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# Engines of Prosperity

## *The Promise of the Zones for Employment and Economic Development (ZEDEs) in Honduras*

Ryan C. Berg and Matthew Carusi

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### *Introduction*

Special economic zones (SEZs) are autonomous zones designed to facilitate free-trade operations. SEZs can be broken down into the [following types of zones](#): free-trade zones, which are duty-free areas to warehouse and transit goods; enterprise zones, which provide tax benefits to underperforming industries; specialized zones, which include technology parks; and freeports—the largest type of economic zones, combining work and residential spaces. A 2008 World Bank [report](#) defined SEZs as having the following characteristics: a geographically secured area, a single management system, eligibility for benefits based on the location within the zone, and a separate customs area.

Advocates of SEZs argue that they can improve a country's economic standing by making it more competitive on the global stage. One way to achieve this goal is by improving a country's [infrastructure](#). Building out more extensive road networks or port systems is beneficial not only for businesses operating inside the SEZ, but also for the entire country's future economic trajectory. Another argument in favor of SEZs is that they strengthen a country's [institutional framework](#). In developing countries, this narrative can be particularly relevant because weak institutions often constrain foreign investors from making large-scale commitments. SEZs attempt to fill this gap by increasing the efficiency of the regulatory frameworks, property rights, and investment flows. Since a wealth of SEZs are awarded a certain level of legal autonomy, establishing these unique governance structures can be arranged. SEZs offer similar advantages for streamlining efficiency in the labor market. Wages can be more flexible and the process of [hiring and firing employees can become easier](#). Workers can further be attracted by the availability of better healthcare and education systems, as well as by the [availability of internet or phone services](#). All these factors are crucial in attracting the best possible talent, both domestically and internationally, giving them reasons to set up operations inside an SEZ.

The intended results of these characteristics are that GDP per capita within the SEZ would increase substantially and that surrounding areas would be able to reap these rewards. These are known as spillover effects, wherein new influxes of foreign and intellectual capital would spill over into the surrounding communities. However, the verdict on this subject is less clear. According to a [2017 World Bank study](#), the literature on SEZs does not confirm a clear link between achieving widespread spillovers and increasing regional employment levels. There is more evidence to support the claim that limited spillover effects exist in surrounding areas up to 50 kilometers outside the SEZ.

One of the archetypical SEZ success stories is that of the Shenzhen Special Economic Zone. Established in 1980, the zone lowered taxes and opened the area to direct foreign investment. In addition to making Shenzhen a favorable business environment, the zone's strategic location next to Hong Kong enabled it to become part of a broader network of trade, swelling the area's GDP per capita from \$195 in 1980 to \$25,000 in 2017. Today, there are over 4,000 SEZs in the world, including nearly [500 in Latin America and the Caribbean](#). SEZs launched in Central America as early as the 1970s—and even earlier in the case of [Panama](#)—where they played a critical role in job creation and the diversification of these countries' economies toward manufacturing and industrial goods. Although some of these zones have enjoyed explosive growth, others have been more muted in their effects. The more flexible regulations observed in many SEZs have earned them criticism as being good for business, but also good for crime, with fears of [money laundering, corruption, and other types of illicit financial activities](#). While the threat of SEZs being exploited for criminal activity has been reduced thanks to the application of international standards and regulations, there remains an overarching question of how best to organize SEZs to promote inclusive and far-reaching economic growth.

In Honduras, the Zones for Employment and Economic Development (*Zonas de Empleo y Desarrollo Económico* in Spanish, or ZEDE) are a type of SEZ that delegates greater autonomy to zone administrators. Established in 2013 through a constitutional amendment, ZEDEs function as special subdivisions of Honduras. Within their borders, ZEDEs have a significant degree of freedom to adopt their own taxation systems and legal regimes, although these are subject to oversight by a national committee. This is crucial for the well-being of ZEDEs, as it allows them to replicate laws and regulatory regimes from other countries, making them more compatible for creating a business. Indeed, legislation could even be drawn from a mixture of different systems, depending on the best fit. In addition to organizing their own legal systems, ZEDEs were empowered to provide their own civil services, including housing, utilities, law enforcement, and dispute resolution. With a focus on building grassroots institutions, the ZEDE model appears designed to create zones that emulate Hong Kong even more closely than the Shenzhen SEZ.

