
*-Jorge
Constantino
Colindres*

**Make Honduras Great:
Charter Cities as a
Development Program**

*-Dr. Mark
Lutter*

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Abstract

We propose building charter cities to help develop Honduras and alleviate the refugee crisis. Charter cities are large real estate developments under a new jurisdiction with a blank slate, or close to it, in commercial law. The new jurisdiction allows the charter city to adopt the best practices in governance, attracting investment, creating jobs, and stimulating economic growth. Singapore, Hong Kong, and Dubai were able to become world class cities due in large part to their governance, the same opportunity exists in Honduras.

Legislation which allows the creation of charter cities, known as Zones for Employment and Economic Development (ZEDEs), exists in Honduras. However, because of the complexity of creating a new legal system, no charter city has been publicly approved. Our goal is to demystify the challenges of creating a charter city such that it can become part of the strategy of developing Honduras. We propose a plan and timeline which demonstrates the cost effectiveness of charter cities as a policy strategy for poverty alleviation and development.

The paper is split into two sections. First, we review the migrant crisis, the failed solutions, and the governance challenges of Honduras. Second, we review the ZEDE legislation, offering a plan for developing a ZEDE. The appendix has additional information regarding models for the real estate aspect of a charter city.

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I. BACKGROUND: MIGRANT CRISIS AND FAILED POLICIES

Central America remains mired in poverty. Panama and Costa Rica are the richest countries in the region, with per capita GDP just under \$10,000. By contrast Nicaragua is the poorest, with a per capita GDP just under \$1300. Central America is also one of the most violent places in the world. El Salvador and Honduras have the highest and second highest homicide rates in the world. The poverty and violence have caused to large numbers of citizens to flee their respective countries for the United States, triggering a domestic political crisis.

The introduction is split into four sections. First, we review the migrant crisis. Second, we discuss the violence rates in Honduras. Third, we review the business environment in Honduras. Last, we analyze past development attempts in Honduras and Central America.

1. Migration Crisis at the U.S. Border

In June 2014, the United States Department of Homeland Security reported that over 52,000 unaccompanied children had arrived on the U.S. border with Mexico over a period of nine months¹. What was then known as the *2014 American immigration crisis* became a regular phenomenon through the following years; from FY 2013 to FY 2018, a total of 217,733 unaccompanied children (ages 0-17) from Honduras, El Salvador and Guatemala were apprehended at the U.S. southwest border².

Unaccompanied Alien Children Apprehensions by Country						
Numbers below reflect Fiscal Years 2013 - 2018						
Country	FY2013	FY2014	FY2015	FY2016	FY2017	FY2018
El Salvador	5,990	16,404	9,389	17,512	9,143	4,949
Guatemala	8,068	17,057	13,589	18,913	14,827	22,327
Honduras	6,747	18,244	5,409	10,468	7,784	10,913
Mexico	17,240	15,634	11,012	11,926	8,877	10,136

Figure 1. U.S. Border Patrol Southwest Border Apprehensions by Sector FY2018

¹ Forsyth, Jim. 2014. "Homeland Security says 52,000 minors at U.S. borders since October." *Reuters*, June 20.

² U.S. Department of Homeland Security. 2018. U.S. Border Patrol Southwest Border Apprehensions by Sector FY2018. October 23. <https://www.cbp.gov/newsroom/stats/usbp-sw-border-apprehensions>.

In total there have been 2,334,466 irregular migrants apprehended at U.S. southwest border since FY 2013. The amount of apprehensions has remained relatively steady, from 414,397 in FY 2013 to 396,579 in FY 2018³. However, the apprehension of unaccompanied children has almost tripled within the last eight years, from 18,622 apprehensions in FY 2010 up to 50,036 in FY 2018⁴, illustrating the desperation of many Central Americans.

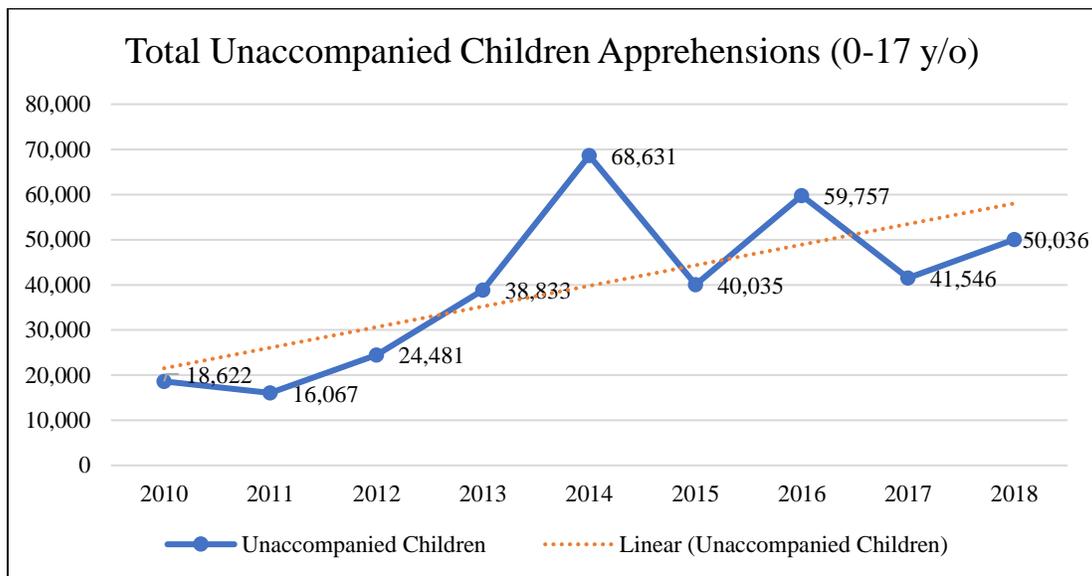


Figure 2. U.S. Border Patrol Total Monthly UAC Apprehensions by Sector (FYs 2010-2018)

Children find themselves more vulnerable to violence, poverty, and exploitation in Mexico and Central America. A 2014 study by the U.S. Congressional Research Service identifies “High violent crime rates, poor economic conditions fueled by relatively low economic growth rates, relatively high poverty rates, and the presence of transnational gangs” as the main factors contributing to the surge in unaccompanied child migrations⁵. In another study by the United Nations High Commissioner for Refugees (UNHCR), interview results from 404 unaccompanied

³ U.S. Customs and Border Protection. 2017. "U.S. Border Patrol Fiscal Year Southwest Border Sector Apprehensions (FY 1960 - FY 2017)." Department of Homeland Security. December. <https://www.cbp.gov/sites/default/files/assets/documents/2017-Dec/BP%20Southwest%20Border%20Sector%20Apps%20FY1960%20-%20FY2017.pdf>; Bernal, Rafael, and Brett Samuels. 2018. "Border apprehensions up nearly 100,000 in fiscal 2018." The Hill, October 10.

