Economic Development: Theory and Policy

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6.1 Introduction

- What is the Lucas paradox?
- It clarifies why capital does not flow to poor although this should be the case since factor rewards are substantial between rich and poor countries.
- Why is financial integration no promoter of economic development?
- Bad institutions are again at the core
- Is foreign aid a good idea and is it effective at all?
- The answer to this question is rather depressing
- Are Charter cities a way out?
R. Lucas (1990), Why Doesn’t Capital Flow from Rich to Poor Countries?, AER, Vol. 80(2)

- From standard textbook theory we know that different levels in output per capita are induced by different levels of capital per capita, if
  - production is subject to constant returns to scale
  - output is produced with labor and physical capital
- If, moreover, the production function is subject to diminishing marginal returns, different levels of capital per capita generate differences in the factor rewards for capital
  \[ \Rightarrow \text{we should expect investments taking place in the poorer regions only, since there } k \text{ is low and } r^p \text{ is therefore high.} \]
- This process should continue until factor rewards are globally equalized.
• Lucas starts now to emphasize his argument with some theory. Let’s assume output per capita $y$ obeys

$$y = Ak^\beta. \quad (1)$$

• Then, under competitive markets

$$r = \frac{\partial y}{\partial k} = \beta Ak^{\beta-1}. \quad (2)$$

• Since $k = y^{1/\beta} A^{-1/\beta}$

$$r = \beta A^{1/\beta} y^{(\beta-1)/\beta}. \quad (3)$$
6.2 Lucas Paradox

- Lucas found at that time that
  \[
  \frac{y_{USA}}{y_{India}} = 15 \tag{4}
  \]

- The average of Indian and US capital shares is 0.4, such that \( \beta = 0.4 \).
  \[\Rightarrow\] the ratio of marginal products of capital

  \[
  \frac{r_{India}}{r_{USA}} = \left( \frac{y_{USA}}{y_{India}} \right)^{\frac{1-\beta}{\beta}} = 15^{1.5} = 58 \tag{5}
  \]
if this model would be a good approximation of reality, we should have observed massive and rapid capital flows from the US and other rich countries to poor regions in the world

- Since we do not observe this flows something must be wrong
- One obvious effect is that the model presented so far treats labor inputs in India and the US as identical ignoring differences in human capital
- The underlying production function would be

\[
Y = AK^\beta (hL)^{1-\beta}
\]

\[
\Rightarrow \frac{Y}{L} = Ak^\beta h^{1-\beta}
\]

- From the observation \( \frac{y^\text{USA}}{y^\text{India}} = 15 \) we obtain

\[
15 = \left( \frac{k^\text{USA}}{k^\text{India}} \right)^{0.4} \left( \frac{h^\text{USA}}{h^\text{India}} \right)^{0.6}
\]
6.2 Lucas Paradox

- Observing further

\[
\left( \frac{h_{India}}{h_{USA}} \right) = 0.2, \tag{9}
\]

we obtain

\[
15 = \left( \frac{k_{USA}}{k_{India}} \right)^{0.4} \left( 0.2 \right)^{-0.6} \tag{10}
\]

\[
\Rightarrow \left( \frac{k_{USA}}{k_{India}} \right) = \left[ 15 0.2^{0.6} \right]^{\frac{1}{0.4}} \tag{11}
\]

- As output per efficient unit of labor reads

\[
\frac{Y}{hL} = y = Ak^\beta h^{-\beta} \tag{12}
\]

we yield

\[
\frac{y_{USA}}{y_{India}} = \left( \frac{k_{USA}}{k_{India}} \right)^{0.6} \left( \frac{h_{India}}{h_{USA}} \right)^{0.4} \approx 3 \tag{13}
\]
6.2 Lucas Paradox

- The predicted rate of return ratio becomes now

\[ \frac{r_{India}}{r_{USA}} = 3^{1.5} = 5 \]  

(14)

which is substantially smaller than 58 but still substantially higher than 1

- Lucas suggests the existence of externalities due to human capital accumulation, such that

\[ Y = Ah^\gamma K^\beta (hL)^{1-\beta} \]  

(15)

\[ y = Ah^\gamma k^\beta \]  

(16)

\[ r = \beta A^{1/\beta} y^{(\beta-1)/\beta} h^{\gamma/\beta} \]  

(17)

with \( y \) and \( k \) expressed in efficient units of labor.
6.2 Lucas Paradox