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ZEDEs are [circumscribed by Honduran law](#), however, in all topics related to sovereignty, application of justice, national defense, foreign relations, electoral matters, and issuance of identification documents and passports. Furthermore, any legal framework adopted by ZEDEs must provide equal or greater protection for human rights than what is contained within the Honduran constitution.

This white paper will provide an overview of what ZEDEs are, what their purpose is, and what the legal framework looks like for their existence. Following that assessment, the paper will juxtapose the current challenges threatening the survival of ZEDEs with the potential that they have for creating long-term economic growth. Finally, the paper presents a series of recommendations for policymakers on what steps can be taken from this point onward.

## *ZEDEs at a Glance*

One of the most ambitious ZEDEs currently under construction is Próspera ZEDE. With two-thirds of its 1,000 acres located on the island of [Roatán in the Caribbean Sea](#), and one-third of its acreage on the opposite-facing portion of mainland Honduras, Próspera is an autonomous community that aims to be a hub for multinational investors. Like other ZEDEs, Próspera maintains its own legal system and tax code. According to Próspera's [website](#), its aggregate tax revenue as a percentage of GDP will eventually be capped at 7.5 percent by January 1, 2030, or upon reaching 50,000 residents. This is more than three times lower than in the rest of Honduras, where tax revenue represents 23.4 percent of GDP, and over four times lower than in the United States, where it is 33.3 percent of GDP. Promoters contend that this cap is reasonable given the high levels of productivity expected in the ZEDE because of its regulatory optimization. These policies have generated significant interest for the island in the form of [\\$80 million](#) in capital raised so far and an influx of cryptocurrency firms wanting to relocate. The island has also declared that capital gains from trading in cryptocurrencies will not be taxed and that leading cryptocurrencies will be accepted for payment of fees and taxes, which has effectively rendered bitcoin a legal tender.

Similarly, Ciudad Morazán, another ZEDE in Honduras, combines factory space and residential houses in the same development. Workers have access to affordable housing in a [safe community](#) conveniently located near their place of employment. It shares a similar governance structure to that of Próspera, in that it maintains autonomous municipal services and a special legal code. Ciudad Morazán also offers a unique incentive in the form of access to a [deep-water port](#) located about 25 miles away in the city of Puerto Cortes. Its infrastructure and access aim to attract manufacturers who want to streamline their logistic exporting operations through the port.

Conversely, ZEDE Orquídea does not combine residential and workspace areas. Rather, it boasts 1,000 hectares (2,471 acres) for agricultural production. Produce grown in this zone can be processed and sold overseas to important markets like the United States without being subject to sales taxes, offering tremendous economic advantages and creating an enabling environment for ZEDE Orquídea's aim to become an agricultural production hub.

The theoretical underpinnings of ZEDEs are rooted in the political thought of a nineteenth-century Honduran scholar and statesman, José Cecilio Del Valle, who championed decentralized governance for the region modeled after Swiss cantons, and in the 1880 Honduran Constitution, which [introduced](#) the principle of municipal autonomy and the state's role in promoting economic development. The ZEDE legislation also drew on the work of Nobel-prize-winning economists who popularized the idea of "charter cities," or regions that would be governed by an internal charter rather than the general law of a country. They posit that allowing zones within a country to experiment with different mechanisms for governance and accountability will allow for the cultivation of best practices and models for the rest of the country to [adopt](#). The level of autonomy afforded to the ZEDEs also permits private sector actors to enter the realm of public service provision, where governments have long held a monopoly. In doing so, they seek to deliver public services at a level that has not been previously achieved. Critics maintain that without working to change the quality of governance in a country as a whole, corruption will continue to seep into the

model zones. Proponents point to the success of competitive federalism among semiautonomous political subdivisions in other countries, such as the United States, Switzerland, and Germany. They argue that “[Tiebout competition](#)” promotes a race to the top as semiautonomous jurisdictions compete for residents and businesses by improving their tax and regulatory policies.

