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Success and the City

How charter cities could transform
the developing world

By Brandon Fuller and Paul Romer



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Foreword

It is rare when a truly “new” idea emerges in the field of international development and rarer still when the idea has the potential to engender massive change. This is why the idea of creating a Charter City in Honduras, presented by Paul Romer and Brandon Fuller, is so important.

While the idea is not new in the sense of never having been seen, it is new in the sense of uncovering the importance and potential of something that has been overlooked. Romer and Fuller’s idea, in short, is to try and replicate the key elements of the dynamic that existed between Hong Kong and the People’s Republic of China when it took over the city and its highly effective institutions and organisations and use these to test models that were transplanted to China and eventually helped to spur massive economic growth and reductions in poverty.

That institutions – the norms and structures or “rules of the game” that determine how organizations and individuals co-exist and prosper or work at cross purposes and stagnate – are critical for development has not been a secret to the international development community. Figuring out how to create successful institutions, however, has been a mystery. The typical small-scale interventions of even the largest development agencies simply lack the scale and persistence to create wider, sustainable change. A program, or even programs, to train staff at a ministry or conduct seminars for chambers of commerce or fund scholarships simply will not cut it. Whole new sets of ministries and new chambers and new judiciaries and other organizations are needed.

On the other hand, the transfer of knowledge of institutions and familiarity with their function is occurring globally, and on a massive scale, through migration. Tens of millions of people from societies with poor institutions have elected to leave and in so doing have chosen to opt into societies with institutions that work and that offer them a chance to earn a living and offer more to their families. More than just money,



these diasporas are also sending and bringing home new ideas for businesses, for education, and understanding and expectations for how societies and rules should function to allow economic growth and freedom. Though these transfers are having impacts at the family, neighbourhood, and village levels the impacts are still too disaggregated, too slow, and too atomized to have impact at the national or even regional level and to create macro level self-sustaining change.

The idea to establish a charter city as presented by Romer and Fuller offers a potential new path around both of these sets of obstacles.

Creating city-sized institutions and organisations is a scale that is small enough to be do-able yet large enough to have impact. Such a city can also accelerate and concentrate the transfer of knowledge and practice that is occurring through globalisation and migration and do so without forcing the poor to make the enormous economic and human sacrifices that migrating to North America or Europe requires.

The government of Honduras is working to establish a special development region that is based in part on the idea of a charter city. In so doing, it hopes to give the country, and any Hondurans who choose to opt in, a chance to try a new model of development. This presents Canada, in partnership with others, a chance to join in the experiment and to do something that it has been unable to accomplish anywhere with its traditional development assistance and traditional development actors: Be successful in a meaningful way on a scale that matters.

Honduras is currently a country of focus for Canada and is its largest recipient of bi-lateral aid in Central America. All of this attention amounts to roughly CD\$23 million a year spread over 20 widely divergent projects. Additionally, 500 Hondurans participate annually in Canada's temporary foreign workers program. This is probably the limit for Canada for traditional development assistance to Honduras. Yet it is impossible to see any or all of this having any significant macro impact in a country of over seven and a half million people.

Recognizing this shortcoming, Canada has been trying to supplement its traditional development assistance by promoting trade and signing trade agreements. These agreements offer an important opportunity for countries like Honduras to create the types of formal sector jobs that can reduce poverty and give poor Hondurans the types of opportunities they now must seek in the United States. But the agreements only offer an opportunity. They cannot, in and of themselves, provide the types and scale of change necessary to fully realize it. The agreements are also undermined by Canadians' worries over labour, environmental, and judicial standards and their enforcement in places like Honduras.

A charter city would, again, be able to surmount both obstacles. The city would bring a set of institutions and structures that would allow a country like Honduras to more fully and equitably benefit from foreign trade. These institutions would also directly address concerns about labour, environmental, and other standards.

What Paul Romer and Brandon Fuller propose is an experiment and there remain details to be ironed out. There are also few places more difficult to try such an experiment than Honduras. Yet, if the Charter City concept proves successful the potential reward is staggering: A new model of development that actually works. If the idea does not work, neither Honduras nor Canada would be worse off. That alone makes this a risk worth taking. The question now for Canada is, how serious is it about its commitment to help the world's poor? Is it willing to try new ideas and new models that will give countries like Honduras the resources to take control of their own development? If so, there is no better place to start than with proposal presented here by Paul Romer and Brandon Fuller.



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Executive Summary

The United Nations expects the urban population in less developed regions to double in the next four decades alone, from roughly 2.5 billion to over 5 billion people.¹ This wave of urbanization presents a unique opportunity for billions of people to live healthier, greener, and more prosperous lives. The Charter Cities Initiative aims to channel this unprecedented scale of urban growth in a positive direction, offering new choices to reform-minded political leaders as well as new choices to migrants in search of better places to live and work.

A charter city is a new type of special zone, one that can serve as an incubator for reform. In partnership with credible allies, a developing country can pursue reforms in a special zone large enough to one day accommodate a city with millions of residents. By starting on a new and undeveloped site, the formal rules in a charter city, and the norms that these rules encourage, can differ markedly from the ones that prevail elsewhere in the country. These rules can nevertheless be legitimate in the eyes of the migrants to the zone, just as the rules in high-income countries are legitimate in the eyes of the few immigrants that manage to move from less developed countries.

Honduras recently decided to pursue a path that is based in part on the charter cities concept. The Congress there defined a new legal entity, la Región Especial de Desarrollo (RED). The government will soon use the RED to establish a reform zone to which families can move safely and legally. The RED government will be largely independent from the Honduran central government. The leadership in the RED will have the power to partner with foreign governments in critical areas such as policing, the courts, customs, and anti-corruption.

By participating in the governance of the RED, credible partner governments can make the new city a more attractive place for would-be residents and investors. With protections from a modern system of law and administration, foreign direct investment in infrastructure can support the growth of a new city in the RED, a city that can eventually become a hub for the Americas.

