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Creating the First Honduran ZEDE: Lessons in Political Economy, Institutional Design, and Governance Systems

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Abstract

This paper is a case study of the creation of the first ZEDE (Zones for Economic Development and Employment) in Honduras, the Próspera ZEDE, from 2016-2021. We provide a detailed accounting of the process by which the first ZEDE was formed, how its governance structures came to be, and what challenges and difficulties it faced. We draw from this experience lessons about institutional formation, political economy in the process of special jurisdiction formation, errors made in the formation process, and generalized lessons for future efforts. While the authors led the effort described in the case study, we focus on an objective factual accounting of what occurred as well as the internal reasoning processes by which decisions were made in an effort to transparently highlight lessons learned and contribute unique insights to the institution building literature.

Keywords: Institutional economics, political economy, special jurisdictions, ZEDE.

Resumen

Este artículo es un estudio de caso de la creación de la primera ZEDE (Zonas de Desarrollo Económico y Empleo) en Honduras, la ZEDE Próspera, de 2016 a 2021. Aquí detallamos el proceso de formación de la primera ZEDE, cómo surgieron sus estructuras de gobierno y qué desafíos y dificultades enfrentó. De esta experiencia, extraemos lecciones sobre formación institucional, economía política en el proceso de formación de jurisdicciones especiales, errores cometidos en el proceso de formación y lecciones generalizadas para esfuerzos futuros. Si bien los autores lideraron el esfuerzo descrito en el estudio de caso, nosotros nos enfocamos en una contabilidad fáctica objetiva de lo que ocurrió, así como en los procesos de razonamiento interno mediante los cuales se tomaron las decisiones en un esfuerzo por

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resaltar de manera transparente las lecciones aprendidas y contribuir con conocimientos únicos a la literatura del desarrollo institucional.

Palabras clave: Economía institucional, economía política, jurisdicciones especiales, ZEDE.



1. Introduction: Background: Special Jurisdictions, Charter Cities, and ZEDEs

This paper begins with an introduction to the concepts of special jurisdictions as herein defined as well as the ZEDE program in Honduras. Section 2 provides an account by Erick Brimen, author of this paper and founder of Honduras Próspera Inc., regarding the approval process for the initial creation of the ZEDE special jurisdiction. Section 3 details the negotiation process by which the governance institutions of the Próspera ZEDE were created, as well as the reasoning behind them.

The commonly used term for a special jurisdiction is special economic zone, which The World Bank describes as having the following characteristics: “geographically delimited area, usually physically secured (fenced-in); single management/administration; eligibility for benefits based upon physical location within the zone; separate customs area (duty-free benefits) and streamlined procedures” (The World Bank, 2010, p.9). However, the focus of this case study is fundamentally different from a traditional special economic zone as described above. Instead, this case study focuses on the creation of a special jurisdiction—a legally distinct, partially autonomous geographically delimited area of a sovereign nation with autonomy from the central government’s traditional legislative bodies over most areas of public policy within the jurisdiction. This is not to be confused with the term “special jurisdiction” as it exists in the legal field’s scholarly literature, which refers to a specific court with a unique jurisdiction to hear certain forms of litigation as delineated by statutory law. The reason for this terminological delineation will be clarified below.

This case study examines the first such special jurisdiction created in Honduras under the auspices of the ZEDE law. (space to explain what ZEDE is). This unique legal regime was inspired by Paul Romer’s 2009 TED talk, titled “Why the world needs charter cities” (Romer, 2009). In this talk, Romer points out an uncomfortable fact about global economic development, described herein by Mason and Lutter (2020, p.4):



Governance is the most important determinant of long-term economic outcomes (Rodrik, Subramanian, and Trebbi, 2002). Unfortunately, poor governance has led to persistent poverty in much of the Global South (World Bank, 2018). In many countries, the cost in fees, time, and bribes to register a business or secure permits functionally prohibits entrepreneurship in the formal sector. For example, according to the World Bank Ease of Doing Business Index, it takes on average 36 percent of per capita income just to legally register a business in sub-Saharan Africa (World Bank, 2020). While economists largely agree on the importance of institutions for economic growth, reforms that change long-run growth rates are rarely implemented for public choice reasons (Acemoglu, Johnson, and Robinson, 2004).

Mason and Lutter explain how charter cities can solve this seeming conundrum (2020, p.4):

In existing jurisdictions, would-be improvements in governance are too often stifled by entrenched interests and ineffective bureaucracies (Mason 2019). By creating a special jurisdiction in a new city built on greenfield land, charter cities avoid these public choice problems that often stymie reforms in existing jurisdictions without radically changing the rents enjoyed by elites in existing cities. Greenfield sites therefore allow for deeper institutional change than would otherwise be politically feasible. A city is the optimal unit for implementing reforms that can generate sustained economic growth. Villages are too small to lead to meaningful impact, and nationwide reforms can be politically difficult to adopt and eliminate choice for individuals (Romer 2009). Cities, on the other hand, are large enough to fully exploit the benefits from economies of scale and from



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Journal of Special Jurisdictions



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density. And while a charter city would initially be small, initial investments from large employers can create a critical mass of people to justify additional investment in and migration to the charter city, creating a virtuous cycle of growth.

