


How a Start-Up Utopia Became a Nightmare for Honduras

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Argument

An expert's point of view on a current event.

U.S. investors are suing Honduras over special economic zones, and the dispute could bankrupt the country.

By **Guillaume Long**, a senior research fellow at the Center for Economic and Policy Research, and **Alexander Main**, the director of international policy at the Center for Economic and Policy Research.



A person with a top hat, long red hair, and evil clown make-up stands in the central foreground as a man in the near background holds up a white protest sign reading "No A Las ZEDES", translated to "No to the Employment and Development Zones".

A protester holds a signal that reads "No to the ZEDES" during a demonstration against employment and economic development zones in Tegucigalpa, Honduras, on July 23, 2021. Orlando Sierra/AFP via Getty Images

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In June 2009, Honduras was rocked by a military coup that saw the country's elected president, Manuel Zelaya, bundled out of the country at gunpoint. What followed was 12 years of deeply corrupt and oppressive post-coup governments that proved incapable of addressing Honduras's extremely high levels of poverty or curtailing an unprecedented spike in migration to the United States, peaking in 2021. Today, Hondurans are focused on rebuilding their democratic institutions and undoing some of the most harmful policies of the post-coup era. The task ahead for the center-left administration of Xiomara Castro, who was elected as Honduras's first female president in November 2021, is anything but easy—particularly as some key reform measures are openly opposed by the U.S. ambassador in Tegucigalpa.

One such measure, which Castro appears deeply committed to, is the elimination of the country's "employment and economic development zones," or ZEDEs. ZEDEs are part of a long history of special economic zones, duty-free zones, and freeports that have gained renewed momentum in recent decades for the supposed purpose of attracting foreign investment to developing economies. But Honduran ZEDEs are far more extreme than economic zones found in other countries such as Singapore, the Cayman Islands, and Panama. They allow private corporations to enjoy an astonishing level of autonomy, including establishing their own courts, laws, tax systems, and private police forces—all with virtually no transparency or accountability mechanisms.

In 2021, the United Nations expressed strong concern over Honduran ZEDEs, stating that they posed a potential threat to human rights in Honduras. The U.N. estimated that ZEDEs could wind up controlling approximately 35 percent of the country's territory. That same year, a Honduran corruption watchdog published a scathing report on the ZEDEs, highlighting the opportunity they provide for corrupt actors to engage in money laundering and other illegal activities.

Understandably, ZEDEs are highly unpopular in Honduras. The slogan "No to the ZEDEs" featured prominently in Castro's electoral campaign. Shortly after Castro's inauguration, the Honduran Congress voted to repeal the law that allowed for the creation of ZEDEs. A broad-based National Movement Against the ZEDEs and in Defense of Sovereignty, which was formed under the prior government and includes unions, Indigenous groups, human rights organizations, and prominent academics, is also pressing Castro to shut the ZEDEs down.

However, investment provisions under the Dominican Republic-Central America Free Trade Agreement (CAFTA-DR) have provided ZEDE investors with a powerful means of fighting back against Castro's proposed reform. Citing potential future losses, Honduras Próspera, a Delaware-based U.S. company that is operating a ZEDE called Próspera on Roatán island, off the northern coast of Honduras, is suing the Honduran government in an investor-state dispute settlement court located at the World Bank. Though U.S. President Joe Biden has announced his opposition to such investment-state arbitration in future trade agreements, the ZEDE investors' claim has received a potent boost from the State Department and the U.S. ambassador in Tegucigalpa.

A stable and democratic Honduras is clearly within U.S. interests—not least because it would stem the flow of migration northward—but the administration's inconsistent stance on ZEDEs risks standing in the way.

Enshrining ZEDEs in Honduran law was a messy and undemocratic affair from the start. After the first iteration of ZEDEs was decreed by President Porfirio Lobo in 2011, Honduras's Constitutional Court the following year found Lobo's decree to be unlawful because it violated Honduran sovereignty. In response, the Honduran Congress simply replaced those

constitutional judges with new pro-ZEDE judges. Then-Congress President Juan Orlando Hernández, who would later become president of Honduras in 2014, played a leading role in this purge. In 2013, the revamped Constitutional Court issued a ruling that allowed the Congress to approve the ZEDE-enabling law.

Lobo and Hernández—the two presidents who engineered the ZEDes' creation—have both since been indicted on corruption charges in Honduras. Lobo is currently barred from entering the United States due to his “involvement in significant corruption,” while Hernández is in U.S. custody awaiting trial on drug trafficking and weapons charges.

Three ZEDes were eventually created in Honduras. The Próspera ZEDE, which was granted official status in 2017, advertises itself as the “fastest-growing private city project in the world,” home to “some of the world’s most innovative new companies” in financial technology, gene therapy, robotic constructions, and more. Its promoters, a group of Silicon Valley self-proclaimed “innovators,” dreamed of building a truly autonomous charter city, one that would allow the unbridled forces of capital and the markets to work their magic for the benefit of humanity—and for Próspera’s investors, of course.

Próspera has been hailed—alongside “Itana” in Nigeria and cryptocurrency cities in El Salvador and Senegal, among others—as the embodiment of the new libertarian “start-up city” utopia. However, in practice, Próspera has little to show in terms of investment or infrastructure, with only a handful of buildings constructed to date. It has successfully antagonized the surrounding community of Crawfish Rock. The locals first believed the project to be a seaside resort, only to realize that the land around them was gradually being gated and privatized. Then they found out that the project, planned in three stages, might engulf their ancestral land.