The RED presents an opportunity to tackle directly the biggest obstacle to growth and development all over the world: the dysfunctional systems of rules and enforcement that keep people from reaching their true potential. It is possible for Canada, along with other reputable governments, to help establish institutional credibility in an undeveloped region in Honduras to which millions of people could move. Such a partnership can do what traditional aid cannot: offer people a chance to live and work in a safe and well-run city, a city that provides economic opportunities for Canadians and Hondurans alike, and a city that has the potential to inspire reform in Honduras and throughout the Americas.



¹ United Nations Department of Economic and Social Affairs (2010). *The World Urbanization Prospects: The 2009 Revision*. United Nations. Available on the Internet at: <http://esa.un.org/unpd/wup/index.htm>, as of February 11, 2012.

Sommaire

Les Nations Unies s'attendent à ce que la population urbaine dans les régions moins développées de la planète double au cours des quatre prochaines décennies seulement, pour passer de 2,5 milliards à 5 milliards de personnes.² Cette vague d'urbanisation représente une opportunité unique pour des milliards de personnes de mener une vie plus en santé, plus prospère et dans un environnement plus sain. En s'appuyant sur cette croissance urbaine d'une ampleur sans précédent, l'Initiative des villes à charte espère proposer des choix nouveaux aux leaders politiques souhaitant mettre en œuvre des réformes ainsi qu'aux migrants à la recherche d'un meilleur endroit où vivre et travailler.

La proposition sur les villes à charte s'appuie sur l'idée que les pays en développement peuvent conclure des partenariats avec des alliés fiables et crédibles pour adopter rapidement des réformes dans des zones spéciales qui seront d'une taille suffisante pour pouvoir un jour devenir des villes avec des millions de résidents. En débutant sur un site nouveau et non encore développé, les règles formelles d'une ville à charte, de même que les normes que ces règles encouragent, peuvent se distinguer fortement de celles qui dominent ailleurs dans le pays. Ces règles peuvent tout de même être perçues comme légitimes aux yeux des migrants dans la zone, tout comme les règles qui prévalent dans les pays à revenu élevé sont légitimes pour les quelques immigrants des pays moins développés qui réussissent à y déménager.

Le Honduras a récemment décidé de s'engager dans une voie qui se fonde partiellement sur le concept des villes à charte. Le Congrès de ce pays a instauré une nouvelle entité juridique, la Región Especial de Desarrollo (RED). Le gouvernement s'appuiera bientôt sur la RED pour établir une zone réformée où les familles pourront déménager en toute sécurité et en accord avec la loi. L'administration de la RED sera en grande partie indépendante du gouvernement central hondurien. Les décideurs au sein de la RED auront le pouvoir de conclure des partenariats avec des gouvernements étrangers dans des domaines d'une importance cruciale tels que la police, l'administration de la justice, les douanes et la lutte anticorruption.

En participant à la gouvernance de la RED, des gouvernements partenaires crédibles peuvent faire de la nouvelle ville un endroit plus attrayant pour les résidents et investisseurs potentiels. En s'appuyant sur la protection offerte par un système moderne de justice et d'administration, les investissements étrangers directs dans les infrastructures peuvent encourager la croissance d'une nouvelle ville dans la RED, une ville qui pourra éventuellement devenir une plaque tournante pour les Amériques.

La RED offre une occasion de s'attaquer directement aux plus gros obstacles à la croissance et au développement à travers le monde : les systèmes dysfonctionnels de règles et de mise en œuvre des règles qui empêchent les gens d'atteindre leur plein potentiel. Le Canada pourrait, avec d'autres gouvernements ayant bonne réputation, aider à l'établissement d'une crédibilité institutionnelle dans une région non développée du Honduras où des millions de personnes pourraient déménager. Un tel partenariat peut faire ce que l'aide traditionnelle ne peut faire : offrir aux gens une chance de vivre et de travailler dans une ville sécuritaire et bien gérée, une ville qui procure des opportunités économiques pour les Canadiens comme pour les Honduriens, une ville qui a le potentiel d'inspirer la mise en œuvre de réformes au Honduras et à travers les Amériques.

2 Nations Unies, Département des affaires économiques et sociales, *The World Urbanization Prospects: The 2009 Revision*, 2010. Consulté sur Internet le 11 février 2012 à l'adresse <http://esa.un.org/unpd/wup/index.htm>.

Introduction

A charter city is a new type of special reform zone. It extends the concept of a special economic zone by increasing its size to the scale of a city and expanding the scope of its reforms. During this century of rapid urbanization, charter cities can offer families in the developing world an option that far too many currently lack: a choice between several well-run cities, each of which is competing to attract them as residents. This combination of choice and competition is the best strategy for improving the worldwide quality of life.

Honduras recently took bold steps toward establishing a new reform zone, based in part on the charter cities concept. The goal is to try new reforms in a new city that can offer a safer and economically dynamic alternative for families who currently lack good options. Should the new city succeed, it can demonstrate the potential for reform elsewhere in Honduras, much as British-run Hong Kong helped to inspire reform and development in China. As a leader in the Americas, Canada can partner with other countries to help Honduras achieve this goal, not with traditional aid or charity, but with the institutional know-how that supports economic prosperity and the rule of law.

The Urbanization Project

Roughly 10,000 years ago, humans began a remarkable undertaking, what Shlomo Angel has called “the Urbanization Project.”³ Ever since, we have been drawing together in dense urban areas. This project is roughly halfway done; about 3.5 billion people now live in cities. By the end of this century, total population will likely stabilize at 10 to 11 billion, and most societies will converge in urban areas at rates of 70 to 80 percent.⁴ This means that we will see more urbanization this century than in all of history to date. It also means that in the lifetimes of today’s children, we will complete the urbanization project. We will have built the system of cities that our descendants will live generations to come.

Informal settlements offer none of the protections that formal rules can provide.