⁴ 2018. "U.S. Border Patrol Total Monthly UAC Apprehensions by Sector (FY 2010 - FY 2017)." Department of Homeland Security. July. <https://www.cbp.gov/sites/default/files/assets/documents/2018-Jul/BP%20Total%20Monthly%20UACs%20by%20Sector%2C%20FY10-FY17.pdf>; *Supra*, note 2.

⁵ A. Kandel, William, Andorra Bruno, Peter J. Meyer, Clare Ribando Seelke, Maureen Taft-Morales, and Ruth Ellen Wasem. 2014. Unaccompanied Alien Children: Potential Factors Contributing to Recent Immigration. Washington DC: Congressional Research Service.

child migrants revealed that the presence of family or opportunities in the United States, followed by the preponderance of societal violence and domestic abuse in their home countries were their driving motivations⁶.

2. Rule of Law, Crime Prosecution, and Security in Honduras

In addition to poverty, personal security is one of the main factors of high migration rates from Central America. In Honduras, for example, homicide rates rose rapidly after the 2009 political crisis, peaking rate at 86.5 homicides per 100,000 people in 2011⁷. The murder rate gained San Pedro Sula, the industrial capital of Honduras, the unfortunate title of Murder Capital of the World. Not coincidentally, a large percentage of migrants leaving the country do so from San Pedro Sula⁸.

For Jorge, one of the authors of this piece, it was not an uncommon experience to drive by the aftermath of shoot outs and assassination attempts across the city, seeing cars and frequently visited venues such as restaurants or sports areas filled with bullet holes.

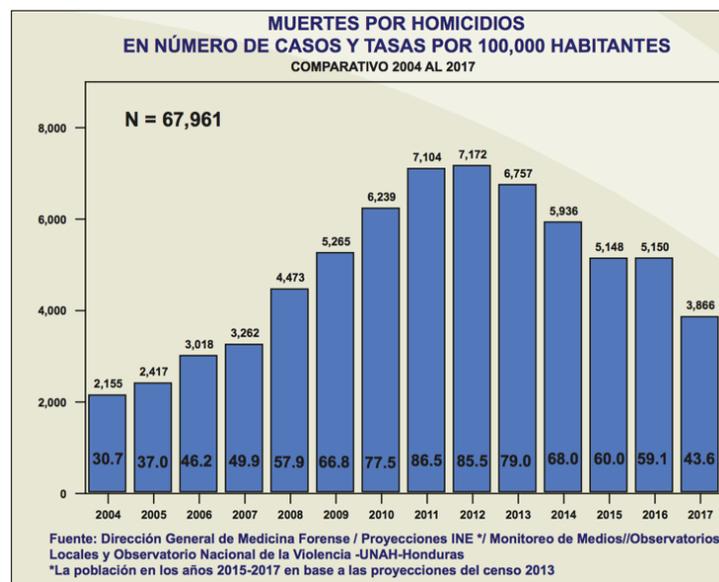


Figure 3. UNAH. 2018. Observatorio de la violencia.

⁶ UN High Commissioner for Refugees (UNHCR). 2014. Children on the Run: Unaccompanied Children Leaving Central America and Mexico and the need for International Protection. UN High Commissioner for Refugees (UNHCR).

⁷ UNAH. 2018. Observatorio de la violencia. Boletín Enero-Diciembre 2017. Edición No. 48. Tegucigalpa, M.D.C.: Instituto Universitario en Democracia, Paz y Seguridad.

⁸ Romo, Rafael, and Nick Thompson. 2013. "Inside San Pedro Sula, the 'murder capital' of the world." *CNN*, March 28. <https://edition.cnn.com/2013/03/27/world/americas/honduras-murder-capital/index.html>.

In 2013 the Asociación para una Sociedad Más Justa, a Honduran nonprofit, published a study estimating that 96% of homicides in the country are left without conviction⁹. Another study estimates that, between 2004 and 2014, over 174,000 people were forced to abandon their homes due to violence and insecurity¹⁰.

Impunity, however, is not limited to homicides, and is also common in public corruption cases. In Transparency International's 2017 Corruption Perceptions Index, Honduras ranked 135/180 countries, revealing systemic challenges facing Honduras¹¹.

3. Doing Business in Honduras¹²

One of the main obstacles to reducing poverty in Honduras is the difficulty of doing business under its current legal system. According to the World Bank, Honduras ranks 121 out of 190 countries on its ease for doing business, considerably lower than all other Central American countries, except for Nicaragua (132), and lower than the regional average of Latin America and the Caribbean. Regionally, Costa Rica scores highest on the Doing Business index (67), followed by Panama (79), and El Salvador (85).

As seen in the chart below, Honduras ranks worse on the Paying Taxes subcategory; on average, each year the Honduran tax system requires 48 different payments, 224 hours to comply with its regulations, and 44.4% of a company's profits to be paid in taxes and mandatory contributions. On the other hand, OECD countries' tax system require on average 11.1 payments per year, 159.4 hours to comply, and 39.8% of a company's profits.

⁹ 2014. "Homicidios en Honduras impunes en un 96%." *El Heraldo*, November 25; Nazario, Sonia. 2016. "How the Most Dangerous Place on Earth Got Safer." *The New York Times*, August 11.; Gurney, Kyra. 2014. Honduras Solves 1% of Homicide Cases: Report. December 19
<https://www.insightcrime.org/news/brief/honduras-solves-1-of-homicide-cases/>.