Although the ZEDE law is not always framed as controversial, the zones have faced accusations by opponents given their connection to corruption in the [government](#) of former Honduran president Juan Orlando Hernández. Opponents contend that there is no practical difference between the 2013 ZEDE law and the 2011 “[Special Development Regions](#)” (REDS) law, which was struck down as [unconstitutional](#) in October 2012 by the Honduran Supreme Court. Based on this premise, opponents of the ZEDE framework argue that the January 2014 Honduran Supreme Court [decree](#) upholding the constitutionality of the 2013 ZEDE law was produced by corruption, pointing to the congressional impeachment and replacement of four justices who opposed the 2011 REDS law, which was encouraged by President Hernández. The merits of this contention are subject to scrutiny since the vote sustaining the 2013 ZEDE law was unanimous and because there are significant differences between the 2011 REDS law and the 2013 ZEDE law from a [sovereignty perspective](#). For example, the 2011 REDS law allowed non-Hondurans to have a direct policymaking role in its national oversight committee, whereas the 2013 ZEDE law did not. Also, the 2013 ZEDE law included a specific savings clause barring it from being interpreted to supersede core attributes of sovereignty, whereas the [2011 REDS](#) law did not. However, ZEDEs continue to be a topic of fierce debate, and from nearly their inception have been the target of allegations claiming they serve as vehicles for the erosion of Honduran sovereignty.

In April 2022, Hernández was [extradited](#) to the United States on drug trafficking and firearms charges. Hernández’s arrest further tarnished the reputation of ZEDEs—and their purported links to corruption—because he had promoted them as means of economic reform during his presidency. Furthermore, the current Honduran president, Xiomara Castro, repeatedly denounced ZEDEs on the campaign trail by claiming that they undermined Honduran [sovereignty](#). In that same month, the Honduran Congress unanimously repealed the 2013 law that allowed for the creation of ZEDEs. This decision has led to considerable confusion over the legal effect of the repeal. A number of provisions, most notably [Article 45](#) of the ZEDE Organic Law, as well as the [Honduras-Kuwait Treaty of Reciprocal Investment](#), guarantee a period of legal stability preventing the zones from being abolished with the stroke of a pen. Nevertheless, continued attacks from the administration may severely restrict further investment, both within the ZEDEs and across the board. Striking down the law has also placed many Honduran lawmakers in a difficult political position should they attempt to support the zones. More recently, President Castro continued her anti-ZEDE theme in [her speech to the United Nations General Assembly](#).

A range of critics have also raised concerns that ZEDEs do not achieve their main goals as implied by their name—that is, serving as zones of employment and economic development. Others have claimed that ZEDEs abrogate the constitutional rights of Hondurans by giving the enterprises tasked with running the zones a voice in decisionmaking within the zone (often, a certain number of votes on the local council). For example, in one ZEDE, the technical secretary (equivalent to a governor or mayor) may make most public policy decisions only with the preapproval of two-thirds of a nine-person council of trustees, five of whom are selected and four of whom are appointed by the company that runs the zone. Opponents of the ZEDE contend that this gives the company that runs the zone an effective veto over [decisionmaking](#). Nevertheless, there is flexibility in ZEDE governance that allows for the institution of several mechanisms. For instance, in the preceding example, community residents enjoy referendum authority to overturn public policies with which they disagree by majority vote, and as literal fiduciaries of the community,

every ZEDE resident has standing to challenge their actions using arbitration services administered by retired U.S. judges, international litigators, or the [American Arbitral Association's International Centre for Dispute Resolution](#). Furthermore, the same ZEDE allows for the creation of internal special districts, which can self-govern in accordance with any other desired [democratic norm](#). Innovative nuances in ZEDE governance often go unmentioned.

Another major challenge for ZEDEs is the prominent levels of corruption and violence that persist across Honduras. According to Transparency International, Honduras currently ranks [157th out of 180 countries](#) on the Corruption Perception Index 2021 scale. In other words, this equates to an annual loss of [\\$2.5 billion, or 12 percent of Honduras's GDP](#). Despite commitments by the Castro government to fight corruption, the issue persists throughout government agencies and, more troublingly, in law enforcement.