Charter Cities appeared to be the solution to stagnation and the inability to change governance institutions for the better in the developing world. However, Romer focused on the physical form which these developments may take—cities, as the name suggests. This focus on the physical instantiation obscures the true “magic” which could make a charter city successful: deep and lasting institutional improvement. These kinds of institutional improvements are only possible in new special jurisdictions that are fully or partially autonomous, within which a charter city can be created.

It should be noted that this concept of a special jurisdiction is separate both from charter cities and from special economic zones. A charter city can be built upon a special jurisdiction, but so can many other things. As the World Bank described, special economic zones are typically quite small, cannot expand geographically, and most importantly, do not solve any deep institutional issues. Instead, they focus on reducing barriers to trade via altering tariffs and duties, and perhaps bureaucratic and administrative processing, to marginally reduce the friction involved with operating in the zones. Lower import duties and one-window permitting does not last economic development make; only special jurisdictions can do that (The World Bank, 2008).

Further, in Romer’s initial conception, charter cities were to be governed and administered by other, more prosperous nation states. While this makes intuitive sense, it is uncomfortably close to neocolonialism, as several scholars have rightly pointed out (Amavilah, 2011; Van de Sand, 2019; Cao, 2019). Furthermore, it ignores the fact that institutional formation occurs nested in a specific geographic, economic, and cultural context, necessitating local input in the new institutional framework. The institutions



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Journal of Special Jurisdictions



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which make Singapore prosperous may not work well in Honduras. Singapore is an entrepot with a highly financialized economy and high population density, while Honduras is a rural and underdeveloped nation with vastly different geographic, cultural, and economic circumstances. As such, having Singapore create institutions for a special jurisdiction in Honduras makes little sense.

Given the power of the special jurisdictions Romer hypothesized to catalyze rapid economic development in underperforming nations, Honduras is a logical place to begin. In 2009, the year Romer gave his seminal talk, Honduras' GDP per capita was a mere \$1,789 and nominal GDP was \$14.5 billion (The World Bank, 2020), or less than two weeks of Amazon's revenue in 2020 (Protalinski, 2020). Perhaps most importantly, Honduras was ranked 133rd on the World Bank's Doing Business Index in 2009—a suitable proxy for overall institutional quality (The World Bank, 2009). Given this reality, Honduras seemed an excellent place to launch the first of these special jurisdiction formation efforts.

In late 2010 and early 2011, Romer's talk caught the attention of a group of young reformers in Honduras who had already been considering and developing highly similar ideas organically for well over a decade. One of these reformers, Octavio Sanchez, was Chief of Staff to Porfirio Lobo, President of Honduras at that time. The notoriety of someone of Paul Romer's stature endorsing the concept of special jurisdictions elevated its legitimacy, making possible the passage of legislation enabling the creation of such semi-autonomous zones in Honduras.

Because they had already been working on these ideas for some time, Sanchez and the Honduran reformers were able to act swiftly. By the end of the summer of 2011, the Honduran Constitution was amended and enabling legislation was passed allowing for the creation of the semi-autonomous zones. However, this initial attempt was not meant to succeed. These initial zones, known as Region Especial de Desarrollo (RED Zones), were ruled unconstitutional in 2012 by the Honduran Supreme Court, who cited their



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lack of democratic accountability and total exclusion of the Honduran judicial hierarchy, among other concerns (Colindres, 2018).

Undeterred, the Honduran reformers soldiered on, amending the law and its related constitutional amendments to remedy the issues the Supreme Court found with the law. This new system of special zones, known as ZEDEs (Zonas De Empleo Y Desarrollo Económico), are subject to a number of democratic approval mechanisms and possess a judiciary which is integrated into the Honduran judicial hierarchy. These and many other important changes were met with broad support in the Honduran Congress in 2013, with the President of the National Congress and soon-to-be President Juan Orlando Hernandez leading the charge. The ZEDE Constitutional amendments and ZEDE Organic Law were approved by an overwhelming majority of the Honduran Congress, with 102 of 128 deputies voting in support (La Prensa, 2013). The law was immediately challenged on constitutional grounds, but unlike REDs, was found to be constitutional in a unanimous vote of the Honduran Supreme Court.