¹⁰ Ordoñez, Edwin. 2017. "Honduras: 174 mil personas abandonaron sus hogares por la violencia." *El Heraldo*, January 18.

¹¹ Transparency International. 2018. Corruption Perceptions Index 2017.

¹² The World Bank. 2018. Doing Business. Honduras.

<http://www.doingbusiness.org/en/data/exploreeconomies/honduras>.

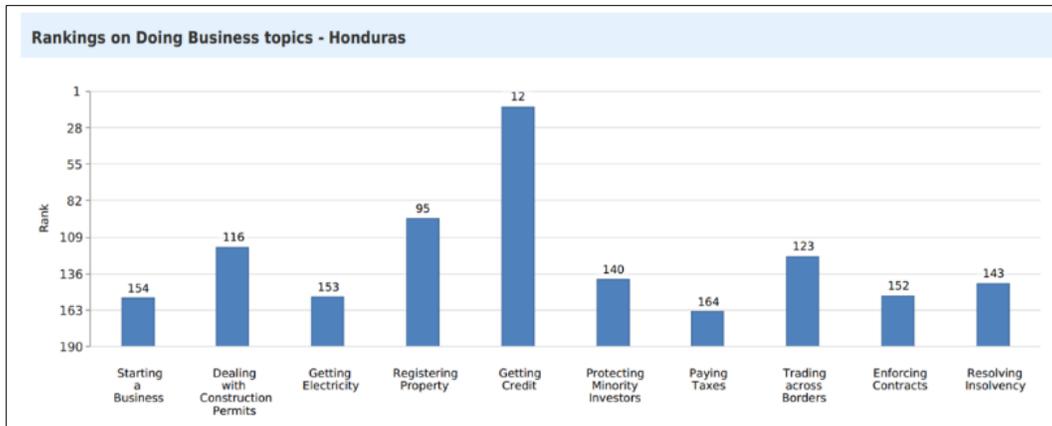


Figure 4. The World Bank. 2018. Doing Business.

The Doing Business index estimates that registering a business in Honduras requires about 11 procedures, 13 days, and 40.7% of income per capita. By contrast in OECD countries starting a business requires on average 4.9 procedures, 9.3 days, and only 3.1% of income per capita.

Additionally, the ease of Enforcing Contracts subcategory reveals a very poor performance on the Honduran judiciary’s part, as it takes 920 days on average to enforce a contract through the court system, at a cost of 35.2% of the claim value. In contrast, on average, a contract can be judicially enforced in OECD countries within 582.4 days at a cost of 21.2% of the claim value.

4. Attempted Solutions

In 2015, the Obama Administration responded to the Central American immigration crisis by launching a new U.S. Strategy for Engagement in Central America, through which the U.S. more than doubled its funding for Central American aid programs from \$338.1 million in FY2014 to \$753.7 million in FY 2016. Since fiscal year 2016, the U.S. Congress has appropriated an estimated \$2.1 billion for Central American assistance programs¹³. The strategy adopted by the U.S. prioritizes the “northern triangle” countries of Honduras, Guatemala and El Salvador, to which most of the funds have been allocated, partly “in support of the Plan of the Alliance for

¹³ Meyer, Peter J. 2018. U.S. Strategy for Engagement in Central America: An Overview. Washington DC: Congressional Research Service;

Prosperity in the Northern Triangle (A4P)”, a regional four-point action plan specifically crafted under then vice-president Joe Biden’s leadership as a means to tackle the migration crisis¹⁴.

Additionally, since 2016 the “northern triangle” governments have allocated an estimated \$7.7 billion to the Alliance for Prosperity Plan, which was drafted with the technical assistance of the Inter-American Development Bank (IADB). However, though billions of dollars have been allocated for Central American development in recent years, approximately 33% of Salvadorans, 59% of Guatemalans, and 66% of Hondurans continue to live in poverty. Since 2014, the poverty indicators of Honduras and El Salvador have varied only slightly, and the most recent poverty indicators from Guatemala are from 2014, showing the aid is having, at best, a lagging effect¹⁵.

In 2016, the MACCIH (“Support Mission Against Corruption and Impunity in Honduras”) began operations in Honduras as an international anti-corruption initiative established by the Organization for American States (OAS). Recognizing the limitations of the Judicial Power and the Public Ministry (crime prosecution body), the MACCIH brought a team of international experts and prosecutors to assist Honduran authorities in the handling of high-profile public corruption cases. Since its establishment, the MACCIH has helped investigate and prosecute several corruption cases involving congressmen, judges, political parties, a first lady, a former president’s brother, and dozens of government officials.

However, the lack of an independent judiciary has prevented any convictions in these cases. Both the Honduran National Congress and the Supreme Court have acted against the MACCIH’s efforts to prosecute high-ranking officials by passing legislation to block the prosecution of several congressmen and by issuing a judicial resolution diminishing the functions and powers of the international mission¹⁶.

¹⁴ Meyer, Peter J. 2017. U.S. Strategy for Engagement in Central America: Policy Issues for Congress. Washington DC: Congressional Research Service; Biden, Joseph. 2015. "Joe Biden: A Plan for Central America." *The New York Times*, January 29.

¹⁵ Meyer, Peter J. 2018. U.S. Strategy for Engagement in Central America: An Overview. Washington DC: Congressional Research Service; IDB. 2017. IDB Group pledges \$750 million for key infrastructure projects in the Northern Triangle. June 14. <https://www.iadb.org/en/news/news-releases/2017-06-14/northern-triangle-in-major-infrastructure-push%2C11824.html>.

¹⁶ Proceso Digital. 2017. "Caso de alto funcionario que afectó independencia judicial, anuncia MACCIH." *Proceso Digital*, May 26; Diario La Prensa. 2018. "Corte Suprema ordenaría parar funciones de la Ufecic." *La Prensa*, May 30; Center for Latin American & Latino Studies. 2017. *El Monitor de MACCIH*. Washington DC: American University; El Heraldo. 2018. "Diputados hondureños acusados por corrupción quedan libres; caso fue archivado."