Corruption within law enforcement has been especially problematic since Honduras has one of the highest crime rates in the world. Despite halving its murder rate over the last decade, an average of [13 people](#) are murdered in Honduras every day. This equates to [38.6 homicides per 100,000 inhabitants](#). To make matters worse, Mexico's aggressive efforts to fight powerful drug cartels have pushed many of these organizations into Central America. Honduras has [become](#) a major trafficking hub, thanks to its large swaths of uninhabited jungle and weak judicial system. Once drugs are covertly smuggled into Honduras, they can be shipped to the border with Guatemala. Government control is extremely weak in these transit areas and most drug cartels possess more wealth and firepower than local security forces. This has increased the cycles of violence across the country and allowed some drug cartels to assume de facto control over rural departments. High crime rates might continue to dissuade foreign investors from moving to Honduras or investing in major projects, such as ZEDEs.

From an institutional standpoint, Honduras still has serious governance issues. With corruption persistent in various branches of government, long-term investments are much riskier. The World Bank's final Ease of Doing Business index ranked Honduras [133rd out of 190](#) total countries. Low marks were awarded for issues like obtaining construction permits and enforcing contracts. Although their autonomous governance structure makes ZEDEs somewhat immune to institutional constraints, uncertainty remains over whether future Honduran governments would be willing to uphold these principles in the face of intense public pressure.

### *The Promise of ZEDEs*

While the above challenges should not be dismissed, ZEDEs nevertheless offer a unique economic solution for Central American countries seeking to expand free-trade operations. If successful, the model could galvanize higher levels of foreign direct investment in the region. An interested country need only look at the [ZEDE Organic Law](#) as a starting point. This ease of adoption also makes ZEDEs appealing as a credible counteroffer to other SEZ regimes. The development of a regional network of ZEDEs would also be in line with recommendations published by the World Bank outlining the need for improved networks among countries in the [Central American SEZ space](#). Should the Honduran ZEDEs continue to bear fruit, the model could lead to a new surge in private sector-led investment and development throughout Central America. This would be extremely significant because most free-trade zone models have been implemented outside of Latin America in more developed markets like Dubai, Hong Kong, and Singapore.

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The successful implementation of ZEDEs would also be a major policy achievement for the Biden administration. Given that one of its major political goals has been to address the root causes of Central American migration, ZEDEs offer an existing mechanism through which to do so. Lack of economic opportunities has been one of the main driving forces behind the huge influx of Honduran migration to the United States. Vice President Kamala Harris has persuaded U.S. companies to invest nearly **\$3.2 billion** in the region. ZEDEs could reinforce these gains by attracting a diverse range of jobs from existing sectors, like agriculture, and new ones, like technology. Physical working conditions could also be improved through regulations stating that ZEDEs employers be paid in dollars and that average salaries be at least **10 percent higher** than the national minimum wage. Furthermore, one of the provisions contained within the ZEDEs law is that **90 percent** of day labor opportunity zones must be provided to Hondurans. This would create opportunities both for the intellectual diffusion of ideas and for the improvement of working conditions on the ground.

In the wake of the Covid-19 pandemic and increasing geopolitical tensions with China, policymakers in Washington, D.C., have urged U.S. companies to relocate their supply chains from Asia. The Biden administration would benefit from ZEDEs given the United States' cordial diplomatic relations with countries in Central America and Honduras's ideal geographic proximity to the U.S. market. ZEDEs could serve as an important policy tool for nearshoring. Manufacturing operations could be held in ZEDE locations, such as Ciudad Morazán, where access to a deep-water port and a competitive labor pool would create strategic advantages for companies. If U.S. companies were to take full advantage of the nearshoring opportunities in ZEDEs, it would be a major political victory for the Biden administration. It would be able to address the economic root causes of migration in Central America and publicly fulfill its commitment from the Summit of the Americas to近岸 critical supply chains.

ZEDEs are far from the only option for SEZ organization and governance being considered in Central America. In recent years, China has worked assiduously to consolidate its own economic and political interests throughout the Western Hemisphere. Its flagship Belt and Road Initiative (BRI) recently expanded into Latin America, with a total of **21 countries** signing on to the agreement so far. Through this project, China has been able to significantly exert more soft power in the region through the funding and construction of large-scale infrastructure projects. Economic incentives have become a crucial tool for gaining political concessions on issues of major geopolitical importance to China. Persuading Latin American countries to withdraw their recognition of Taiwan is one of China's most pressing objectives. Out of the 14 countries around the world that still recognize Taiwan, **eight of them** are located in Latin America. Beijing is pushing hard to reduce this number through a combination of economic incentives and other gifts.

