territory. But as Honduras launches the first trial of Romer’s charter city model, a number of core challenges remain.

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Inspired by Romer’s vision, the Honduran legislature passed a constitutional amendment in January 2011, creating a new legal entity called a “Special Development Region,” or RED by its Spanish acronym.² It’s anticipated the first RED will be somewhere on Honduras’s gulf coast, near the sleepy seaside town of Trujillo.

But for all of its attractions, the charter city model – and the Honduran plan in particular – still faces significant challenges before it can muster the kind of widespread support from potential partners it needs to succeed. What follows are three big questions we think supporters of the new Honduran city need to address, and two ways to do so.

#1. Is the charter city model antidemocratic?

The first question proponents of the Honduran charter city need to address is whether and how accountability in the new zone can be ensured without democracy. Can the new zone gain traction among potential partners and potential migrants if significant checks and balances do not exist? With respect to its origins and execution, the RED has an

Full disclosure: Several individuals at the Center for Global Development have close links to the proposed Special Development Regions in Honduras. Paul Romer is a CGD non-resident fellow. CGD’s president Nancy Birdsall and senior fellow Michael Clemens are both charter members of the Transparency Commission appointed to oversee the zones. CGD does not take institutional positions. The views expressed here reflect the authors’ personal views, offered in CGD’s spirit of open debate. For more on the charter cities concept, see Romer (2009); for more on the development in Honduras, see “City Building: Hong Kong in Honduras” (2011). Clemens (2011) details the power of immigration to reduce poverty.

¹ Mallaby (2010)

² National Congress of Honduras (2011)

uncomfortable relationship with democracy. First, its planners have decided that the risks associated with elections in the developing world are too great, and have opted instead to impose, at least initially, an unelected system of government within the RED. Second, the formation of the RED stems from a troubled period in Honduras's democracy, and reflects an explicit desire to combat populism by keeping governance decisions for the RED out of the hands of future Honduran leaders.



Source: dreamsofcities.blogspot.com. The anticipated site of Honduras's first "Special Development Region" spans largely uninhabited farmland east of Trujillo on the gulf coast.

Immigrants to the charter city will be ruled by a governor appointed by Honduran President Pepe Lobo. Future governors will be appointed by the members of a Transparency Commission, comprised of eminent international figures, also appointed by President Lobo.

In lieu of the ballot box, the charter city model offers poor migrants the opportunity to vote with their feet. As Romer and co-author Brandon Fuller explain in a working paper, "legitimacy derives from residents' decisions to opt-in to the new rules as well as the social inclusion that follows from equal application of the rules to all residents."³

The notion that people move to find public policies they like—what economists call Tiebout sorting—is a theory with long history and some empirical support within the United States.⁴ But picking up one's family and moving across international borders poses enormous tradeoffs and costs. It's commendable that families are free to enter and exit the RED. But

³ Fuller and Romer (2012)

⁴ Banzhaf & Walsh (2008)

this free movement is rarely considered a substitute for democratic political participation, or an alternative to basic voting rights. We are not arguing that Hondurans have a god-given right to elect their local representatives. However, under the charter city vision many (if not most) of the residents of RED will be non-Hondurans and would lack any representation.

We have enormous respect for both the ethics and intellect of the individuals we know who have been appointed to the Transparency Commission so far, including, of course, our boss and CGD president Nancy Birdsall.⁵ But the members of the Transparency Commission will wield enormous power over a population they know little about, and to whom they have zero accountability. Fuller and Romer note that this period of rule by the commission will be temporary:

As the population of the RED grows and conditions of safety and trust emerge there, the Commission will recede into the background by managing a transition to local democratic selection of the governor and the local legislature.⁶

While it is silly to equate the Transparency Commission with a military junta—after all, Honduras changed its constitution of its own volition to empower the Commission with such unique powers—the phrasing here is eerily reminiscent of the paternalistic declarations made by coup leaders, declaring that their true intentions are purely democratic in the long run.⁷ Although the analogy is imperfect, under both scenarios there is a discernible democratic deficit.