According to local fiscal policy think-tank FOSDEH, from 2000-2018 the Honduran government allocated an estimated \$21 billion to poverty reduction programs¹⁷. However, official data showed 64.3% of Honduran households living in poverty by 2017, a 0.6% increase from 2001 when 63.7% of households lived in poverty¹⁸. The failure of recent policies adopted by the U.S. and the Honduran governments to curb irregular migration, which emphasize increased funding for country development and poverty reduction programs, demonstrates the need to pursue alternative solutions.

For its part, the Honduran government has also attempted several economic reforms to curb the country's high violence and poverty rates. Since 2011 the Honduran Congress adopted several pieces of legislation to improve corporate and labor law¹⁹; develop public private partnerships²⁰; liberalize the energy market²¹; enact a new Tax Code with a scheduled comprehensive tax reform²²; and the enactment of several industry-specific tax benefits²³.

II. Building a Honduran Charter City

The most aggressive and ambitious reform came with the passage of a constitutional amendment and special legislation to allow for the creation of "Charter Cities" across Honduras. Officially dubbed "Zones for Employment and Economic Development, ZEDEs", the National Congress

El Herald, January 24; Hondudiario. 2017. "MACCIH cuestiona decisión de jueza en caso de diputados." *Hondudiario*, December 14.

¹⁷ FOSDEH. 2018. Carta del FOSDEH al Fondo Monetario Internacional. April 21.

<http://www.fosdeh.com/2018/04/carta-del-fosdeh-al-fondo-monetario-internacional/>.

¹⁸ Instituto Nacional de Estadísticas. 2017. LVIII Encuesta Permanente de Hogares de Propósitos Múltiples. Junio, 2017. Tegucigalpa, M.D.C.: Instituto Nacional de Estadísticas.

¹⁹ República of Honduras. 2014. "Decreto Legislativo No. 284-2013." LEY PARA LA GENERACIÓN DE EMPLEO, FOMENTO A LA INICIATIVA EMPRESARIAL, FORMALIZACIÓN DE NEGOCIOS Y PROTECCIÓN A LOS DERECHOS DE LOS INVERSIONISTAS. Tegucigalpa, M.D.C.: Diario Oficial "La Gaceta", June 5.

²⁰ Republic of Honduras. 2010. "Decreto Legislativo No. 143-2010." LEY DE PROMOCIÓN DE LA ALIANZA PÚBLICO-PRIVADA. Tegucigalpa, M.D.C.: Diario Oficial "La Gaceta", September 16.

²¹ Republic of Honduras. 2014. "Decreto Legislativo No. 404-2013." LEY GENERAL DE LA INDUSTRIA ELÉCTRICA. Tegucigalpa, M.D.C.: Diario Oficial "La Gaceta", May 20.

²² Republic of Honduras. 2016. "Decreto Legislativo No. 170-2016." CÓDIGO TRIBUTARIO. Tegucigalpa, M.D.C.: Diario Oficial "La Gaceta", December 28.

²³ Republic of Honduras. 2012. "Decreto Legislativo No. 90-2012." LEY DE FOMENTO A LOS CENTROS DE ATENCIÓN DE LLAMADAS Y TERCERIZACIÓN DE SERVICIOS EMPRESARIALES. Tegucigalpa, MDC: Diario Oficial "La Gaceta", July 18; Republic of Honduras. 2017. "Decreto Legislativo No. 68-2017." LEY DE FOMENTO AL TURISMO. Tegucigalpa, MDC: Diario Oficial "La Gaceta", August 17.; Republic of Honduras. 2018. "Decreto Legislativo No. 145-2018." LEY DE APOYO A LA MICRO Y PEQUEÑA EMPRESA. Tegucigalpa, MDC: Diario Oficial "La Gaceta", November 28.

authorized the creation of semi-autonomous regions which would operate under a policy of low taxes, free trade and competition, by developing their own legal system and judiciary, as well as their own public administration, security forces, and crime prosecuting body²⁴.

Even though the required legislation and constitutional amendments for ZEDEs were adopted in 2013, very little has been achieved by the Honduran government in implementing the aforementioned reforms. The Honduran Charter Cities, or ZEDEs, nevertheless, still represent the country's best policy tool for solving its migrant crisis in a timely fashion. If properly designed and executed, the ZEDE regime would allow for innovative and decentralized governance schemes to tackle the main issues driving irregular migration by providing its residents with security and market friendly institutions.

1. The ZEDE Regime as a Policy Tool

In Honduras, the ZEDE regime continues to be the best policy tool in the books for tackling many of the barriers for economic development. It is difficult to overstate how transformative a successful ZEDE could be. The creation of a new jurisdiction allows the ZEDE to escape the legacy challenges of Honduran governance that otherwise might not be easily fixable.

The ZEDE legislation allows for the implementation of wholesale reforms which otherwise would not be politically feasible on a national scale. Such reforms include areas such as business and land registration systems, labor law, financial law, the court system, taxes, and crime prosecution. A successfully executed ZEDE has the potential to become the best ranked jurisdiction for doing business in Latin America in under five years.

2. Location and Legal Status of ZEDEs

In 2013, the same year that the Honduran Congress passed the ZEDE legislation, Congress approved an Organic Law to regulate the process for creating a ZEDE and established its basic governance framework²⁵, declaring that all zones with low population density (defined by the Honduran National Statistics Institute as any place with less than 35 persons living in a 1km²)

²⁴ República de Honduras. 2013. "Decreto Legislativo No. 237-2012." Tegucigalpa, M.D.C.: Diario Oficial 'La Gaceta', January 24; República de Honduras. 2013. «Decreto Legislativo No. 120-2013.» LEY ORGÁNICA DE LAS ZONAS DE EMPLEO Y DESARROLLO ECONÓMICO (ZEDE). Tegucigalpa, M.D.C.: Diario Oficial 'La Gaceta', September 6.

