The Invisible Hand Behind a Hundred City-States

We sit down with Bob Haywood, the "policy entrepreneur" of Opportunity Zones. Arguably, Haywood has done more than anyone alive to lift people out of poverty.

EDITOR
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Robert Haywood is a quiet genius. He knows his influence is more powerful when he operates that way. He relishes efficacy over accolades. At the risk of embarrassing my interviewee, I would argue no living human being is responsible for helping lift more people out of poverty *than Bob Haywood. He's spent most of his career as a master of launching the special economic zone (SEZ). These special jurisdictions are designed to carve out better institutions in areas of the world dogged by poverty, corruption, and violence. Haywood's fingerprints are all over these engines of creation, more so than all the politicians who took credit for them. You see this man, with a background in physics, has held advisory roles for some of the world's most effective decisionmakers. And at some point, he became more interested in the laws of peoples than the laws of gravity.*

Max Borders: I understand you've been involved in the development of scores of SEZ projects. What are some of the most successful or notable you've been involved in shepherding?

Bob Haywood: Your title and introduction are flattering. In my experience with successful zones, it takes thousands of people in large and small roles to create a sustainable SEZ program. It requires the involvement of politicians, lawyers, bankers, entrepreneurial businesses, engineers, workers, investors, and many more people to build an SEZ. I have played a small part, typically providing a legal, economic, and political foundation that a country's business and political leaders can embrace.

Also, I don't believe I am behind the formation of a hundred city-states. There are less than a dozen true city-states in the world, but there are thousands of special economic zones (SEZs). One of the big differences is that city-states have a large degree of national sovereignty, such as Singapore, whereas most SEZs must operate within the sovereignty of the nation that creates them. A few have the ambition of becoming a new, vibrant city, but the vast majority have the more limited goal of becoming a good place to do business.

Max Borders: I should not have replaced accuracy with rhetorical flourish.

Bob Haywood: Well, China's SEZ program did explicitly want to create new cities, but not new states. In the early 80s, China forecast it had to create a city the size of Beijing not new states. In the early 80s, China forecast it had to create a city the size of Beijing every year in order to absorb the population migrating from the countryside. That was not, and still is not, possible. The approach was to strive to create 20 cities the size of Beijing in 20 years. Becoming a city was one of the explicit goals of the SEZs and Technical and Economic Development Areas.

I want to be clear. We are using the term Special Economic Zone here as a catchall for a wide variety of different types of zones. Some SEZs can be extremely small, the size of a diamond vault in Amsterdam, or quite large about 13,600 mi.^{2}, a little larger than Maryland, in the case of Hainan Island in China. They can prohibit resident populations, or they can contain the population of an entire province. Many SEZs are defined geographically as an area within a country, but SEZs do not have to be geographically defined, they can also be defined by performance characteristics or by industry. For example, the Export Processing Zones (EPZ) were defined by export performance of the investors within a limited geographical area, while programs such as Mexico's Maquila program or India's Export Oriented Units (EOU) having an export orientation without a geographical limitation. Industry-defined zones include most of the world's "Tax Havens" being financial zones, or zone specifically designed for heavy industry, chemicals, garments, electronics, leather, mining, or jewelry. There are also zones that cater specifically to the service industry such as back-office operations, call centers, media development, tourism, education, or research and development. There can even be "Sin Free Zones" such as red-light districts or gambling centers. This is but a small sampling of the various types of zones. What they all have in common, except perhaps for true city-states, is a regulatory environment or laws that differ from the rest of the country.

I actually don't really like the term Special Economic Zones. While many of the early zones just had economic adjustments, modern zones often need to include much more covering the whole gamut of political, social, and economic regulations. Mark Klugmann likes to use the term LEAP zones, to mean Legal, Economic, Administrative, and Political changes in rules and regulations for city-sized zones. I find that term too bureaucratic and process-oriented. I prefer the term Opportunity find that term too bureaucratic and process-oriented. I prefer the term Opportunity Zones because providing individuals and even countries with opportunities to succeed economically and socially is what modern zones are about.