The question, therefore, is not whether billions of people will soon gather together in cities, but where and under what conditions. Under conditions of policy-as-usual, people will flock to slums that surround cities whose governments either do not want additional residents or are incapable of accommodating them. Many people will become second-class citizens in informal settlements that, by definition, offer none of the protections that formal rules can provide. Even for migrants who manage to gain access to formal systems of rules in the developing world, the protections and opportunities in the cities that will accept them will often be well below those offered by the rules in the cities where they would rather live.

This needn’t be the case. The coming wave of urbanization has the potential to dramatically reduce global poverty, and to do so in a way that is not dependent on aid or charity. Fulfilling the poverty-reducing potential of cities will instead require good governance. Good governance brings with it not only safety and equal treatment under the law, but also the investment and mutually beneficial exchange that allow cities to thrive.

3 See Dr. Shlomo Angel’s website at NYU Wagner: <http://wagner.nyu.edu/angel>

4 Angel, Shlomo (forthcoming, September 2012). *Planet of Cities*. Cambridge: Lincoln Institute of Land Policy.

Managing Political Risk

For the firms and sovereign wealth funds capable of investing in large-scale urban infrastructure projects, the rapid growth of cities can offer enormous opportunities for high-return investment; these investments can, in turn, offer billions of people in the developing world the chance to work their way out of poverty. Yet, many such opportunities will go unrealized if the world cannot effectively mitigate political risk, a barrier to exchange that dwarfs all of the familiar tariff and non-tariff barriers that attract so much official attention.

One form of political risk arises when a government cannot commit to the rule of law in its future dealings with investors. A more pernicious form arises when a government is too weak to prevent socially harmful opportunism by predatory firms. Where such risks are high, firms that are efficient and honest stay away. The firms that remain, those that specialize in exploiting institutional weakness, end up limiting competition and opposing reform.

Political risk is a particularly acute problem for infrastructure investments. Because infrastructure lasts for decades and often creates a natural monopoly, opportunism is very difficult to prevent. Over time, both the investor and the regulator need discretion and flexibility to respond efficiently to unforeseen contingencies. This discretion creates opportunities for each side to gradually depart from the intent of the original agreement. The problem lies not so much in the risk of headline-grabbing expropriation or shutdown, but rather in the risk of death by a thousand cuts. The political risks inherent in weak governance, along with related problems such as crime and violence, are enough to keep potentially lucrative and socially beneficial infrastructure investment away from the parts of the world that need it most.

Opportunities will go unrealized if the world cannot effectively mitigate political risk.

There are other options. Proposals that address the bottleneck of political risk in the developing world can generate new opportunities for high-return investment and better choices for the world's poorest residents. The opportunity today is to create new political structures, structures that reduce political risk to a negligible level and create the conditions for inclusive growth driven by foreign investment in urban infrastructure. Charter cities, a new type of special reform zone, are one such structure.

Charter Cities

A charter city extends the concept of a special economic zone by increasing its size and expanding the scope of its reforms. It must be large enough to eventually accommodate a city with millions of residents, the scale at which the services and amenities of modern urban life become feasible. Its reforms must extend to all the rules needed to structure interactions in a well-run city and to support exchange in a modern market economy. The concept allows for government partnerships that facilitate the transfer of working systems of rules to new locations.

Rules in this context encompass what academics often refer to as “institutions” – the social norms and the formal laws (together with enforcement systems) that determine how people interact. Outdated rules often hold people back. Some rules might make it too easy to be a criminal or too hard to start a formal sector business. Other rules limit competition, for example by prohibiting private firms from producing and selling electric power. As a result, the citizens of poor countries often end up paying the most for basic goods such as electricity, if they have access to it at all.⁵

Social groups have difficulty achieving the consensus required to change their rules and norms.

The places where rules are weak and inefficient are also the places where job-creating investment could offer the highest returns. Yet firms build new factories not in the parts of the world where people are most eager for formal-sector jobs, but in places where electricity is inexpensive, people and property are safe, and the rules for doing business are straightforward, predictable, and reasonably efficient.

Though better rules should be easy to replicate, experience shows that social groups at all scales, from firms to cities to nations, have great difficulty achieving the consensus that is required to change their rules and norms. In this setting, competition between different jurisdictions – with each trying to attract new members by implementing better rules – can be a powerful source of human progress. This competition is particularly powerful if new entrants, new start-up jurisdictions, can challenge incumbents.

Migrating to Better Rules

The world’s poor are well aware that better rules prevail elsewhere. Gallup reports that 630 million people would like to move permanently to another country. If such migration were allowed, more would surely follow as people in the developing world began to learn of opportunities elsewhere through their increasingly global social and familial networks.

The income gains experienced by the people who beat the odds and manage to migrate illustrate just how much difference the rules can make. The people who move to environments with good rules earn wages three to seven times higher than the wages they earned in the environment of dysfunctional rules they left behind.⁶ This kind of individual gain, multiplied by the billions of people who would benefit, suggests that the pure gain, the pure increase in output for the world as a whole, is astonishingly large – large enough even to dwarf the cost of building the new cities where they could move.

5 Legros, Gwénaëlle, Ines Havet, Nigel Bruce, and Sophie Bonjour (2009). *The Energy Access Situation in Developing Countries*. United Nations Development Programme and World Health Organization. Available on the Internet at http://content.undp.org/go/cms-service/stream/asset/?asset_id=2205620, as of February 11, 2012.

6 Clemens, Michael, Claudio Montenegro, and Lant Pritchett (2008). *The Place Premium: Wage Differences for Identical Workers across the U.S. Border*. Center for Global Development Working Paper No. 148. Available on the Internet at <http://www.cgdev.org/content/publications/detail/16352>, as of February 11, 2012.



To put this gain in context, consider that, by most estimates, further reductions in barriers to trade would increase worldwide income by less than a few percentage points. The estimated gain from letting all people move to places with good rules? An increase in worldwide income of 50 to 150 percent.⁷

Because the most desirable countries either will not or cannot accept migrants in sufficiently large numbers, the scale of migration remains so small that it can realize only a tiny fraction of this potential increase in worldwide output. On the other hand, forcing immigration on countries that don't want it is no more sensible than ignoring the hundreds of millions of people who could lift themselves out of poverty if offered a chance to move to a place with better rules. Charter cities offer a third option: copying rules that work and putting them to use in new cities where migrants are welcome.