²⁵ The basic governance framework established in the law includes the Committee for the Adoption of Best Practices (CAMP), as the approving and supervising committee for ZEDE projects; and the Technical Secretary, as the legal representative and highest executive authority within a ZEDE.

within the municipalities located in the territorial Departments contiguous to the Gulf of Fonseca and the Caribbean Sea, could be subject to the ZEDE special regime.

Thus, the congressional authorization for the development of ZEDEs encompasses all low-density zones within the Honduran Departments of Cortés, Atlántida, Colón, Gracias a Dios, Valle, and Choluteca. Any area meeting these criteria could be incorporated into the ZEDE regime and subject itself to a local semi-autonomous governance structure. The development of ZEDEs in Departments which are not contiguous to the Gulf of Fonseca or the Caribbean Sea would require additional authorization from Congress, and in the case of high-density zones, express consent from the inhabitants through a binding referendum would be legally required for incorporation into the ZEDE regime²⁶.

While previous charter cities legislation in Honduras had been ruled as unconstitutional by the Supreme Court, the ZEDE regime has been validated by the Supreme Court's Constitutional Chamber, and currently enjoys constitutional and legislative authorization, as well as judicial validation, and political support from the ruling party²⁷.

3. Incorporation to the ZEDE Regime

The procedure to incorporate into the ZEDE regime is relatively straightforward. However, to date, interested parties have suffered from a lack of understanding and communication from the competent authorities. According to official government sources, the procedure to incorporate a low-density area into the ZEDE regime consists of the following steps²⁸:

1. Consent from Land Owners. – The first step is for the land-owner(s) of the property where the ZEDE will be developed to consent to incorporation. The property owner must make a statement before a Public Notary, expressing his or her consent to incorporate the property into the special regime. The CAMP will register this statement within its special land records.

²⁶ República de Honduras. 2013. «Decreto Legislativo No. 120-2013.» LEY ORGÁNICA DE LAS ZONAS DE EMPLEO Y DESARROLLO ECONÓMICO (ZEDE). Tegucigalpa, M.D.C.: Diario Oficial 'La Gaceta', September 6.

²⁷ Bell, Tom W. 2013. Startup City Redux. June 27. <https://fee.org/articles/startup-city-redux/>; Peralta, Adriana. 2014. "Honduran Supreme Court Rejects Claims of ZEDE Unconstitutionality." *The PanAm Post*, June 21.

²⁸ These steps have been construed from available information taken from the ZEDE legislation and the government's official ZEDE website. If procedures have changed, they have not been made publicly available. *See*: República de Honduras. 2018. ZEDE. Zonas de Empleo y Desarrollo Económico. <http://zede.gob.hn/>.

2. Develop Project Blueprints. – The concept and different stages of the project must be developed, and then presented to CAMP with the following:
 - a. Feasibility Study;
 - b. Evidence of Financial Capacity; and, a
 - c. Master Development Plan.
3. Approval From CAMP. – The project details, with the aforementioned documents, must be presented to CAMP for approval. The review process and approval of the project should take place within 30 days after the reception of a complete proposal. During the review process, the CAMP may “ask for clarifications on the proposals presented before them and establish yearly fees for the services CAMP will provide to that ZEDE during the life of the project.”
4. Nominate Technical Secretary. – Once the project is approved by CAMP, the developers must nominate one person for the role of Technical Secretary, which CAMP will approve or reject.
5. Initiate Development. - Once incorporated into the ZEDE regime, the development must start within a year of its registration, with an option for a six-month extension.

Though the legal procedure for incorporation is explained in a fairly clear fashion, developers face considerable operational challenges posed by the sheer complexity of attempting to comply with the wide-ranging obligations which accompany a ZEDE’s legal, economic, administrative, and political autonomy.

4. Operational Challenges

Establishing the governance of a ZEDE is complex. The nearest modern precedent is the Dubai International Financial Center, which imported a curated version of common law in 2006, when its Judicial Courts started operating under a parallel legal system based on English common law as a default go-to case law²⁹. In addition to creating a new system of financial law, ZEDEs must also create the rest of the legal system and coordinate the provision of public services such as education, health, social security, science, environmental protection, conflict resolution, security, and penitentiary systems.

²⁹ Hwang, Michael. 2008. *The Courts of the Dubai International Finance Centre — A Common Law island in a Civil Law ocean*. November 1. <https://www.difccourts.ae/2008/11/01/the-courts-of-the-dubai-international-finance-centre-a-common-law-island-in-a-civil-law-ocean/>.

General Overview of a ZEDE's Obligations	
1. Establish a Legal System	<ul style="list-style-type: none"> a. Adopt national or international business friendly laws, or develop an independent body of internal norms, and adapt them to comply with international and constitutional law, the ZEDE's Organic Law, and the legislation there specified. b. Define whether the ZEDE will operate under a common or a civil law tradition. c. Designate a default go-to case law from a foreign country, or gradually develop the ZEDE's own binding jurisprudence.
2. Establish a Conflict Resolution System	<ul style="list-style-type: none"> a. A judge must be designated for the ZEDE's judicial jurisdiction, as well as for the Tribunal for the Protection of Individual Rights. b. Designate a default arbitration center for the resolution of private disputes. c. Develop a legal assistance service for economically vulnerable persons.
3. Design a Fiscal and Economic Regime;	<ul style="list-style-type: none"> a. Determine the applicable taxes within a ZEDE and define its budgeting rules in accordance to its GDP. b. Establish internal transparency measures. c. Develop or adopt the applicable financial law.
4. Public Governance Scheme;	<ul style="list-style-type: none"> a. Determine the financial feasibility of the ZEDE's public administration. b. Design and set up the necessary trusts for managing the ZEDE's finances and public services.

	<ul style="list-style-type: none"> c. Draft and formalize a Citizen Coexistence Agreement with tenants. d. Create public spaces for tenants to exercise protest rights.
5. Establish Social Services Systems;	<ul style="list-style-type: none"> a. Design and Develop Education, Health, Social Security, Science, Environmental Protection, Security, Crime Prosecution, and Penitentiary Systems.
6. Stability Contract;	<ul style="list-style-type: none"> a. Draft and formalize a Stability Contract with the State of Honduras, if considered proper and feasible. The Stability Contract must be approved by Congress and have a minimum duration of 10 years.