In addition to China, I have been fortunate to work with zones in various stages of development. Of the 174 countries I have worked in, more than half the countries and territories of the world were developing new zones or rethinking how to update their zone regulations. During these visits, I have both received an education and dispensed advice. The advice was primarily focused on creating a defensible legal foundation that was politically acceptable and economically sound.

My lifetime work in helping to create SEZs requires some background. The first zone I visited was in Port Said in Egypt in 1977. It was not doing well. In that same year, I visited Dubai before the concept of zones emerged there. Shortly thereafter, while on faculty at HBS, I met Dick Bolin, a man who deserves a lot of credit for promoting zones, and I ended up writing a Harvard Business School case study on the zone he invested in El Salvador. It was not successful due to the kidnapping of his El Salvadorean partner.

In 1979, I moved to Hong Kong to manage an electronics trading company that procured electronic parts and consumer products from companies in a dozen countries. In 1980 we invested in China. This gave me an opportunity to inspect the Chinese Special Economic Zone program, specifically the Shenzen zone from the very beginning. I left Hong Kong by 1984 and became involved with the Maquila Industry, a diffuse export zone in Mexico, and wrote the Juarez 2000 report presenting an analysis of the industry and a strategy for its development over the next 20 years which emphasized a need to move up the technology ladder and increase the value added per worker. I am still pleased that the industry did upscale, and that my projection for maquila employment for the year 2000 of 1,000,000 employees, which many considered wildly optimistic, was off by less than 1 percent.

Further work on zones followed in Mexico, China, Honduras, United Arab Emirates, Kenya, Dominican Republic, Puerto Rico, Tanzania, Jordan, Israel, Vietnam, Russia, Albania, Kazakhstan, India, Pakistan, Iraq, Bangladesh, Philippines, and even the small nations of Vanuatu, Timor Leste, and Liberia to name just a few. In some cases, I got involved early helping countries draft their zone laws and establish an administrative structure. At other times, I was brought in later to help existing zones transition to higher-valued industries.

But more important than working in these various countries has been my work with multilateral organizations in creating a more receptive environment for zone development.

After a brief flurry of interest in the late 70s and early 80s, the World Bank, IMF, USAID. ILO, UNIDO, OECD, other aid agencies, and more recently the WTO soured on the idea of zones. The World Bank specifically and loudly called them second-best options and discouraged countries from creating them. Except for Peter Ryan at UNIDO, in over 30 years of meetings with multilateral organizations, I don't think I ran into any other person actively advocating for zones.

Involvement in multilateral organizations can have a significant impact. For example, the agreement at the 2001 WTO ministerial meeting in Doha to extend the ability of small middle-income countries to offer fiscal incentives for export and the determination that a least-developed country would be defined as one with a GDP of less than $1,000 in constant 1990 dollars as opposed to current dollars. This has raised the maximum GDP of a least-developed country to about $2,300 today. Least-developed countries are permitted to offer fiscal incentives. These changes were very important to many zones, particularly in the Caribbean and Central America, where tax holidays (fiscal incentives) for exporters were quite common. I do not know who is actively engaging with these multilateral organizations today and that hurts the development of new SEZs.

Max Borders: Can you talk about a couple of these in detail?

Bob Haywood: Sure. I think one of the interesting projects I initiated was the

Bob Haywood: Sure. I think one of the interesting projects I initiated was the development of the Qualified Industrial Zones (QIZs) in Jordan and Egypt. In a review of this program, the World Bank stated that "Somehow it became a discussion item at the second Economic Summit of the Middle East and North Africa" held in Amman Jordan in 1995. That "somehow" was a result of a speech I gave at the Economic Summit on creating a tangible "peace dividend" to reward Jordan for signing a peace agreement with Israel. The program continues to provide duty and quota-free entry into the US for goods produced jointly between Israel and Jordan/Egypt/or the Palestinian Territories. After eight years, it produced over $1 billion in annual Jordanian exports to the United States and around 30,000 jobs in Jordan. I insisted Egypt be included in the program on the premise it should not be punished for signing a peace agreement with Israel years earlier, but it did not participate until 2005. In 2021, Egyptian exports to the United States under this program were $1.2 billion, about 37 percent of the country's exports to the United States.