Turning to the genesis of the RED itself, it is important to note that the enabling legislation for the new zone won broad approval in the Honduran legislature. But Honduras is a country in the process of reestablishing its democratic order in the wake of a constitutional crisis. As Adam Davidson writes in a recent *New York Times* profile:

Shortly after the 2009 coup that overthrew Manuel Zelaya, Honduras's newly elected president, Porfirio Lobo, asked his aides to think big, really big. How could Honduras, the original banana republic, reform a political and economic system that kept nearly two-thirds of its people in grim poverty?⁸

Lobo came to power after Zelaya, a democratically elected leftist with populist tendencies, was forced into exile and prevented by the military from challenging Lobo in presidential elections. The RED is, among other things, a way to enshrine market-oriented economic policies outside the reach of future elected leaders. With this background, the Lobo

⁵ Fuller (2011)

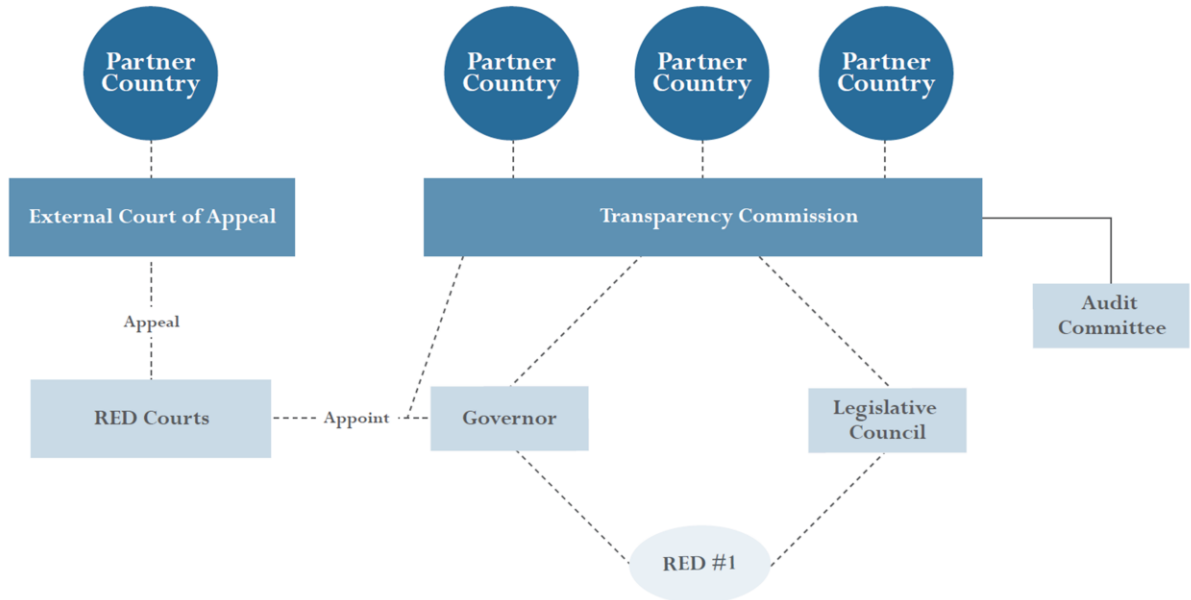
⁶ Fuller and Romer (2012)

⁷ “Mali Coup Leader” (2012)

⁸ Davidson (2012)

government would do well to focus on reaffirming its democratic *bona fides*. That shouldn't be inconsistent with founding a charter city, but it should affect how the city is governed.

Figure 1 RED Governance Structure



Source: Fuller and Romer (2011). Note that the governor will be appointed rather than elected by residents of the RED, and elections for the Legislative Council will not be held until “conditions of safety and trust emerge”. Also, partner countries to oversee the Transparency Commission have not stepped forward, thus the commission will also be appointed by the Honduran President.

#2. Does the Honduran charter city have a time inconsistency problem?