The charter cities proposal suggests that developing countries can partner with credible allies, using reform zones to implement rules that are known to work well. By starting on a new site, the

formal rules in a charter city, and the norms that these rules encourage, can differ markedly from the ones that prevail elsewhere in the country. These rules can nevertheless be legitimate in the eyes of the migrants to the zone, just as the rules in a high-income country are legitimate in the eyes of the few immigrants allowed in.

In a charter city, 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. For example, William Penn's charter for Pennsylvania (which inspired the term, charter city) was a critical step in the development of rules that enforce a separation between church and state. His legal guarantee of freedom of conscience attracted people from all over Europe. It had instant legitimacy for the immigrants at a time when religious tolerance in Europe and the United States was extremely controversial. Ultimately, this core value of Penn's social start-up spread throughout the colonies and eventually was embedded in the Constitution of the United States. In the same way, reforms that have a chance to take hold in charter cities can then spread to the surrounding region.

To grow, new cities will have to attract new residents by offering good rules. In doing so, successful new cities will give existing cities stronger incentives to reform. This competitive dynamic suggests a very different way to think about development policy. Rather than enumerate an ever longer wish list of laudable end goals, we could settle on one goal as a means to those ends: Give every family a choice that far too many currently lack, the chance to choose among several well-run cities, each of which is competing to attract new residents.

If people move to places with good rules, worldwide income could increase by 50 to 150 percent.

⁷ Clemens, Michael A. (2011). "Economics and Emigration: Trillion-Dollar Bills on the Sidewalk?" *Journal of Economic Perspectives*, 25(3): 83–106.

Structure of a Charter City

A charter city's governance structure could vary significantly depending on where it is established, but all charter cities would share four common elements. The first is an undeveloped piece of land that is large enough to eventually host an entire city. A good target size is 1,000 square kilometers, roughly the size of Hong Kong and Singapore. The second common element is a charter that pre-specifies the broad rules that would apply there. The third element is a commitment to choice, backed by both voluntary entry and free exit for all residents, employers, and investors. The fourth is a commitment to the equal treatment of all residents under the law.

Charter cities share four common elements: undeveloped land, a charter, a commitment to choice, and equal treatment of all.

The broad commitment to choice means that only a country that wants to create a charter city will offer the land. It also means that only people and firms who make an affirmative decision to move to the new city will live under its rules – staying only if those rules are as good as those offered by competing cities.

A charter or constitution should outline general principles and describe the process whereby the detailed rules and regulations will be established and enforced in a city. It should provide a foundation for a legal system that will let the city grow and prosper. This legal system, which might be given instant credibility of enforcement by a partner country, will be particularly important for attracting foreign direct investment in long-lived urban infrastructure.

Of course, a charter should not specify a centralized economic plan. Nor should it contain rules for a detailed spatial plan for the city, one that specifies what people can do in every specific location. The rules that will encourage economic opportunities and vibrant city life will be those that leave broad scope for experiments and let competition and choice determine which experiments persist. Moreover, in a city where population and income per capita will both grow rapidly, the rules should allow much more flexibility and change than would be required in a less dynamic environment.

There are three distinct roles for participating nations: *host*, *source*, and *partner*. The host country provides the land. The source country supplies the people who move to the new city. The partner country helps to ensure that the charter will be respected and enforced for decades into the future.

Because these roles can be played by a single nation or by several countries working together as partners, there are many potential charter city arrangements. One possibility is for one country to assume all three roles, much as China did in establishing the special economic zone where the new city of Shenzhen emerged, with the central government acting as “partner” to the local authorities. India is considering such a path, using innovative governance structures and public-private partnerships to create new cities on greenfield sites. The key to going it alone is the ability of the central government to credibly commit to would-be residents and investors that the special rules in a new reform zone will be upheld.

Honduras is pioneering another path, one that leverages the credibility of partner nations. Roughly 75,000 Hondurans make the hazardous trek to the United States each year, typically in search of work to support the families they leave behind. Honduran officials estimate that about 10,000 of these migrants are kidnapped and held for ransom by criminal gangs along the way. If they get to the US, they live every day with the fear and indignity of illegal status.

To bring economic opportunities closer to home, the Honduran National Congress recently defined a new legal entity, the Special Development Region, known locally as la Región Especial de Desarrollo (RED). Honduras will soon use the RED legislation to establish a new reform zone to which families can move safely, legally, and intact. The RED will have the authority to manage potentially large inflows of residents but the overriding goal is to offer new opportunities to as many families as possible, families that currently lack good options.

The Honduran zone will be larger, broader in its scope for reform, and more innovative in its approach to governance.

Compared to special zones elsewhere in the world, the Honduran zone will be larger in scale, broader in its scope for reform, and most importantly, far more innovative in its approach to governance. In the new zone, Honduras will fill the roles of host and primary source. To provide effective governance, establish the rule of law, and ensure equal treatment under the law, the leadership in the RED will work directly with international partners. It is in these cooperative partnerships that Canada could play a particularly important role.

Reconciliation in Honduras

Congressional support for the RED legislation was nearly unanimous, spanning the ideologically diverse collection of political parties in Honduras. This consensus reflects the success of the program of political reconciliation led by President Lobo and Congressional President Juan Orlando Hernandez. That program builds on the desire by all Hondurans for fundamental social change.

In recent decades, Hondurans have struggled to escape from a colonial legacy of economic exclusion. As in many other countries in the region, the turmoil from this struggle has left its own legacy of fear and distrust. The damaging political crisis of 2009, which resulted in then President Zelaya's removal from office, sprang from the low level of trust and further undermined it.