The high initial investment required, the project’s complexity, and the setup costs of complying with the obligations of a full-fledged ZEDE, all represent considerable operational constraints which may very well limit the prompt development of the project. However, we believe a ZEDE can be developed by stages. A simplified initial phase in the form of a special business or investment district, as the one detailed in this paper, drastically reduces the initial setup costs, thus allowing for the timely development of a ZEDE which can offer secure and business friendly spaces to help develop Honduras.

5. Initial Operating Phase: Special Business District

An initial phase of a Charter City can take the form of a special business district, understood as a secure space with business-friendly institutions. This allows developers to drastically reduce setup costs by adopting only the most essential functions of the ZEDE regime, such as an internal, independent police force; an efficient conflict resolution system based on private arbitration; a competitive tax regime; and a business-friendly legal system. Initially, the district would have a business-only tenant policy, allowing for residential spaces until a later stage of development.

All other obligations and responsibilities would be handled through a combination of jurisdictional grants, either to the national or municipal government, and by maintaining the current setup of several public services and utilities. The charts above showcase how each of the

main operational challenges faced by a ZEDE would be dealt with under a simplified, special business district model.

INITIAL OPERATING PHASE: Administrative and Social Obligations	
Obligation to Provide	Special Business District
Public Services (energy, water, aqueducts, solid waste, etc.)	<i>Tenants continue paying current service fees for enjoying national and municipal public services. On a latter phase, in the case of energy, a ZEDE can purchase it directly from generator company, negotiating better conditions through fixed supply contracts.</i>
Education	<i>No education system required for a business-only district. The setup of an education system can be left for a later stage of development which includes residential spaces, in which case an external education services provider may be contracted by the ZEDE.</i>
Healthcare	<i>Adopt national or international health related regulatory measures for tenants. Emergency medical services can be contracted by the ZEDE for a business only district. A general healthcare system can be developed until later stages of development which include residential spaces.</i>
Social Security	<i>Businesses and Employees continue to pay the mandatory social security charges from the national system and continue to receive its benefits. An alternative social security system can be put in place</i>

	<i>once the initial revenue offsets the setup costs, allowing for the contracting of collective insurances and private pensions.</i>
Promotion of Science	<i>Promotion of science can be handled through internal tax incentives for research and development investments and for non-profit scientific research projects. Strategic alliances with internationally recognized academic and research institutions can be furthered by the ZEDE.</i>
Environmental Protection	<i>Internal regulations must be set in place. Developers can adopt national or foreign standards and provide for administrative oversight.</i>

INITIAL OPERATING PHASE: Law & Order Obligations	
Obligation to Provide	Special Business District
Internal Legislation	<i>Internal legislation must be defined. National law, with business-friendly modifications, or a competitive legal system from a foreign country, can be adopted.</i>
	<i>The Supreme Court will name a judge for the district, upon nomination by CAMP and the developers. The judicial bodies, powers, and</i>

Conflict Resolution	<i>structure will be defined by CAMP and the developers. For the arbitration system, a local center can initially be set as the default choice for resolution of private disputes within the ZEDE's jurisdiction. An alliance for an international arbitration center to serve as the ZEDE's default dispute resolution system can also be negotiated.</i>
Legal Assistance	<i>A specific percentage of tax revenue, or land leasing proceeds, ought to be allocated for legal assistance to economically vulnerable persons.</i>
Internal Security	<i>Internal security can be hired from a private company, which must undergo a legal and human rights training before assuming police duties.</i>
Crime Prosecution	<i>A crime prosecution body would preferably be left for later development stages, thus crime would be investigated by internal security officials and remitted to the National Public Attorney's Office through a jurisdictional concession granted by the ZEDE. If a penal judge has been assigned to the district, an internal prosecutor could be designated for him to operate under world renown best practices for criminal prosecution systems.</i>
Penitentiary System	<i>A penitentiary system ought to be left for final stages of development. A jurisdictional concession can be granted to the national government for the handling of inmates. The Honduran government could negotiate a service fee per inmate.</i>

6. Development Vision

A ZEDE project can be approved and its development started within a two-three years' time-frame. This can be accomplished by starting small, only with the essential functions offered by the ZEDE regime. The initial operating phase can be modeled after an industrial or business park, taking advantage of existing infrastructure and labor market. Examples of industrial and business parks are listed in the appendix. A residential area, as well as incorporation of additional industries, can be left for subsequent phases.

Taking local and international developments as a reference, we estimate that the minimum required investment for developing a ZEDE under an initial operating phase, can oscillate between \$50 million and \$200 million, depending on the size of the development. If additional expansion is required, the ZEDE legislation allows for the extension of its jurisdiction through land acquisitions and voluntary incorporation.

7. Development Timeline

12 months

Overview: Production of a feasibility study, a master plan, and financial models, as required by CAMP guidelines for processing applications to the ZEDE regime.

1. **Location selection:** Identify potential locations. Include relevant information such as access to public utilities, access to transportation including roads, ports, and airports;
2. **Governance framework:** Create a high-level outline for the ZEDE's governance framework, including its essential components such as:
 - a. *Legislative process.* Describe the organizational structure and process by which laws are proposed and adopted in the ZEDE, as well as the participation mechanisms for tenants.
 - b. *Legislation.* Determine what the founding laws of the ZEDE will be, they may be drawn from a common law country, a more competitive country with a civil law tradition, or from national norms with business-friendly modifications (commercial, company, labor, environmental, and financial law, among others).
 - c. *Dispute resolution.* Develop a proposal for the organization of the ZEDE's judiciary, the applicable case law, and the procedural norms; a default arbitration

center for private disputes must be defined, as well as a mechanism for solving disputes between the ZEDE and its tenants.