A second challenge relates to the issue of time inconsistency, or the fact that policymakers' preferences today might be inconsistent with their preferences tomorrow. This is relevant because while the current Honduran president and Congress are heavily invested in the RED and its unique governing structure, future governments need not be. This is an important issue because in order for the RED to attract foreign investment, which is essential to its success, it needs to convince investors that the government of Honduras can credibly commit to protecting the autonomy of the RED and the quasi-sovereign powers of the Transparency Commission. The proponents of the RED are well aware of this risk, which is why they emphasize the great lengths to which domestic actors will have to go in order to modify the powers of the Transparency Commission. As Fuller and Romer (2012) write:

The Transparency Commission will be largely independent of future governments in Honduras. To change the enabling legislation that specifies the powers of the Transparency Commission, the Honduran Congress

would need a two-thirds majority vote of approval *as well* as an approval by referendum among the residents of the RED. This procedure serves two purposes: it provides a check on the conduct of the Transparency Commission, but it also sets a very high hurdle for any future Honduran government that wishes to interfere in the reform zones (an additional “guarantee” to firms and residents of the special zone could come via treaties negotiated by the Transparency Commission and approved by the current Honduran Congress, presumably with partner countries).[[citation]]

Much like America’s founding fathers insisted on a high hurdle for amending the U.S. Constitution, Honduran legislators have tied the hands of future Honduran governments by legislating a high bar for amending the powers of the Transparency Commission. On its face, the institutional framework governing the RED seems to be iron clad. Yet, one thing we know about Honduras is that very little has proven to be iron clad, historically speaking. We refer again to the 2009 constitutional crisis when then-President Manuel Zelaya was ousted in a coup.⁹ According to data collected by the Center for Systemic Peace, between 1954 and 2010, Honduras witnessed five successful coups (1956, 1963, 1972, 1975, 1978) and two unsuccessful coups (1977, 1999) in addition to the 2009 coup involving President Zelaya.

What is to prevent a future leader or government of Honduras from negating the institutional undergirding of the RED?

#3. Is it possible to create a blank slate in Honduras?

One of the underlying assumptions motivating the charter cities concept is that in countries with weak institutions and poor governance, one can carve out a piece of undeveloped territory and establish a new set of institutions (and the norms these rules encourage), which might offer residents—as well as foreign migrants—the opportunity to break from the suboptimal institutions that prevail in their respective home countries. In other words, the belief is that charter cities can provide a relatively blank slate on which to operate.

But is it realistic to expect that charter cities can truly operate on a blank slate? After all, culture is a deeply embedded social construct. Take, for instance the well-known paper of Fisman and Miguel on the issue of diplomatic parking tickets in New York City.¹⁰ Diplomats from countries around the world converge in New York City to staff their countries’ missions at the United Nations. In a context of weak legal enforcement (diplomatic

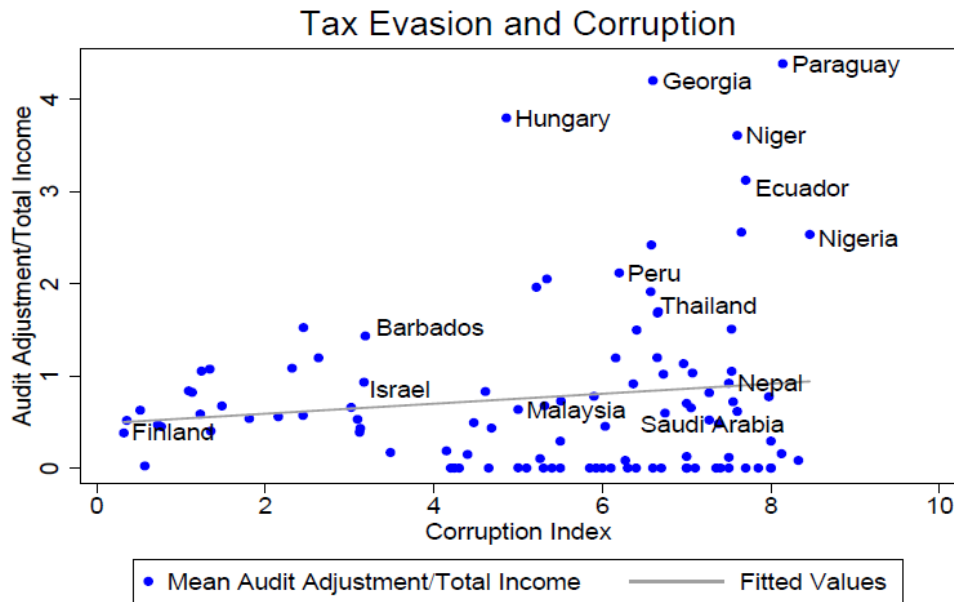
⁹ Ruhl (2010). Zelaya was ousted after he attempted to hold a referendum on convening a constitutional convention, a move that was seen by some an effort to extend his rule. A Honduran truth and reconciliation commission ruled that Zelaya had broken the law by insisting on holding the referendum, but that the effort to oust him through a coup was also illegal.