In April 2022, a few months after Castro’s inauguration, the new Honduran Congress, made up of an array of parties on the right and left, voted unanimously to repeal the ZEDE law. But Próspera, boasting “strong legal stability protections, protected by international treaty for a minimum of 50 years,” was prepared for this eventuality. In December 2022, Próspera announced that it was seeking arbitration at the International Centre for Settlement of Investment Disputes (ICSID) for a sum of nearly \$10.8 billion. In the absence of any sizable investment, Próspera’s case was hedging its bets on the loss of future profits.

ICSID, established in 1966 as a means to resolve legal disputes between international investors and states, is an investor-state dispute settlement (ISDS) court under the World Bank. ICSID allows investors to effectively sue governments for investment losses, including future profits. Investors can claim damages for any regulatory decision—including limiting fossil fuels or imposing restrictions on cigarette packaging—thus making it very difficult for governments to put in place labor or environmental safeguards or, as in the case of Honduras, take measures to protect the country’s sovereignty and democracy.

These dispute settlements are designed to allow corporations to sue states—but not the other way around. Studies of ISDS mechanisms show that states win just 36 percent of arbitration cases. Plus, refusing to pay damages awarded to a corporation is rarely an option as arbitration cases are often executed in the jurisdictions of countries where the state may have assets. International reserves, a state-owned company, or even a state-owned aircraft or vessel can be seized to make good on payment. Arbitration decisions can even end up tabulated as part of a country's foreign debt.

Fortunately for Honduras, ISDS mechanisms are increasingly frowned on the world over. Several countries, such as Ecuador, India, Indonesia, and South Africa, have withdrawn from bilateral investment treaties that include ISDS clauses over the last few years; some have even left the ICSID. In Europe, many countries are leaving the Energy Charter Treaty because its ISDS clauses hamper policies to phase out fossil fuels.

Even in the United States, the mood has shifted. Former President Donald Trump, in his renegotiation of what is now the United States-Mexico-Canada Agreement, agreed to severely limit the scope of ISDS to a narrow set of sectors. More recently, Biden, referring to the ISDS process, denounced “special tribunals” for corporations and promised not to include them in future trade agreements. U.S. Sen. Elizabeth Warren, alongside more than 30 other members of Congress, has also denounced Próspera’s use of ISDS to “bully” Honduras and has urged the Biden administration to support the Honduran government.

Próspera, meanwhile, has not wasted any time in hiring lobbyists and seeking political allies in Washington. In October 2022, Sens. Bill Hagerty and Ben Cardin sent a letter to the Biden administration denouncing the Honduran government over the ZEDE law’s repeal. Any “direct or indirect expropriation of U.S. investments in Honduran [ZEDEs],” they wrote, “would be regarded as a direct assault on the guarantees of CAFTA-DR.” Some House Republicans, including Reps. Paul Gosar, Mario Díaz-Balart, Michael Waltz, and Maria Elvira Salazar, have also expressed support for Próspera and called for individual sanctions in response to attempts to shut down the ZEDEs—condemning threats to U.S. investment and even alluding to Chinese influence in the region.

The U.S. ambassador to Honduras, Laura Dogu, who has made a habit of publicly criticizing the Honduran government on domestic policy, has also rushed to the rescue of the Próspera ZEDE. A few weeks after the U.S. Embassy tweeted about Dogu’s deputy meeting with Próspera investors in September 2022, the U.S. ambassador slammed the Castro government for wanting to “reduce or eliminate investment incentives.” “Without a doubt,” the ambassador said, the Castro government’s “actions are sending a clear message to companies that they should invest elsewhere, not in Honduras.” The U.S. State Department, in apparent disregard for Biden’s opposition to ISDS, has also voiced similar concerns, alleging that the Honduran government’s decision to repeal the ZEDE law “further contributed to uncertainty over the government’s commitment to investment protections required by international treaties.”

“Every millimeter of our homeland that was usurped in the name of the sacrosanct freedom of the market, ZEDEs, and other regimes of privilege was irrigated with the blood of our native peoples,” Castro told the U.N. General Assembly in September 2022. “My social and democratic government will return to a state of justice and the rule of law so that this will never happen again.”

But the Honduran president’s passionate appeal for democratic sovereignty, a recurrent theme in Central American history, clashes with the deeply ingrained notion in the psyche of much of the U.S. foreign-policy establishment that still considers Honduras a part of the proverbial “backyard,” where the United States can promote and protect what it believes to be in its own interests.

In response to the migrant crisis at the southern U.S. border, the Biden administration says it is focused on addressing the root causes of migration in Central America, which include “lack of economic opportunity, poor governance and corruption, crime and violence.” Supporting an investment scheme, like the Honduran ZEDEs, that threatens human rights, enables corruption, undermines the rule of law, and is shielded from government regulation does the opposite of addressing those root causes.

Próspera’s \$10.8 billion claim is equivalent to roughly two-thirds of Honduras’s annual state budget. Such an arbitration decision would simply render the country bankrupt. It is time for the growing number of ISDS critics, including the current U.S. administration, to go beyond the “do as I say, not as I do” mantra and support Honduras’s democratic sovereignty in the face of an egregious case of corporate abuse.

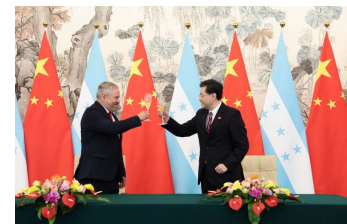
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Chinese Foreign Minister Qin Gang and Honduran Foreign Minister Enrique Reina attend a ceremony marking the establishment of diplomatic relations between the two countries at the Diaoyutai State Guesthouse in Beijing on March 26.



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