Beijing has found significant success in El Salvador, where it has forged an agreement to develop an SEZ comprising around **14 percent of Salvadoran territory and nearly half the country's coastline**. In addition to the sheer amount of territory this zone would encompass, the zone would also bar U.S. and European construction, telecommunications, tourism, and shipping companies from attempting to operate within its borders. While China boasts some of the largest SEZ success stories, there is little indication that Beijing is seeking to replicate in Central America the systems and practices that made zones like Shenzhen so successful—namely, local-level autonomy and openness to a wide array of foreign businesses. Indeed, around the world, **Chinese development projects** typically employ few local workers and often result in the client countries assuming unmanageable levels of debt. Should the Chinese model become ascendant in the Americas, the result will be a far less open and competitive environment for private business.

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## *Policy Recommendations*

Considering the recent developments regarding the legal jeopardy of ZEDEs and the Biden administration's push toward nearshoring in the Western Hemisphere, U.S. policymakers seeking to promote the importance of ZEDEs should consider the following recommendations:

- 1. Pursue an alignment of ZEDEs with the Biden administration's goal of addressing the root causes of migration from Central America.** Since assuming office in 2021, President Biden has been under intense political pressure to reduce the record high numbers of migrants arriving daily to the U.S. southern border. In fiscal year 2022, [more than 2 million arrests](#) were made at the southern border. Many of these migrants are from Central America, where they face threats of violence and even bleaker economic prospects. To stem the tide of migrant arrivals, the Biden administration has initiated steps to address the root causes of migration. Lack of economic opportunities is one of the most pressing issues. This could provide ZEDEs with an [elevated level of importance](#). With their promise to employ more Hondurans and pay better wages than elsewhere in the country, ZEDEs could become a valuable tool for growing economic prosperity in the country. Moreover, ZEDEs enable intellectual diffusion and job growth in Honduras. A secondary pillar of the Biden administration's root causes strategy is addressing economic insecurity and inequality to combat mass migration. However, undoubtedly, bringing foreign companies to Central America would create opportunities for the diffusion of intellectual talent. This would let local entrepreneurs flourish and allow for the advancement of more sophisticated industries. Furthermore, ZEDEs offer the prospect of stronger job growth and well-paying jobs for ordinary Hondurans in the ZEDE jurisdictions and surrounding communities.
- 2. Encourage the successful implementation of ZEDEs to fulfill the Biden administration's goal of nearshoring important industries.** In the wake of the Covid-19 pandemic and increasing geopolitical tensions with China, U.S. policymakers have eagerly called on private companies to近shore their supply chains closer to domestic markets. The Biden administration echoed these claims at the 2022 Summit of the Americas by including supply chains in the [Americas Partnership for Economic Prosperity](#). ZEDEs provide the administration with an existing economic tool through which to persuade U.S. companies across a wide variety of industries to set up manufacturing or refining operations.
- 3. Incorporate ZEDEs into an alternative economic view to the SEZ model proposed by China.** As noted previously, China is expanding its economic cooperation in Central America in the form of SEZ agreements, like the one proposed in El Salvador. This presents Beijing with an opportunity to further deepen its ties within the region. ZEDEs offer a way to counteract this influence by proposing an economic model that allows for free trade to occur, while at the same time creating ample job opportunities for Hondurans.

4. **Ensure ZEDEs are implemented in a responsible and sustainable manner to incentivize similar SEZ projects in the region.** If the implementation of ZEDEs proceeds efficiently, then it will be possible to replicate similar projects across Central America. Countries would be able to look at the effectiveness of the ZEDE model in Honduras and craft their own models based on their specific needs. This could help shore up stability in the region and create future opportunities for continued economic cooperation. ■

*Ryan C. Berg* is director of the Americas Program at the Center for Strategic and International Studies (CSIS) in Washington, D.C. *Matthew Carusi* is a former intern with the CSIS Americas Program.

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