A Truth and Reconciliation Commission was formed to investigate the crisis and included former Guatemalan Vice-President Eduardo Stein, former Canadian ambassador to the United States Michael Kirgen, Rector of the Universidad Nacional Autónoma de Honduras Julieta Castellanos, Permanent Representative of Peru to the Organization of American States María Zavala Valladares, and Honduran Law Professor Jorge Omar Zelaya.⁸ The commission released its findings in July of 2011, concluding that President Zelaya had broken the law by persisting in efforts to hold an illegal referendum, but that the method by which he was removed from power was an illegal coup. The commission emphasized that the situation was made worse by the lack of a clear legal process, such as impeachment, for removing a Honduran president who violates the law.

Since the crisis, a broad consensus has emerged about the urgent need for building trust and establishing such basics as prevention of crime and protection of contracts. Even as they continue work to strengthen existing institutions, the elected leaders in Honduras have decided to establish a safe haven where they can make a sharp break from a cycle of insecurity and instability that stokes fear and erodes trust.

⁸ Comisión de la Verdad y la Reconciliación Honduras. *Perfiles*. Web page. Available on the Internet at <http://www.cvr.hn/home/la-comision/perfiles/>, as of February 11, 2012.

A safe haven can break the cycle of insecurity and instability that stokes fear and erodes trust.

To create this new environment, the members of Congress recognized that they would have to go beyond their existing special zones based around the export-processing “maquila” industry. These smaller zones have expanded employment in such areas as garments and textiles, but they have not brought the improved legal protections that are desired for their own sake and are needed to attract higher-skilled jobs.

For the Honduran government, a special zone on currently undeveloped land offers a chance to push ahead with reforms that might otherwise stall because of the difficulty of changing entrenched patterns of behaviour or because of conflict among different vested interests. Reform in the RED needn’t involve coercion or conflict, as only those people who want to live under the new rules will opt in. Yet, success in the RED can translate into a stronger appetite for reform in the rest of Honduras by demonstrating what is possible.

The sense of urgency for progress and reconciliation is reflected in the pace at which the Honduran government has moved to establish the first RED. Congress passed a constitutional amendment giving the government the power to create REDs in January 2011, passing the amendment again in a mandatory follow-up vote in February. In July 2011, Congress passed a constitutional statute that broadly defines the governance structure for REDs. Soon, Congress expects to define the boundary for the first RED and the President expects to appoint the people who will be in charge there. In parallel, the government is looking to its allies for partners that can help provide the rule of law necessary to generate investment, jobs, and safety in the first RED.

RED Governance

The constitutional provisions for Honduran REDs provide two anchors for governance an External Court of Appeal and a nine member Transparency Commission. Below, Figure 1 gives a schematic representation of these two anchors.

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. Treaties negotiated by the Transparency Commission and approved by the current Honduran Congress can offer additional protections to firms and residents under international law.

The Transparency Commission is the anchor for the executive and legislative functions in the RED. To get things started, President Lobo recently appointed five initial members of the Transparency Commission:

1. George Akerlof – Professor of Economics at the University of California at Berkeley, Senior Resident Scholar at the International Monetary Fund, and Nobel Prize Winner
2. Harry Strachan – Former President of INCAE Business School, Director Emeritus at Bain & Co., and Managing Partner at Mesoamerica Partners and Foundation in Cost Rica

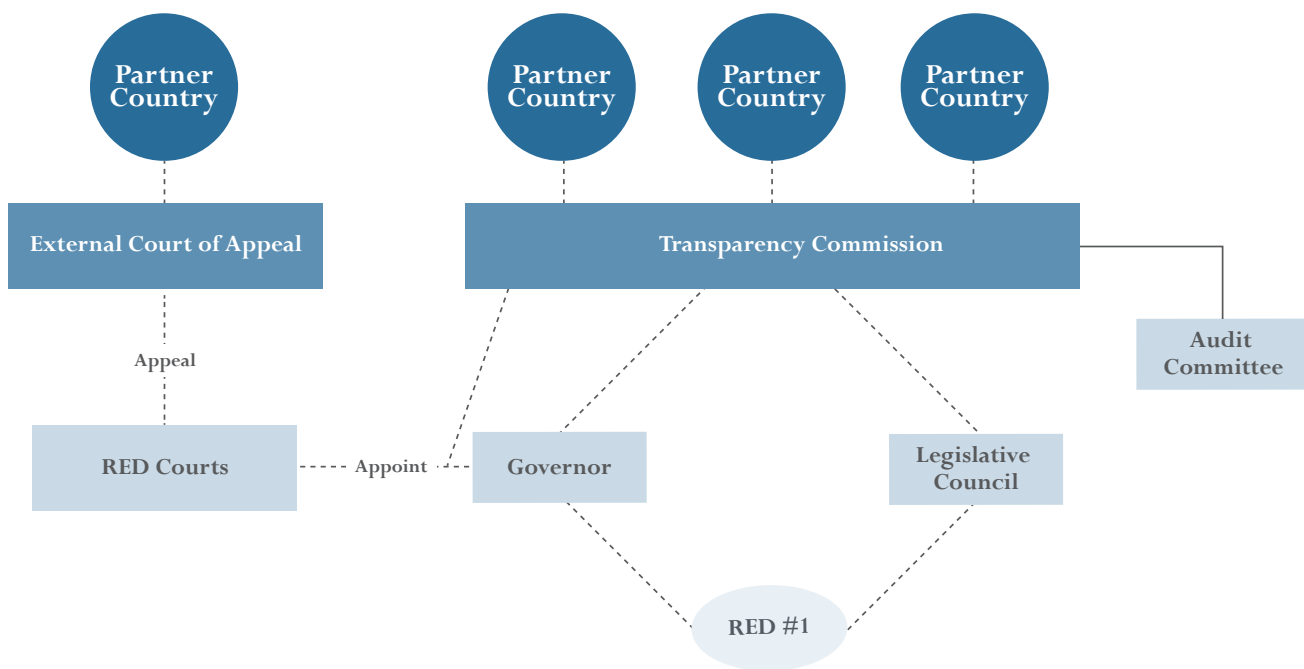
3. Ong Boon Hwee – Former Chief Operating Officer of Singapore Power and Former Brigadier General in the Singapore Armed Forces
4. Nancy Birdsall – President and Co-Founder of the Center for Global Development, former Senior Associate at the Carnegie Endowment for International Peace, and former Executive Vice President at the Inter-American Development Bank
5. Paul Romer – Professor of Economics at the New York University Stern School of Business

These initial members have agreed to serve in a *pro tempore* capacity until the president appoints the full nine-member Transparency Commission. While some of the initial five members may be asked to remain as permanent members, it is also possible that they will step down once a suitable replacement is found.