- Hence, the predicted rate of return becomes now

\[
\frac{r_{India}}{r_{USA}} = \left( \frac{y_{USA}}{y_{India}} \right)^{(1-\beta)/\beta} \left( \frac{h_{India}}{h_{USA}} \right)^{\gamma/\beta}
\]  

(18)

- Assuming that \( \frac{y_{USA}}{y_{India}} = 3 \) and that an American is five times more productive than an Indian would imply for \( \gamma = \beta = 0.4 \)

\[
\frac{r_{India}}{r_{USA}} = (3)^{1.5}0.2 = 1.04
\]  

(19)

implying that the interest rate differential vanished.

- Insight: correcting for human capital differentials reduces the predicted return ratios substantially and to unity if we account for local knowledge spillover.
Standard theory suggests
- capital-poor economies free themselves of binding capital constraint by financial integration
- strengthening of the domestic capital market $\rightarrow$ more efficient capital allocation
- international risk sharing

But ... *taken as a whole, the vast empirical literature provides little robust evidence of a causal relationship between financial integration and growth*  
Source: Schularick/Steger
6.3 Financial Integration and Economic Growth

- **Empirical strategy:**
  1. Cross-sectional regression

\[
\Delta y_i = \alpha + \beta IFI_i + \gamma' X_i + \varepsilon_i, \tag{20}
\]

with \(\Delta y_i\): log gdp growth per capita and \(IFI_i\): avr. capital inflow/GDP

2. GMM panel estimation

\[
y_{i,t} = \alpha y_{i,t-1} + \beta IFI_{i,t} + \gamma' X_{i,t} + \eta_i + \varepsilon_{i,t} \tag{21}
\]

with \(\eta_i\): country specific effect

and \(X\) representing a set of controls
### 6.3 Financial Integration and Economic Growth

Period: 1980-2002

**Dependent variable: growth rate of real GDP per capita**

<table>
<thead>
<tr>
<th>Regression</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4 System GMM</th>
<th>5 System GMM</th>
<th>6 System GMM</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>OLS</td>
<td>OLS</td>
<td>OLS</td>
<td>System GMM</td>
<td>System GMM</td>
<td>System GMM</td>
</tr>
<tr>
<td>Financial integration</td>
<td>0.017**</td>
<td>0.010</td>
<td>0.004</td>
<td>0.003*</td>
<td>0.001</td>
<td>0.000</td>
</tr>
<tr>
<td>(0.041)</td>
<td>(0.295)</td>
<td>(0.621)</td>
<td>(0.100)</td>
<td>(0.665)</td>
<td>(0.829)</td>
<td></td>
</tr>
<tr>
<td>Initial income</td>
<td>-0.244***</td>
<td>-0.246**</td>
<td>-0.354***</td>
<td>-0.040</td>
<td>-0.058*</td>
<td>-0.080**</td>
</tr>
<tr>
<td>(0.022)</td>
<td>(0.026)</td>
<td>(0.000)</td>
<td>(0.237)</td>
<td>(0.089)</td>
<td>(0.012)</td>
<td></td>
</tr>
<tr>
<td>Initial schooling</td>
<td>0.277**</td>
<td>0.294**</td>
<td>0.226**</td>
<td>0.034</td>
<td>0.055</td>
<td>0.042</td>
</tr>
<tr>
<td>(0.026)</td>
<td>(0.021)</td>
<td>(0.032)</td>
<td>(0.421)</td>
<td>(0.178)</td>
<td>(0.186)</td>
<td></td>
</tr>
<tr>
<td>Inflation</td>
<td>0.008</td>
<td>0.007</td>
<td>0.019</td>
<td>0.004</td>
<td>0.059***</td>
<td>0.077***</td>
</tr>
<tr>
<td>(0.682)</td>
<td>(0.723)</td>
<td>(0.317)</td>
<td>(0.195)</td>
<td>(0.003)</td>
<td>(0.000)</td>
<td></td>
</tr>
<tr>
<td>Government balance</td>
<td>-0.021**</td>
<td>-0.016</td>
<td>-0.005</td>
<td>-0.020**</td>
<td>-0.011</td>
<td>-0.006</td>
</tr>
<tr>
<td>(0.047)</td>
<td>(0.191)</td>
<td>(0.680)</td>
<td>(0.033)</td>
<td>(0.231)</td>
<td>(0.426)</td>
<td></td>
</tr>
<tr>
<td>Openness</td>
<td>0.122</td>
<td>0.234**</td>
<td>0.004*</td>
<td>-0.041***</td>
<td>0.006</td>
<td></td>
</tr>
<tr>
<td>(0.297)</td>
<td>(0.040)</td>
<td>(0.000)</td>
<td>(0.096)</td>
<td>(0.055)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Population growth</td>
<td>-0.252***</td>
<td>2.007*</td>
<td>2.939***</td>
<td>0.34</td>
<td>0.47</td>
<td>0.85</td>
</tr>
<tr>
<td>(0.009)</td>
<td>(0.058)</td>
<td>(0.002)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