Given the reputation of Honduras for corruption and impunity, the authors of the ZEDE regime knew they would need to insulate the legal stability of the ZEDE system from the day-to-day affairs of the legislature as much as possible. As such, the ZEDE organic law has three strong elements of legal stability, despite the provision of the Honduran constitution stating that ZEDEs are “subject” to national legislation “in all topics related to sovereignty, application of justice, national defense, foreign relations, electoral matters, and issuance of identification documents and passports” (Constitute, 2020, p.74). First, a two-thirds vote of Congress is required under the ZEDE amendments for any future legislation that would invoke this constitutional provision to amend or otherwise repeal the ZEDE organic law to expand the national laws that currently apply within ZEDEs (Constitute, 2020). Second, Honduras’ treaty obligations to investors in



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Journal of Special Jurisdictions



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Kuwait, (La Gaceta, 2014),¹¹ the United States (United Nations, 1995), and CAFTA member nations (USTR, 2004) guarantee that Honduras will not abrogate the ZEDE program as an obligation of the treaties. Third, CAMP, the Committee for the Adoption of Best Practices, has expressly and by non-objection agreed to comply with such treaty obligations and to resolve disputes concerning Próspera’s legal authority by private arbitration, which agreement is enforceable by the promoter and organizer of any given approved ZEDE under CAFTA-DR (Próspera 2019d).

Put differently, substantially amending the ZEDE Organic Law and constitutional amendments in such a way that materially changes the legal autonomy of the jurisdiction requires a 2/3rds majority vote of Congress in a highly partisan legislature, which would then put Honduras in violation of treaties with Kuwait, the United States, and CAFTA member nations, while simultaneously opening the Honduran government up to international litigation on the world stage for rescinding investor protections. The reputational and pecuniary damages this could cause to the Honduran government serve as powerful bulwarks protecting the legal stability of the ZEDE program.

Recognizing the aforementioned importance of autonomy and the ability to “start from scratch,” the ZEDE Organic Law and enabling constitutional provisions create ZEDEs as nested within the Honduran governmental hierarchy akin to municipalities, but with an extraordinary degree of autonomy. Out of dozens of articles that make up the Honduran constitution, the ZEDE amendments provide that only six articles, which pertain to treaties, human rights, and territorial integrity, are fully applicable within ZEDEs (Constitute, 2020). While ZEDEs are “subject to” national legislation in all sovereign matters, the ZEDE organic law, in turn, states that the “only” national

¹¹ This treaty was duly signed by public officials from both countries on January 15, 2014, as well as ratified by the Honduran National Congress; the Honduran Committee for Adoption of Best Practices has represented that the treaty is in effect and we are awaiting confirmation of effectiveness from the Foreign Ministry of Kuwait.



legislation that currently applies within the “spatial ambit” of any ZEDE are those concerning national symbols, national territory, and criminal law (La Gaceta, 2013). Thus, all other types of national laws have been impliedly repealed within the jurisdiction of an approved ZEDE by the Organic Law. Therefore, an approved ZEDE is free to adopt governing structures and rules that differ from the national laws of Honduras in most areas of public policy, subject to oversight and approval by CAMP”, which is an independent Honduran agency also established under the ZEDE Organic Law.

2. Creating the Próspera ZEDE: The Initial Approval Process

The journey to the creation of the first ZEDE began in 2016. I (Erick Brimen) founded an investment fund focused on, among other things, funding special jurisdiction projects of the type described herein. I set out not to create a ZEDE or a special jurisdiction, but provide funding for those that existed around the world in the style of a venture capitalist. As such, in searching for investable deals, I was eventually led to Honduras, with its unique enabling legislation, which we later discovered was the most advanced in the world. I initially began conversations with some individuals who were leading very early stage ZEDE efforts within the country, which led to an introduction to CAMP, the body which oversees ZEDes.

After several phone conversations, my business partners and I came to meet with CAMP in Tegucigalpa in the spring of 2016, where they pitched us on Honduras generally and the ZEDE program specifically. This instigated a six month long legal due diligence process with the Honduran government to confirm the “realness” of the ZEDE program, if the Honduran government was credibly committed to it, and what the status of the nascent ZEDE projects were at the time. While this was going on, I was continuing to scour the global for investable special jurisdiction projects, with very few promising leads appearing.



Visiting Honduras, the potential of the nation seemed apparent to me. In my time in Tegucigalpa and on Roatan conducting due diligence, the sheer entrepreneurial spirit of the people I met signaled a massive amount of untapped potential, if only Honduras' institutions would allow it to be unleashed. This realization occurred at the same time we realized how "real" the ZEDE program was, and how advanced the enabling legislation was. The combination of the sheer grit of the Honduran people, the structure of the ZEDE law, and the lack of credible deal flow elsewhere led me to an inevitable conclusion: rather than investing in special jurisdictions, I must focus all my efforts on building the first one here, on Roatan and in Honduras.