Among their most important near term responsibilities will be to propose to the president the nine permanent members of the Transparency Commission and to establish a procedure to suggest to Congress the boundaries for the RED. The commissioners will also establish a process for receiving development proposals from would-be investors and will ensure that business dealings related to the RED remain transparent, competitive, and free of corruption.

Business dealings related to the RED will remain transparent, competitive, and free of corruption.

Figure 1 RED Governance Structure



President Lobo will also appoint a Honduran citizen who will serve as the governor of the first RED. After this initial appointment by the president, the responsibility for replacing the RED governor will transition, for a time, to the Transparency Commission. 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.

The audit committee will be one of the key tools that the Transparency Commission can use to monitor the performance of the RED government. This committee will audit not only the finances of the RED government and its officials, but also the performance of key agencies. For example, in evaluating police performance the audit committee can draw on crucial statistics such as the crime rate, the clearance rate for crimes by the legal system, and the incidence of police misconduct.

The audit committee will monitor the performance of the RED government.

Initially, the RED governor will work with the Transparency Commission to nominate judges for the independent court system in the RED. The nominations will be subject to approval by the Honduran Congress, but nominees can be drawn from jurisdictions all over the world, giving the RED access to a relatively deep pool of judicial talent.

The RED governor will also have the power to negotiate a cooperative agreement that anchors the RED courts in the successful judicial system of a partner country. President Lobo recently requested that the Supreme Court of the Republic of Mauritius consider acting as a court of appeal for the judicial system that will be established in the new RED. The Chief Justice of the Supreme Court in Mauritius, Y.K.J. Yeung Sik Yuen, in consultation with other members of government, has committed in principle to taking on this role.

As a recent development success story, Mauritius is a natural partner for Honduras. Mauritius transformed itself from a poor, sugar-reliant economy to one of the most successful economies in Africa, in part by using special zones to encourage trade-led growth. Another key aspect of Mauritian success has been its cultivation of strong and reliable legal institutions. In an arrangement that will be familiar to Canadians, the Mauritian court system is further backed by its means of appeal to the Privy Council in the United Kingdom.

Just as the strength and integrity of the Mauritian court system has been key to enhancing growth and development in Mauritius, the governments in Honduras and Mauritius believe that this historic agreement will ensure an independent judiciary in the RED and will provide important assurances to potential residents and investors.

The use of an External Court of Appeal is just one of many innovative possibilities for cooperative governance. For example, the RED might enlist an organization such as Crown Agents (which was spun-off from the British government as a not-for-profit corporation) to manage customs or tax collection. It might also work with the Canadian Commercial Corporation to establish and manage a transparent procurement process. The RED government could also enlist a reputable policing authority to train police officers and help to hold the police leadership accountable for fair and effective policing. The Royal Canadian Mounted Police, an organization that already has experience providing policing services to local jurisdictions in Canada, would be a natural candidate for this role, perhaps working in partnership with other reputable policing authorities.

Mauritius transformed itself by using special zones to encourage trade-led growth.

The Transparency Commission will have a chance to set initial norms and expectations in an area that could grow to be an important hub city for the Americas. Its initial members must embody unquestioned integrity. They must set the highest standards of honesty and excellence. Collectively, the members should have leadership experience holding elected office, fighting crime and corruption, researching and devising sound policy, and responsibly managing large, private non-profit and for-profit organizations.



After President Lobo appoints the first nine permanent members of the Transparency Commission, the Commission itself fills its vacancies. This provision is intended to provide investors and new residents of the zone with an assurance about the continuity of governance in the RED, even in the unlikely event of political upheaval in the rest of the country comparable to that which Honduras experienced in 2009.

The creation of a Transparency Commission lets the Honduran government quickly establish the legal framework for the first RED, but it leaves open the option for partner countries to lend their support over time, providing an additional layer of accountability and international credibility. One option is for a partner country to take on some responsibility for filling vacancies on the Transparency Commission. This could emerge through a *de facto* arrangement like the one that gives the leadership of the IMF to someone from Europe. Under this approach, a specific country might be consulted about a replacement for a specific seat on the Commission. Support could also take the form of a treaty that

specifies a fixed term for a seat on the Commission and assigns the partner country the legal responsibility for appointing someone to that seat.

An Anchor in Strong Institutions

With a modern system of laws, courts, and policing providing protection, the Honduran government believes that foreign direct investment in infrastructure can support the growth of a new city in the RED, a city that can eventually become a hub for the Americas. Participation of trusted outsiders in the legal and administrative systems will serve to make the new city an even more attractive place for would-be residents and investors.

This is the approach that China used when it resumed sovereign control of Hong Kong and needed to establish a new Supreme Court for the Hong Kong Special Administrative Region. To guarantee the credibility and independence of this new body, China, through a treaty with Britain, agreed that justices for this new court could be recruited from other common law jurisdictions. The Court of Final Appeal in Hong Kong includes judges from New Zealand and South Africa, as well a former Chief Justice of the Supreme Court in Australia.

In establishing their own special region, the Hondurans are seeking support for an anchor in legal and administrative systems that will offer everyone equal and effective protection under the law. Hondurans want this legal protection for themselves. Out of enlightened self-interest, they also want it for the investors, employers, and new residents who will join them in building a modern urban economy in the RED.

Aid can save lives during humanitarian crises, but routinely falls short of sparking sustained development.