¹⁰ Fisman and Miguel (2007)

immunity means visiting foreign diplomats living in New York do not have to pay parking fines), diplomats from high corruption countries rack up significantly more parking violations.¹¹

Or take another recent example from the economics literature. The United States is said to lose hundreds of billions of dollars a year in revenue due to tax evasion. In a recent study, DeBacker, Heim and Tran (2012) examine 25,000 confidential IRS tax audits of foreign-owned corporations.¹² They suggest that “corporate tax evasion by foreign-owned corporations in the U.S. provides a natural experiment because it subjects firms with different home-country norms to the same legal and enforcement incentives in the United States.” As the figure from their paper suggests below, the authors find that high corruption norms are robustly associated with increased tax evasion, especially among small and medium firms. The take-away then is that cultural norms shape firm behavior—Nigerian firms are more likely to engage in tax evasion than Swedish firms, *ceteris paribus*, even when they are all doing business within the same institutional context (e.g. the United States).

Figure 3. Tax Non-Compliance and Corruption



Source: Internal Revenue Service, Transparency International

Source: DeBacker, Heim and Tran (2012)

¹¹ Furthermore, officials from countries where anti-American sentiment is greater commit significantly more parking violations.

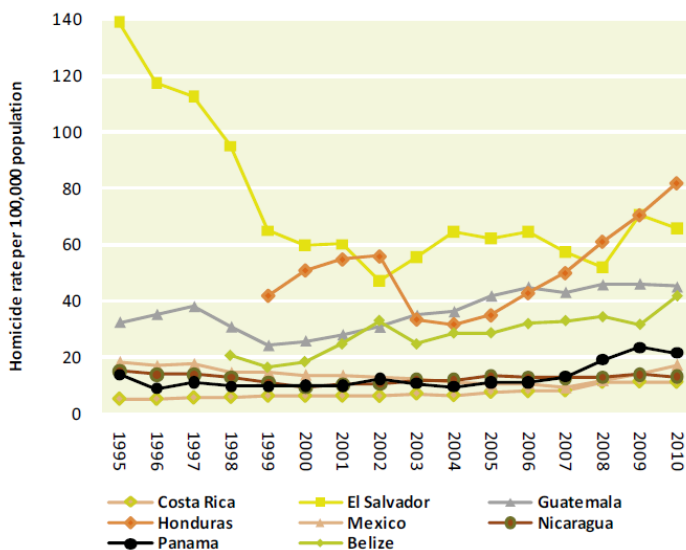
¹² DeBacker, et al. (2012)

If these and other studies are to be believed, it seems reasonable to expect that the norms and beliefs which will prevail in the RED will be, at least in part, a function of the preexisting norms and beliefs of Hondurans and those migrants from outside of Honduras.

Even if one ignores these findings from the literature and accepts the premise that the RED can provide a reasonably close approximation of a blank slate, it is a slate—thanks to open borders—that is vulnerable to negative spillovers from the rest of Honduras. Unfortunately, the domestic challenges facing Honduras are myriad—chief among them is violent crime. According to the United Nations Office on Drugs and Crime (UNODC), Honduras has the highest per capita murder rate of any country in the world.¹³ The murder rate in Honduras doubled between 2005 and 2010 to 82 intentional homicides per 100,000 inhabitants. As the figure below demonstrates, even when compared to its regional peers in Central America, Honduras’s homicide rate stands out.