- d. *Fiscal Regime*. Define the ZEDE's tax regime, its budgetary processes, customs controls, and transparency measures.
 - e. *Registering and operating a business*. Outline the process for creating, registering, and operating a business within the ZEDE's jurisdiction.
 - f. *Property registry*. Outline the security mechanisms, organization, and processes for the ZEDE's property registry.
3. Security: Outline the ZEDE's security system, describing how internal police services will function, as well as recruitment processes and financials for its sustainability. The crime prosecution and penitentiary systems should also be outlined, defining whether there will be a jurisdictional grant or concession to the national government or if the ZEDE as such will assume such an obligation during any of its stages.
 4. Market Research: Determine what kind of businesses will become ZEDE tenants, in accordance to the project's requirements and market conditions in the commercial, industrial, services, and tech sectors.
 5. Master Plan: Develop a master plan, including renderings and descriptions of each phase of the project's development.
 6. Financial modeling: Create the required financial models to illustrate the sustainability of the proposed ZEDE project in the short, medium and long term, as well as within multiples scenarios.
 7. Key-Contractors: Identify potential contractors for construction, security, administrative governance, financial, and legal services. Determine whether these services will be contracted directly or through an open tender process.

Estimated cost: \$1,500,000.00

4 months

Overview: Government Approval and MOUs with key partners.

1. Memorandums of Understanding: Draft and sign MOUs with key partners including
 - a. Anchor tenants;
 - b. Land owners (land purchase or joint venture);

- c. Construction contractors;
 - d. Governance, legal, and financial service providers;
 - e. Honduran government agencies, at the national and municipal levels, for public services;
 - f. Financial institutions offering fiduciary services for the necessary trusts;
 - g. Anchor tenants in each of the segments of interest;
 - h. Development investors.
2. Submission and Approval: Submit the project to CAMP, with all of the required documentation, revise and work the proposal with them until the ZEDE is approved.

Estimated cost: \$250,000.00

18 months

Overview: Execute the ZEDE project under the terms approved by CAMP.

1. Secure funding: Raise the necessary funds for the construction phase through the predefined methods for financing the project. Formalize the required contracts to access the funds.
2. Acquire Land: Decide on the land options based on the project approved by CAMP. Formalize the necessary purchase or joint venture contracts with the landowners, and initiate the respective public notices required by law.
3. Open Tender: Launch an open tender for the acquisition of all necessary services, such as those relate to construction, legal, financial, governance, and security.
4. Initiate Construction: Start the construction works for the minimum required infrastructure to start operations in the ZEDE and bring in the most essential tenants.
5. Develop the Governance Structure: Create the ZEDE's governance structure, hire the required public administration officials, enact the foundational laws, subscribe the citizen coexistence agreement, hire and train the security apparatus, enact the necessary jurisdictional grants and concessions to the national and municipal governments, establish the required trusts, enact the democratic mechanisms through which ZEDE residents will exercise their political rights, and formalize the necessary contracts with anchor tenants for them to start operations.

Estimated Cost: \$50 - \$200 million, depending on size of development and results of open tender process.

8. Conclusion: The ZEDE's Competitive Advantage

In the past 18 years the Honduran government allocated an estimated \$21 billion of national and international funds to country development and poverty reduction programs. Yet, the number of households living in poverty increased during that time span, violence levels remain high, and governance continues to be poor.

Generating economic clusters through special economic zones or districts provides a reliable and cost-efficient policy alternative to alleviate poverty, and create safe spaces where businesses can thrive under improved economic and security conditions. Recent data shows that by 2015 roughly 39 special tax zones were operating in Honduras, most commonly through the Free Zone regime, housing approximately 500 companies which have generated an estimated 146,000 direct and 164,000 indirect jobs³⁰.

While beneficial, the free zones in Honduras have not proven transformative. Job growth through the free zones has stagnated. Additionally, the application of the Free Zone Law has been criticized for discriminating against small and midsize manufacturers. The ZEDE regime, in turn, provides a more equal incentive structure for small and large companies, producers of services and goods, and exporters and companies producing for the domestic market³¹.

The ZEDE regime is not limited to tax benefits; nor is entry to the regime restricted to big businesses or industry specific investments. Rather, ZEDEs offer a comprehensive institutional framework which allows for the adoption of business-friendly legal rules, a decentralized governance structure, an arbitration-based conflict resolution system, and the establishment of local-independent security and crime prosecution bodies.

Migration will continue to the United States so long as there is demand. The demand comes from the desire for Central Americans to escape violence and improve their lives. Past efforts to

³⁰ AZFA. 2017. *Reporte Anual Estadístico. Zonas Francas Honduras*. Asociación de Zonas Francas de las Américas.

³¹ Engman, Michael. 2011. "Success and Stasis in Honduras' Free Zones." In *Special Economic Zones: Progress, Emerging Challenges, and Future Directions*, by Thomas Farole and Gokhan Akinci, 47-68. Washington DC: World Bank Publications.

develop Central America have proven ineffective. Charter cities are a realistic, scalable strategy which can improve the lives of Hondurans and reduce the strain on America's political system. They deserve a chance.

ABOUT THE AUTHORS

Jorge Constantino Colindres is a lawyer and public policy analyst based in San Pedro Sula, Honduras. He currently serves as Managing Partner for Board Solutions – Central America, a regional firm specialized in corporate governance and family office services. As legal counsel he has focused in commercial, administrative, and tax law practice, and has several years of experience in research and policy reform efforts. In 2016, he led a successful policy reform campaign where 15 of his 20 policy proposals were adopted by the Honduran Congress within the country's new Tax Code, garnering Atlas Network's Award for Free-Market Solutions to Poverty.

Dr. Mark Lutter is Founder and Executive Director of the Center for Innovative Governance Research, a nonprofit creating the ecosystem for charter cities. Prior to launching the Center for Innovative Governance Research, he was Lead Economist for NeWAY Capital, an asset management firm which made early stage investments in charter cities. During graduate school, he consulted on several new city projects and special economic zones. He has a PhD in economics from George Mason University where his research focused on charter cities.

Disclosure: The process of writing this paper led Mark and Jorge to form a company to explore building a charter city

Appendix

There are numerous examples of industrial parks and business districts which could serve as the first phase of a ZEDE development. These districts generate an economic cluster where business opportunities and jobs become available, and their impact is usually felt by the surrounding communities. We include three business districts in Latin America and one in Spain as examples.