The goal is to offer people the chance to move to a region in Honduras that offers the protections that many people seek by migrating – often under perilous conditions – to North America. The protections in the RED will in many cases be better than those available to undocumented immigrants in North America because all residents in the RED will have legal status as well as the option of moving with their families intact.

Though aid can save lives during humanitarian crises, it routinely falls short of sparking sustained development.⁹ The Honduran RED presents Canada and other developed nations with an opportunity to export something far more potent than aid – the institutional credibility at the foundation of growth and development.

Now is the time for Honduras's most credible allies to step forward. Soon, the Honduran Congress will work to establish the boundaries for the first RED, and President Lobo will appoint the initial members of the Transparency Commission as well as the governor for the first RED. Once the RED government is in place it can begin to coordinate with Honduran allies on the critical areas of governance, such as policing and the courts, for the new reform zone.

Canada: Uniquely Positioned

Canada is particularly well-placed to partner with Honduras. As a model of good governance in the Americas, Canada operates according to well-established rules and sensible reform. It was one of the first high-income countries to deal with its deficit, debt, and entitlement problems in the early 1990s. Internationally, Canadian Prime Minister Lester Pearson was the first to see the potential in the use of an armed UN peacekeeping force as a means of resolving and preventing violent conflict within and among states.

In a world where attitudes toward immigration are becoming increasingly hostile, Canada also stands apart. Canada welcomes many more immigrants per capita than the United States, a policy that both contributes to Canada's economic prosperity and extends life-changing opportunities to hundreds of thousands of people each year.

Canada welcomes many more immigrants per capita than the United States.

Of course, many more people from all over the world want to have access to the security and opportunity that strong Canadian governance enables. According to a 2009 Gallup estimate, the number of adults worldwide who would move permanently to Canada if given the chance is about 45 million – a number substantially higher than the current Canadian population.¹⁰ Even Canada, whose immigration policies are quite generous by developed country standards, could not possibly accommodate everyone who would like to move here.

Given this pent up demand for more Canada, the country's commitment to its leadership role in the Americas and the rest of the world remains vital. Even as Canadians grow increasingly aware of the limits of traditional aid, they remain committed to the principle that supporting international development is in Canada's interest as well as the right thing to do. In this regard, Latin American is still high on the Canadian development agenda, as evidenced by trade agreements with Peru, Colombia, Panama, and, most recently, Honduras.

⁹ See for example: Easterly, William (2006). *The White Man's Burden: Why the West's Efforts to Aid the Rest Have Done So Much Ill and So Little Good*. New York: Penguin.

¹⁰ Espipova, Neli and Julie Ray (2009). *700 Million Worldwide Desire to Migrate Permanently*. Web page. Gallup World. Available on the Internet at <http://www.gallup.com/poll/124028/700-Million-Worldwide-Desire-Migrate-Permanently.aspx>, as of February 11, 2012.

The Honduran RED offers a new way to think about development assistance, one that, like trade, relies more on mutually beneficial exchange than on charity. The policy would be new and bold, but it would also be completely consistent with Canada's goals of promoting security in the western hemisphere and of forging stronger economic ties through trade with Latin America. By joining others in contributing institutional credibility to governance in the RED, Canada can work with Honduras to do what no amount of financial aid has ever done – offer the citizens of a developing country opportunities to lift themselves out of poverty and to earn a better future for their children.

Seizing the Opportunity Created by Rapid Urbanization

Just as British-run Hong Kong helped to inspire the poverty-reducing reforms of China's special economic zones, reform zones like the RED can improve peoples' choices and encourage reform throughout the developing world. The rapid completion of the urbanization project creates a singular opportunity in human history. No other time has or will see such an enormous demand for urban life. It would be a tragedy if new urban settlements simply replicate the defective forms of governance from which people are so eager to escape. Reform zones can meet the demands for both urban living and better governance.

With just over 50 percent of its population residing in urban areas, Honduras is one of the least urban countries in Central America. Roughly 4 million Hondurans live in cities today, a number the UN expects to rise to over 6.5 million by 2030 and to over 9 million by 2050, at which point nearly 75 percent of the Honduran population will be living in cities. Moreover, a new city can attract people from throughout the region. Until the financial crisis of 2008, more than one million Latin Americans left their home countries each year, headed primarily for the United States.

Reform zones can meet the demands for both urban living and better governance.

The Honduran government sees this rapid urbanization as an opportunity for inclusive growth and reform. Congressional support for REDs reflects an understanding across political parties that inefficient rules are a major obstacle to peace, growth, and development in Honduras. They consider a RED on an undeveloped site, free of vested interests, as a way to fast-track reforms that might otherwise take decades to achieve in existing Honduran cities.

To attract the investors, business firms, and families that create vibrant city life, the RED will need rules that foster a safe and economically dynamic environment. The Honduran government therefore wants to partner with its best-governed international allies to establish the rule of law in the zone. It knows that it cannot do this on its own. Such partnerships will not only help to keep the new city safe and industrious, but will also assure would-be residents about the strength of the commitment to good governance in the RED.

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. By creating the conditions that let a new city emerge in Hong Kong, Britain can claim credit for the single most effective program of development assistance ever undertaken. To be sure, this was not the original British intention, but Britain deserves recognition for eventually shifting toward a new set of goals that were both admirable and remarkably effective. Hong Kong succeeded in part because it relied on opt-in as the mechanism for establishing the legitimacy of an unfamiliar system of rules.

Contrast this with the United States' unsuccessful efforts to create new institutional environments in places like Iraq and Afghanistan, or with the serial failures in Haiti that date back to the US occupation in 1915. This string of disappointments is due in no small part to a failure to understand that, in establishing a new system of rules, opt-in is far more powerful than coercion. These cases involve a model of reform that seems to draw more heavily on the

North's occupation of the South after the US Civil War than on the success of William Penn's city of brotherly love.

Hong Kong relied on opt-in to establish the legitimacy of an unfamiliar system of rules.