The impetus for this project was actually Commerce Secretary Ron Brown's concept of commercial diplomacy. Unlike the current usage of commercial diplomacy—the work done by commercial attachés in the embassy, Ron Brown's concept was the use of the US economy to help achieve US foreign policy objectives. It's a great concept. I proposed to him the QIZ as a tangible way of creating a "peace dividend" and an example of commercial diplomacy.

Humorously, one time he ended a speech by stating that like a horse and cart going through a gate, the horse of regular diplomacy, done by the State Department, would always proceed the cart of commercial diplomacy. I was the next speaker and started my speech with the observation that I did not mind backing the cart through the gate, meaning that commercial activities could actually pave the way for better government-to-government interaction. Historically, commerce has tended to precede diplomacy.

One of the interesting aspects of this project is the speed with which it was implemented. Enabling legislation was introduced to Congress in March 1996. It passed the House in April and the Senate by September. Such speed was only possible because it was introduced as an amendment to existing law, the US-Israeli Free-Trade Agreement, thus minimizing opposition to a wholly new program. I think this is an important principle for any zone development project. Understand the existing laws and use them to your advantage to minimize demands for special consideration.

A good example of this was in the ZEDE Program in Honduras. Under Honduran law, all municipalities have the right to have a local police force, but none do. Municipal budgets are set by the national government. Municipalities don't collect taxes; they have no way of funding a municipal police force. They have to depend on the national government for policing. It turns out that municipalities in Honduras have many rights that are useful in ZEDEs, but they can't exercise most of them because they lack independent revenue. In the ZEDE legislation, I suggested that we could acquire these rights by simply declaring a ZEDE a municipality and then focusing on ZEDE's having independent taxing authority. Using existing municipal law is part of what made the ZEDE law constitutional as it respects the history and the culture of the country.

Max Borders: Why do some SEZs fail or at least fail to flourish like others?

Bob Haywood: It's an interesting question. SEZs fail for a wide variety of reasons, among them are all the reasons that new businesses fail-poor management, undercapitalization, failure to understand customers' needs, poor location, poor infrastructure, and/or poor execution. In addition, they also fail because of government interventions or mismanagement. Examples include inadequate legislation, political infighting, inconsistent regulations, corruption, and poor planning. They can also fail due to increasing political violence or a radical change in government ideology. Sometimes they fail for seemingly idiosyncratic reasons. These reasons applied to both publicly financed and privately financed SEZs, although privately funded SEZs have tended to make better location choices.

To give some examples, I remember talking to a zone manager in Morocco. He was an employee of the Ministry of Commerce and was told by his Minister that his career depended upon ensuring that the Tangier Zone failed. For historical reasons, the depended upon ensuring that the Tangier Zone failed. For historical reasons, the central government did not want the city of Tangier to become too economically strong and independent. The Freezone was attracting too much investment for the central government's comfort. I do not know what happened to the manager's career, but he succeeded. This particular zone no longer exists.

In Alexandria, Egypt in 1973, and at Athi River in Kenya in 1993, the World Bank, which was financing these two zone projects had a policy to avoid promoting "urban congestion. So, the zones were located 25 to 30 km away from their primary cities. In both cases, this meant substantially higher infrastructure costs but more importantly there were no workers in the immediate area to employ, creating problems for productivity and higher costs for investors who had to bus workers from the city. As a result, both zones were slow to take hold and had very poor returns on invested capital. The World Bank again soured on the concept of zones for economic development.

Interestingly, both these zones eventually became successful. In Egypt's case, the zone was located on the main Cairo-Alexandria Highway and the urban area of Alexandria grew out to the zone location over the following three decades, providing a source of labor for the zone.