| Observations | 54 | 54 | 54 | 265 | 268 | 265 |
| Groups       | 54 | 54 | 54 | 54  | 54  | 54  |
| $R^2$ (adj.) | 0.34 | 0.35 | 0.52 |

Arellano-Bond test for second order autocorrelation (p-value) | 0.34 | 0.47 | 0.85 |

Hansen test (p-value) | 0.54 | 0.87 | 0.84 |

Note on regressions (1-3): OLS estimation with heteroskedasticity robust standard errors. P-values are given in row below coefficients.

Note on regressions (4-6): Robust one-step Arellano-Bond system GMM dynamic panel estimation. P-values are given in second row. For the system GMM estimation we treated international financial integration and openness as potentially endogenous, initial income as predetermined, population growth as well as the time dummy variables (not reported) as exogenous, and all other variables are weakly exogenous. We use the entire lag structure for instrumentation, i.e. starting from the (t-2) lag of the difference for the levels equation, and the (t-1) lag of the level for the difference equations.
## 6.3 Financial Integration and Economic Growth

**Period: 1880-1913**

<table>
<thead>
<tr>
<th>Regression</th>
<th>7</th>
<th>8</th>
<th>9</th>
<th>10</th>
<th>11</th>
<th>12</th>
<th>13</th>
<th>14</th>
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</thead>
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<tr>
<td>inflow/GDP</td>
<td>OLS</td>
<td>OLS</td>
<td>OLS</td>
<td>OLS</td>
<td>OLS</td>
<td>System GMM</td>
<td>System GMM</td>
<td>System GMM</td>
</tr>
<tr>
<td>Financial integration</td>
<td>0.268***</td>
<td>0.279***</td>
<td>0.175*</td>
<td>0.003***</td>
<td>0.002***</td>
<td>0.040**</td>
<td>0.043***</td>
<td>0.039***</td>
</tr>
<tr>
<td>Initial income</td>
<td>-0.016</td>
<td>-0.011</td>
<td>-0.025</td>
<td>-0.024</td>
<td>0.033</td>
<td>-0.033*</td>
<td>-0.02</td>
<td>-0.019</td>
</tr>
<tr>
<td>Initial schooling</td>
<td>0.062**</td>
<td>0.060**</td>
<td>0.067**</td>
<td>0.026</td>
<td>0.027</td>
<td>0.026**</td>
<td>0.022**</td>
<td>0.021*</td>
</tr>
<tr>
<td>Inflation</td>
<td>0.164*</td>
<td>0.160</td>
<td>0.165*</td>
<td>0.249***</td>
<td>0.175*</td>
<td>0.000</td>
<td>0.000</td>
<td>0.000</td>
</tr>
<tr>
<td>Government balance</td>
<td>0.014</td>
<td>0.014</td>
<td>0.003</td>
<td>0.044</td>
<td>0.027</td>
<td>-0.023</td>
<td>-0.023</td>
<td>-0.023</td>
</tr>
<tr>
<td>Openness</td>
<td>-0.594</td>
<td>0.201</td>
<td>0.742</td>
<td>0.292</td>
<td>0.232</td>
<td>0.372</td>
<td>0.152</td>
<td>0.153</td>
</tr>
<tr>
<td>Population growth</td>
<td>0.209</td>
<td>0.286</td>
<td>0.515</td>
<td>0.551</td>
<td>0.409</td>
<td>0.503</td>
<td>0.657</td>
<td>0.657</td>
</tr>
<tr>
<td>Constant</td>
<td>-0.213</td>
<td>-0.228</td>
<td>-0.208</td>
<td>-0.299</td>
<td>-0.321</td>
<td>156</td>
<td>156</td>
<td>156</td>
</tr>
<tr>
<td>Observations</td>
<td>23</td>
<td>23</td>
<td>23</td>
<td>21</td>
<td>21</td>
<td>156</td>
<td>156</td>
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<tr>
<td>Groups</td>
<td>23</td>
<td>23</td>
<td>23</td>
<td>21</td>
<td>21</td>
<td>24</td>
<td>24</td>
<td>24</td>
</tr>
<tr>
<td>R2 (adj.)</td>
<td>0.50</td>
<td>0.50</td>
<td>0.52</td>
<td>0.62</td>
<td>0.60</td>
<td>0.23</td>
<td>0.19</td>
<td>0.13</td>
</tr>
<tr>
<td>Arellano-Bond test for second order autocorrelation (p-value)</td>
<td>0.89</td>
<td>0.89</td>
<td>0.90</td>
<td>0.89</td>
<td>0.89</td>
<td>0.90</td>
<td>0.89</td>
<td>0.90</td>
</tr>
</tbody>
</table>