There is now a unique opportunity for a new and distinctively Canadian approach to development assistance. It is not possible to accommodate the millions of people in the Americas who would like to reside in Canada, but it is possible for Canada, along with other credible governments, to help in bringing institutional credibility to new places where millions of people could move, including an undeveloped region in Honduras.

What Specific Role for Canada?

By holding the governor accountable, the Transparency Commission will play an important early role in the governance of a RED. The Canadian government can help President Lobo and the *pro tempore* Transparency Commission immediately by suggesting a credible person for permanent membership on the Transparency Commission. This nomination, informal at first, could evolve into a formal agreement in which the Canadian government agrees to appoint a member to the Transparency Commission whenever the "Canadian" seat is vacated. By doing so, Canada can directly help to keep governance in the RED honest and accountable. The Canadian appointee to the Transparency Commission could serve for a fixed term with an option of reappointment for a second term. The appointee would report to the Canadian official responsible for her appointment, adding an additional layer of credibility and accountability to RED governance.

The RED government will also be able to enlist the support of a partner government in matters of policing. Given the current problems with police corruption in Honduras, establishing an honest and efficient police force in the RED will be critical to the zone's success and to the quality of life of its residents. Effective policing in the RED would also serve as a model for reform in the rest of Honduras.

As noted above, the Royal Canadian Mounted Police is an organization with substantial experience contracting policing services to local jurisdictions in Canada. The RCMP, perhaps in partnership with another respected policing authority such as the Carabineros de Chile, could greatly enhance security and quality of life in the RED by establishing a presence in the zone – training police officers and holding officers accountable for modern standards of service and conduct in policing. What's more, the policing arrangement needn't rely on charity – the services provided by agencies like the RCMP or the Carabineros could be financed from the lease revenues that the RED government collects on land.

Another area in which Canada can help to provide effective governance is the RED judiciary. Honduran courts are among the weakest and least effective in the region. Courts suffer from delays, a lack of transparency, and corruption – all of which undermine justice and inhibit private sector development and foreign investment.

The Mauritian Supreme Court has agreed in principle to serve as a court of final appeal for the RED, but Canada could play a complementary role in the establishment of an efficient and fair judicial system in the zone. The Constitutional Amendment allows the RED government to appoint judges from foreign jurisdictions. At the recommendation of the Canadian government, the RED authorities could nominate Canadian justices for fixed-term appointments in the RED judiciary. Canadian justices could serve out the majority of their term from Canada, hearing local cases from the RED and helping to train local judicial prospects and attorneys.

The RED government will rely heavily on foreign direct investment to finance infrastructure development. An organization such as the Canadian Commercial Corporation could work with the RED government to establish an open and transparent process for requesting and reviewing bids for important projects, such as large-scale infrastructure development. Similar collaborations could involve the RED government working with the Canada Border Services Agency on customs and border control or with the Canada Revenue Agency on tax administration. As with collaboration on matters of policing or the courts, all such partnerships could be based on a fee-for-service arrangement rather than charity.

The aspects of RED governance described here – the Transparency Commission, the police, the courts, procurement, border control, customs, and taxes – are a few of the many possible areas in which the Canadian government can support governance in a Honduran RED. Other areas that will require effective public involvement, such as education, health care, and environmental management, could benefit from Canadian collaboration as well. The key will be the Canadian government’s willingness to think beyond the confines of traditional aid and to embrace the unique opportunities for collaborative governance that the RED structure enables.

Honduran courts are among the weakest and least effective in the region.

The World Wants More Canada

Our urbanizing world does not need more aid; it needs, as the previously cited Gallup numbers readily suggest, more Canada – more of the rules, norms, and know-how that lead to good governance, economic vibrancy, and the rule of law. Canada now has an opportunity to partner with Honduras to tackle directly the biggest obstacle to growth and development all over the world: the dysfunctional systems of rules and enforcement that keep people from reaching their true potential.

Because only people who want to live under the RED’s new system of rules would choose to move there, Canada’s presence would not only be welcome but legitimate. By working together in the RED, Canada and Honduras can do what traditional aid cannot: offer people a chance to live and work in a safe and well-run city, a city that provides economic opportunities for Canadians and Hondurans alike and a city that has the potential to inspire reform in Honduras and throughout the Americas.

Our world needs more Canada – more of the rules, norms, and know-how that lead to good governance, economic vibrancy, and the rule of law.

Authors' Biography



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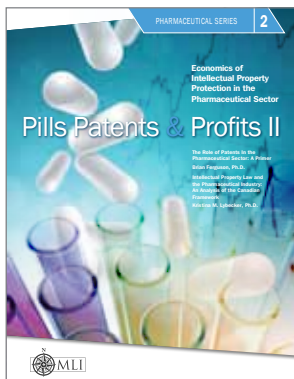
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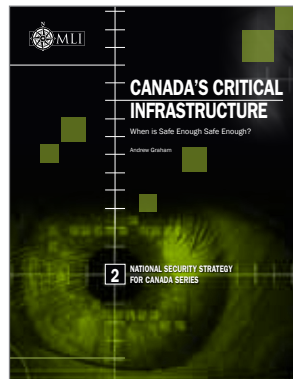
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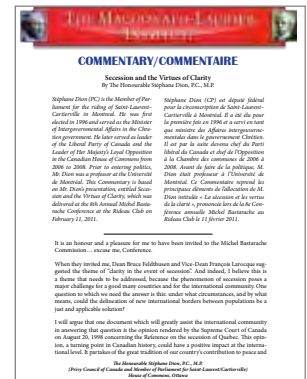
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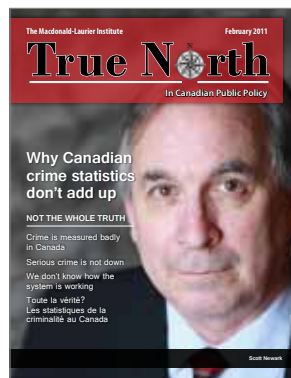
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