These business districts demonstrate the feasibility of the first phase of a charter city. Charter cities, however, have much greater upside. Given better governance, they can attract more tenants to the business district. More importantly, the jurisdiction can be expanded to include more land and turn the business district into a city.

a) *Altia Smart City, San Pedro Sula, Honduras*

Developed by Grupo Karim's, construction of Altia Smart City started 10 years ago, originally designed to attract the outsourcing industry, over 6,000 jobs have been created in the complex, which is now composed of a Business Park, a Recreational Center (RecZen), Shopping Lifestyle Center (Altara), a University (UNITEC), and is currently developing a residential area and a hospital³².

The business park features several BPO companies as tenants, and many of them are currently operating under the Honduran Free Zone regime, which exempts them from income taxes, import duties, value added taxes, as well as from municipal taxes and fees³³. Construction for a second development in Tegucigalpa has also started. With an estimated \$100 million investment, the new business park is expected to spread around a 30 acres land and create several thousands of jobs³⁴.

b) *Ciudad TEC, San José, Costa Rica*

Led by the San José Municipality, the project is focused on fomenting the knowledge economy, innovation and new technologies. Currently under development through a public private partnership, an estimated \$100 million investment has been projected through a 17,000 m² area. Companies such as Microsoft and Cisco have already committed to becoming district tenants, and real estate developers are scheduled to invest \$50 million in the construction of a 21-floor tower to house these companies³⁵.

³² Ammachchi, Narayan. 2017. Grupo Karims Expanding Altia Business Park in San Pedro Sula. <https://www.nearshoreamericas.com/altia-business-park-expansion/>; BBC. 2018. *Las ZEDE, el polémico proyecto de "ciudades privadas" que Honduras quiere construir.* October 23. <https://www.bbc.com/mundo/media-45440323>; Altia Smart City. 2016. Altia Smart City. <https://altiasmartcity.com/components/>;

³³ Mejia, Orfa. 2015. "Más incentivos para los call center." *La Prensa*, August 23.

³⁴ Moss, Loren. 2014. \$100 Million Altia Smart City Development Takes Form in Tegucigalpa. September 11. <https://www.nearshoreamericas.com/tegucigalpa-wins-100-million-altia-smart-city-development/>

³⁵ Gutiérrez Wa-Chong, Tatiana. 2018. "Licitación de Ciudad Tecnológica saldrá en dos meses." *La Republica*, May 15. <https://www.larepublica.net/noticia/licitacion-de-ciudad-tecnologica-saldra-en-dos-meses>; Chacón, Krissia. 2018. "Ciudad tecnológica se gesta en el corazón de San José." *El Financiero Cr*, March 2;

The technological district will also have a university campus from Instituto Tecnológico de Costa Rica and is expected to house research centres as well as start-up incubators and accelerators. Some of the district's tenants, such as Encore Capital, will begin operations in the district under the Costa Rican Free Zone regime. The Ciudad TEC is part of a broader development referred to as a Special Zone for Economic Development with 150 hectares which comprise 31 neighbourhoods³⁶.

c) Distrito Tecnológico, Buenos Aires, Argentina

The technological district of Buenos Aires was created in 2008 to promote tech and telecom companies. 10 years later the district now houses over 300 companies and three universities throughout its extension of 200 hectares. Recent estimates say the district has attracted \$324 million in private investment since its creation, and currently there are roughly 13,000 people working there³⁷.

The district enjoys a differentiated tax regime, which offers benefits lasting through 2029 for foreign companies, and 2034 for small and medium businesses and companies of national capital. The benefits consist of exemptions or deferments in the payment of gross income taxes, legal seals, real estate tax, as well as in the payment of delineation, construction, and solid waste fees. The benefits are offered to companies installed within its area that develop software and IT services, hardware production, biotech, tech outsourcing, robotics, 3D printing, and tech company accelerators, hubs and incubators³⁸.

d) Distrito @22, Barcelona, Spain

An initiative by the Barcelona City Hall, Distrito 22 consists of 4,000 m² of roofed spaces, the re-urbanization of 37 km of streets and sidewalks, and 240,000 m² in public space for equipment, green areas and households³⁹. The district was designed to accommodate private knowledge

³⁶ El Financiero. 2018. "Costa Rica: Sede regional de Microsoft será la primera inquilina del distrito tecnológico en San José." El Economista, octubre 4.

³⁷ Poore, Federico. 2018. Infotechnology. June 29. <https://www.infotechnology.com/labs/300-empresas-y-una-inversion-de-US-324-millones-que-fue-de-el-Distrito-Tecnologico-10-anos-despues-20180223-0010.html>; Seco, Juan. 2018. Distrito Tecnológico: el plan de la Ciudad para que sea el número uno de América Latina. January 01. <https://www.iprofesional.com/management/262064-empleo-tecnolog%C3%AD%C2%ADa-buenos-aires-Distrito-Tecnologico-el-plan-de-la-Ciudad-para-que-sea-el-numero-uno-de-America-Latina>.

³⁸ Ciudad de Buenos Aires. n.d. Beneficios. <http://www.buenosaires.gob.ar/distrito-tecnologico/beneficios-para-empresas>.

³⁹ Ajuntament de Barcelona. 2006. 22barcelona.

http://www.22barcelona.com/index.php?option=com_frontpage&Itemid=83.

economy initiatives, and today includes tech companies, research centres, universities, commercial, and service businesses as tenants.

Every year, around 500 companies begin operations in the district, where it is expected that 25,000 to 30,000 new jobs will be created within the next four years⁴⁰. Additionally, the district counts with a €180 million public investment of infrastructure plan⁴¹, and a recent study estimates that in 2017 the district had €161 million invested in land acquisitions⁴².

⁴⁰ La Vanguardia. 2018. "El distrito 22@ generará unos 25.000 empleos en los próximos cuatro años." La Vanguardia, June 28.

⁴¹ MedCités. 2013. Distrito 22@. November 26. <http://www.medcities.org/web/ktc-malaga/-/best-practices-distrito-22-mlg04>.

⁴² Simón, A. 2018. "El distrito 22@ se consolida como el gran polo empresarial de Barcelona." *El País*, July 3.