Notes on regression (7-9): OLS estimation with heteroskedasticity robust standard errors. P-values are given in row below coefficients. Financial integration valuable is gross inflow of capital from the UK in regressions (7-9) from Stone (1999), change in gross foreign liabilities to GDP between 1900 and 1914 in (10) from Feis (1965), Woodruff (1966) and Twomey (2000). In (11), the financial integration variable is the change in net international investment to GDP between 1900 and 1913/14 which was derived from current account balances in Jones and Obstfeld (1997), Taylor (2002) and international investment positions from Twomey (2000). To provide comparability and avoid estimation bias arising from missing data for some countries in some years, the sample is restricted to a balanced sample for 1900-1913. Separate results for an unbalanced sample for 1880-1913 (for 7-11) and for individual decades provided identical results - with the exception of the crisis decade of the 1890’s.
There is no clear support to the idea of an effect of financial openness on growth, i.e. more integrated economies did not experience faster growth.

Contrary to the past two decades capital inflows over GDP appear as a significant growth driver in the first era of globalization.

Summing up, before WW1 international financial integration spurred economic growth, whereas there is no robust evidence of a comparable effect in recent times.
Schularick and Steger argue in line with Taylor (2004):

- openness in the first era of globalization had a positive effect on growth through its impact on capital investment
- today this association is absent
- Taylor (2004): diversification finance today as compared to development finance before WW1

→ today's capital mobility is high, but does not translate into substantial net capital flows between rich and poor economies

- Before WW1 most international capital flows went from rich to poor regions ⇒ the Lucas paradox was less pronounced
again, why are capital flows small in spite of substantial differences in capital endowments?

- Lucas (1990) stresses differences in human capital endowments
- An alternative explanation for Lucas paradox are capital market failures (distortionary policies, unenforceable property rights etc.)
  - enforcement of property rights as a necessary condition for net investment flows (Shleifer 2003)
  - In the first era of globalization the institutional frame was due to colonization more homogeneous than now
- Lucas proposed that institutional factor could play an important role

Until around 1945, much of the Third World was subject to European-imposed legal and economic arrangements, and had been so for decades or even centuries. A European lending to a borrower in India or the Dutch East Indies could his contract to be enforced with exactly the same effectiveness and by exactly the same means as a contract with domestic borrowers.
6.3 Financial Integration and Economic Growth

- Schularick and Steger (2010) reconsider Lucas’ numerical exercise by implementing a parameter $0 < \mu < 1$ which captures the degree of property rights protection.

- Starting again from

$$Y = A(hL)^{1-\beta} K^\beta h^{\gamma}$$

we obtain

$$r = \mu \beta AK^{\beta-1} h^{\gamma}$$

$$\Rightarrow r = \mu \beta A^{1/\beta} Y^{(\beta-1)/\beta} h^{\gamma/\beta}$$

- Hence, we can expect

$$\frac{r_p}{r_r} = \frac{\mu_p}{\mu_r} \left( \frac{y_p}{y_r} \right)^{(\beta-1)/\beta} \left( \frac{h_p}{h_r} \right)^{\gamma/\beta} = \frac{\mu_p}{\mu_r} \left( \frac{Y_p/L_p}{Y_r/L_r} \frac{h_r}{h_p} \right)^{(\beta-1)/\beta} \left( \frac{h_p}{h_r} \right)^{\gamma/\beta}$$
6.3 Financial Integration and Economic Growth