In Kenya's case, the local town of Kitengela eventually grew from 6,500 in 1990 to a current population of 160,000 with two-thirds of the growth taking place in the last 10 years. If these had been private-sector-owned zones the operators would have gone bankrupt long before the zones became successful. In Kenya's case privately manage zones in Nairobi and Mombasa thrived during the years that the Athi River Zone struggled.

In Russia, the Nakhodka Freezone, in Russia's Far East, failed because of the central government's failure to provide a proper legal framework. In the confusion following the collapse of the Soviet Union, their charter was granted by executive order, financed, and approved by legislation which was subsequently vetoed by the new president. It continued to operate under the executive order for a few years. New legislation was passed and vetoed again by a different president. They even tried to put an SEZ legally above national law by creating a formal treaty between Russia and South Korea that established a joint zone in Nakhodka that was signed by the same president that veto the second legislation. Unfortunately, the South Korean principals were killed in an auto crash right after signing the agreement and the project was never implemented.

In India, their SEZs had less of an impact than originally promised because the Indian government continually meddled with the regulations. In part, this was done because of poor design in the implementing legislation, but in a larger part, it was due to various parts of the government clawing back the incentives that had been provided in the first place. Originally, they were to have a minimum size of 10,000 hectares. and a resident population. No consideration was given in the legislation to the exercise of the democratic rights of the residents in the SEZ. Therefore, the central government, using an old mining law, extended the jurisdiction of the adjoining town over the SEZ, subjecting the SEZ to the local municipal bureaucratic processes and undermining the intended independence of the SEZ.

The last example is Israel. In Israel's case, an American investor spent a reported $6 million promoting a zone before Israel had even passed an economic zone law. The Ministry of Finance was eventually able to prevent the passage of the law and the entire investment was lost. The lesson is: ensure that the legal foundation is in place before seeking investment.

Source: Adrianople Group / See also their special jurisdiction map

Max Borders: China's special economic zones almost failed between 1979-1984, despite the vision of Deng Xiaoping. How did the Chinese turn things around? Were you involved at all?

Bob Haywood: It's a little-known fact that by 1984 China's Special Economic Zones were attracting almost no foreign investment. As mentioned earlier, I first went to China in 1979 and put an investment in China in 1980. We avoided the zones. In 1982, I wrote an article about these zones and stated that the current zones were not good for China and not good for the investor.

The Chinese zones had initially been established as laboratories in which China could observe Western business practices. Moreover, they had been established in somewhat isolated areas so that the activities in the zones would not "pollute the minds" of the Chinese population.

The border with Hong Kong might not seem like a remote area to Westerners, but from a Chinese perspective, it had only a few fishing villages and a small population. It was several hours from any Chinese population center. After a brief flurry of interest, ambiguous legal structures, prevalent corruption, and an inefficient employment management system provided by the Chinese army, foreign investors lost interest. In 1984, the central government recognized that the zones were not fulfilling their intended purpose of attracting foreign investment.

One Chinese official noticed my 1982 article and contacted me. After lengthy discussion and study, and partly to protect Deng Xiaoping, China announced an expansion of the zone program with the creation of Technical and Economic Development Areas in 14 Cities. We were able to get the mandate of these zones, and the earlier zones, to be creating a world-class business environment for investors. This was a much more palatable objective for investors who had not liked being used as experimental "lab rats." The ability to form corporations, lease property, and manage facilities and workers was clarified in the new zones. One needs to remember that in 1980 Communist China all economic entities were owned by the government, and a law on the formation of private companies did not exist. The Chinese Company Law was not approved until the end of 1993. In the decades before the law was passed, either a private investment decree~~,~~ or the laws and regulations of the zones were the only way for foreigners to form a company in China.

Some of the zones have been extraordinarily successful. Some have received in excess of $60 billion in foreign investment and have populations of more than 12 million.

Read the second installment of our conversation with Bob Haywood.

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