Given that the charter cities concept is premised on a belief in open borders, limited state intervention, and labor mobility, what is to prevent the RED from being influenced—indeed, taken over perhaps—by the existing norms and practices which plague much of Honduras today?

Fig. 3.11: Homicide rates by country, Central America (1995-2010)



Source: UNODC Homicide Statistics (2011).

Source: UNODC Global Study on Homicide 2011

¹³ UNDOC (2011)

Bugs or features?

Do these challenges represent bugs in the Honduran experiment, or are they features of Romer's original design?

The solution to the time inconsistency problem and, to a lesser extent, the transformation of norms is intrinsic to Romer's original vision for charter cities. But it's an element of that vision that Honduras has so far failed to acquire: a foreign sovereign to back up the charter. While the Honduran legislature may be tempted to renege on the protections afforded to the RED, involving a foreign partner like Canada or the UK would provide a meaningful way for Honduran leaders to tie their own hands. And borrowing some of the institutional infrastructure of a well-developed partner country would avoid the pitfall of defining institutions purely in the negative. (Achieving good governance is not just about escaping Honduras and achieving an illusory blank slate, but also creating new, robust institutions.)

Romer fully understands this, which is why he and his colleagues have been reaching out to the governments of Canada, the United Kingdom, and other rich countries to convince them to partner with the RED. There has been one success on this front: the government of Mauritius, a development success story of recent decades, has agreed in principle to partner with the RED on its justice system, providing an independent court of final appeals for disputes in the RED.

But without a full suite of partners taking ownership of key facets of the zone's economy, it is not clear how the RED can fulfill the charter city vision. In a sense, Honduras would be attempting to repeat the success of Hong Kong, but without Britain. But in order for RED to be a success, its planners not only have to ensure the new zone is unencumbered by the ghosts of institutions past, but they also have to create a new set of institutions backed up by credible sovereign partners.

Part of the blame here lies with the Honduran legislature. Fuller and Romer write, somewhat optimistically:

Most Chinese still view Britain's use of force in seizing Hong Kong as an affront to Chinese sovereignty. But many will also acknowledge that, if they had the chance to replay history, they would gladly and voluntarily offer Hong Kong to the British. Honduras now wants to make a similar offer.¹⁴

This is less than clear. Honduras appears reluctant to forfeit the degree of sovereignty that the charter city model demands. (And we are skeptical about China's willingness to replay

¹⁴ Fuller and Romer (2012)

Britain's role in Hong Kong.) Contrary to the idea of a charter city as a magnet for foreign capital and migrant labor, Tegucigalpa's *El Heraldo* reports that while Hondurans will be able to freely enter the RED with their national ID cards, foreigners will be subject to an as-yet-undefined immigration-screening system.¹⁵ More worrisome, 90 percent of employment in the RED is to be reserved for Honduran nationals, who must be paid at least 85 percent of the wages of foreigners. And some in Honduras are questioning whether foreigners will be able to buy land within the RED, normally prohibited under the Honduran constitution.¹⁶

On the plus side, the Honduran legislature's reluctance to fully embrace Romer's vision and divorce the RED from the Honduran political system has preserved elements of democracy missing in the abstract model. Hondurans in the city will still be able to vote, presumably, for the Honduran president. But a fundamental tension still remains between democracy and development as the charter city model envisions it.

The charter city model remains one of the most interesting and innovative proposals to stimulate development in the developing world. Thus, it is worth doing right. To make that possible, rich countries need to step up to the plate and lend whatever governance expertise the Hondurans are prepared to accept. To get them on board, the city's planners need to drop the false dichotomy between good governance and a robust, participatory democracy.

¹⁵ "El sueño de una "ciudad modelo" en Honduras" (2011)

¹⁶ "Estatuto de ciudades modelo es inconstitucional " (2011)

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