set of parameters

<table>
<thead>
<tr>
<th>Parameter</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Technology</td>
<td>$\alpha = 0.3; \gamma = 0.15;$</td>
</tr>
<tr>
<td>Relative property rights</td>
<td>$\mu_p^m / \mu_r^m = 0.5; \mu_p^h / \mu_r^h = 0.9;$</td>
</tr>
<tr>
<td>Relative human capital$^a$</td>
<td>$h_p^m / h_r^m \approx 0.41; h_p^h / h_r^h \approx 0.45$</td>
</tr>
<tr>
<td>Relative GDP per capita$^a$</td>
<td>$(Y_p^m / L_p^m) / (Y_r^m / L_r^m) \approx 0.25$ (modern period; actual)</td>
</tr>
<tr>
<td></td>
<td>$(Y_p^h / L_p^h) / (Y_r^h / L_r^h) \approx 0.31$ (historical period; hypothetical)$^b$</td>
</tr>
</tbody>
</table>

(a) The underlying data set is described in Table 1. For each period, the entire sample has been split into two subsamples. All economies with an average GDP per capita above the average level are classified as “rich”, the rest as “poor”. (b) The construction of the hypothetical relative GDP per capita is described in a technical appendix available from the authors.
6.3 Financial Integration and Economic Growth

- For the modern period a rate of return differential of about 1.01 is obtained which is negligible.
  - apparently, the positive effect of relatively low levels of capital endowments on the rate of return is outweighed by a low capital endowments and weak property rights protection.

- For the historical period a rate of return differential of about 1.44 is obtained.
  - contrary to modern times, the income gap was small which dampens the rate of return differential but this effect is overcompensated by a relatively higher human capital endowments and much better property rights protection.
6.4 Effectiveness of Foreign Aid

- Apparently, in the contemporary era of globalization there are no or little incentives to move capital from rich to poor nations.
- One reason might be a weak protection of property rights.
- This raises the question whether or not development aid could be a development strategy and whether or not it does its job at all.
- Believing in the story of the big push going back to Rosenstein-Rodan in 1943, this would be rather a question of the quantity and not about the if.
6.4 Effectiveness of Foreign Aid

H. Doucouliagos and M. Paldam (2008), The Aid Effectiveness Literature: The Sad Results of 40 Years of Research Vol. 23(3)

- Mass poverty is still a major problem
- The public in the DCs is willing to give development aid - in question is rather the level
- Development aid is subject to the moral bias of doing something good which makes it difficult to discuss its efficiency
- Latest findings do not support the notion that aid has a positive effect
- Development aid programs started during the 1960s, where
  - aid agencies aim at social returns about 10%
  - after 40 years, some learning-by-doing effects should have become visible (usually of magnitude between 1-2%)

→ It is strange that there is no measurable effect!
### 6.4 Effectiveness of Foreign Aid

<table>
<thead>
<tr>
<th>Type</th>
<th>Causal link</th>
<th>Conditional on</th>
<th>Conclusion</th>
<th>Significance</th>
<th>Section in this paper</th>
</tr>
</thead>
<tbody>
<tr>
<td>Family A</td>
<td>Aid $\rightarrow$ investment</td>
<td></td>
<td>App. 0.25</td>
<td>Dubious, from 0</td>
<td>5</td>
</tr>
<tr>
<td></td>
<td>Aid $\rightarrow$ savings</td>
<td></td>
<td>App. -0.65</td>
<td>Dubious, from -1</td>
<td>5</td>
</tr>
<tr>
<td>Family B</td>
<td>Aid $\rightarrow$ growth</td>
<td></td>
<td>Positive, small</td>
<td>No</td>
<td>6</td>
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<tr>
<td>Family C</td>
<td>Aid</td>
<td>condition $\rightarrow$ growth</td>
<td>Good policy</td>
<td>Rejected</td>
<td>No</td>
</tr>
<tr>
<td></td>
<td>Aid itself (aid squared)</td>
<td></td>
<td>Positives small</td>
<td>Dubious</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Eight more models</td>
<td></td>
<td>Not replicated</td>
<td></td>
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</tr>
</tbody>
</table>

Note: Aid either leads to increased investments or is crowded out through a fall in savings. Hence, the investment effect minus the savings effect should add to 1 when the BOP effect is added. Significance means that the investment effect is larger than 0, and that the savings effect is larger than -1.
6.4 Effectiveness of Foreign Aid

Note: The densely packed observations in the “box” are enlarged on Figure 1b.
6.4 Effectiveness of Foreign Aid

Figure 1b. The box on Figure 1a enlarged

\[ N = 945. \text{ Correlation, } r = -0.041 \]
6.4 Effectiveness of Foreign Aid

A: 1\textsuperscript{st} wave
Accumulation

\begin{itemize}
  \item Aid
  \item Savings/investment
  \item Growth
\end{itemize}

B: 2\textsuperscript{nd} wave
Growth direct

\begin{itemize}
  \item Aid
  \item Growth
\end{itemize}

C: 3\textsuperscript{rd} wave
Conditional

\begin{itemize}
  \item Aid
  \item Condition
  \item Growth
\end{itemize}

→ key causal flow studied
→ may be included
→ not included
6.4 Effectiveness of Foreign Aid

The trend is the regression:
\[
\mu = 0.310 - 0.043 \ln(N)
\]
\[\begin{align*}
(7.1) & \\
(-4.7) & 
\end{align*}\]
Results from Family A:

- Aid reduces domestic savings, where the crowding out is substantial but not perfect.
- Aid increases accumulation by 25%.
- The remaining 75% lead to an increase in public consumption which is negatively associated to economic growth (see Barro and Sala-i-Martin 2004).
- In any case it is unclear from these type of studies whether aid contributes positively to growth.
6.4 Effectiveness of Foreign Aid

Results form Family B:

- The literature started with growth regressions of the form

\[ g_{it} = \alpha + \beta \log y_i0 + \gamma_{jit}x_{jit}' + u_{it} \]  

(26)

and substituted the convergence term by the aid effectiveness term \( \mu h_{it} \), such that

\[ g_{it} = \alpha + \mu h_{it} + \gamma_{jit}x_{jit}' + u_{it} \]  

(27)

- Barro growth empirics tried about 400 controls and of these 60 have been tried in the aid literature, where each regression works with 5 at the time

\[ \Rightarrow \] there are \( 5.5 \times 10^6 \) possible models from which 5% must be significant at the 5% level

\[ \rightarrow \] results are not robust
Results from Family C:

- The conditionality models accept the zero correlation result, but rejects that this would mean that aid and growth are independent → aid helps in some cases, but not in others
- In econometric terms, the interacted variable $h_{it}z_{it}$ gets a significant coefficient $\omega$, when

$$g_{it} = \alpha + \mu h_{it} + \delta z_{it} + \omega z_{it} h_{it} + \gamma j_{it} x_{j_{it}} + u_{it}$$ (28)

is estimated

⇒ Easterly (2003) concludes that the results from this type of specification are not robust with respect to

- prolongation in the sample period
- changes in the definitions of aid and good policy
Doucoudiagoos and Paldam (2008) discuss the commonalities of aid, i.e. transfers and the presence of natural resources on the economic performance:

1. Dutch Disease
2. Resource Curse
7. Charter Cities

- new type of special reform zone initiated by Paul Romer
  - similar to a special economic zone
  - city with millions of workers—residents
  - cross-national partnerships
  - Two key principles
    1. rules apply only to people who choose to live under them and rules apply equally to all residents
    2. rules can be copied from elsewhere
  - Migration as a competitive factor, in the sense that charter cities copy existing rule that work they must attract migrants
7. Charter Cities

Structure of a charter city

1. A vacant piece of land, large enough for an entire city
2. A charter that specifies in advance the broad rules that will apply there
3. A commitment to choice, backed by both voluntary entry and free exit for all its residents
4. A commitment to the equal application of all rules to all residents
Honduras

- The Honduran Congress recently defined a new legal entity: Special Development Region = Region Especial de Desarollo (RED)
- Compared to existing special zones in the world, the Honduran zone will be larger in scale, broader in its scope for reform and more innovative in its approach to governance
- Implementation of strong institutions
  - FDIs in infrastructure can support growth
  - City may serve as a hub for the Americas
  - Cooperation and participation of trusted outsiders
  - Similarly, China needed to establish a new Supreme Court for the Hong-Kong Special Administrative Region which includes judges from New Zealand and South Africa
- Honduras are not seeking official foreign aid but an anchor for legal and administrative systems