This, in turn, changed the tone of our conversation with CAMP. Rather than conversing in the context of a potential investor in other ZEDEs, we began discussing what it would take to create the first real ZEDE. CAMP's requirements were stringent. Among other things, they requested:

- A full master plan with a vision of population, density, industries to target, and more
- Geographic location with proof of land ownership and clear title to property
- Job generation estimates
- Aggregate investment amount from both us and third parties over the coming 10 years
- Proposed institutional structure and governance framework
- Proof of financial means
- Deep KYC and due diligence on shareholders and principal officers

These efforts took several months to develop, from October 2016 to the fall of 2017, and included courting investors, wireframing a best practices-based governance system, contracting and developing master plans and associated business plans, and much more.



This document included a wireframe overview of the governance structure which would later begin the Charter of the ZEDE of North Bay (later changed to Próspera ZEDE). While this early version was bereft of details, it provided enough structure to convince CAMP we were heading in the right direction. Further, given that the jurisdiction was starting from a greenfield site and would not have any population for at least a year, the initial application did not require a fully fleshed out institutional environment, as that would be hammered out with CAMP over the coming year. CAMP was highly responsive and helpful during this time period and throughout the entire ZEDE formation process, responding to queries, reviewing draft versions of the proposal and providing feedback, and generally helping structure the proposal so as to ensure it carried out the original vision of the ZEDE legislation: creating prosperity in Honduras.

All of this culminated in the approval of the then named ZEDE of North Bay on December 29th, 2017 (Próspera 2017).

3. Building Governance Institutions from Scratch

With ZEDE approval in place, we turned our attention toward crafting best practices based governance institutions that would rapidly catalyze prosperity and attract investment. Over the course of Q1 2018, we heavily conversed with CAMP on the institutional structure and devoted ourselves almost exclusively to those efforts. Once we exhausted what could be done via phone and zoom calls, we travelled to Roatan to meet with CAMP for extensive in-person work sessions. These work sessions culminated in what is known internally as the Roatan Memo (CAMP 2018). This Memo, signed by key Próspera team members as well as the executive committee of CAMP, laid out the general structure and specific rules for institutional structures which had been negotiated and agreed upon between CAMP and Próspera. At only five pages, it was a



short document, but contained both the meat and the guardrails for what would later become the Charter of the ZEDE of North Bay.

The original charter of the ZEDE of North Bay which was borne from the Roatan Memo was approved by CAMP on the 23rd of August, 2018, at the Honduran Embassy in Washington, DC. Clocking in at 8,917 words, roughly 1,400 more than the full US Constitution and amendments. After significant suggestions for improvements from a number of international legal and governance experts, the charter was subsequently heavily amended and improved on September 13th, 2019. We will first review the charter in its current form as currently applicable within the Próspera ZEDE, then briefly discuss the changes made from the original charter as approved in 2018 to the subsequent revision in 2019.

Próspera as a legal entity was organized shortly after CAMP appointed a Technical Secretary to promulgate rules for the “ZEDE Village of North Bay.” The ZEDE Village of North Bay was created as a special economic zone when an initial parcel of land located just south of the Crawfish Rock village and North of the Carrtera Principal (main road) was registered and incorporated into the ZEDE regime with the approval of CAMP by Honduras Próspera LLC, as promoter and organizer, on December 29, 2017 (CAMP, 2017). On August 23, 2018, as his first act of rulemaking, under the ZEDE organic law, the Technical Secretary promulgated the governing Charter and Bylaws for the establishment of the ZEDE Village of North Bay, the name of which was later changed by amendment to Próspera ZEDE effective September 13, 2019 (Próspera, 2018).

3.1. A Public Trust with An Explicit Social Contract

The legal team which worked on the Charter come from a variety of backgrounds and were well versed in international best practices in governance. As such, the team focused on taking aspects of governance institutions which function well in prosperous jurisdictions



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Journal of Special Jurisdictions



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around the world and applied those lessons in Próspera, improving upon them wherever possible. The current form of the Charter is not a direct expression of just the Próspera legal team, but has a strong Honduran influence as well. Not only is the Technical Secretary a Honduran, but each and every word, phrase, and section had to be reviewed and approved by the standing committee of CAMP which oversees the ZEDEs. CAMP's Standing Committee is led by a Honduran, Carlos Pineda, and consists of several other Hondurans as well, Octavio Sanchez and former Prime Minister Ebal Diaz among them. The Standing Committee is comprised only of Hondurans. Ultimately, this was a collaborative and creative effort between Próspera and CAMP that produced the Próspera ZEDE's governance structures as currently enforced.

Próspera's governance structure is designed to function as a public trust with strong checks and balances, as well as the actual and express consent of the governed, human rights guarantees, and eventual democratic participation. This express consent of the governed takes the form of a literal social contract, called the Agreement of Coexistence, which all residents must sign in order to reside in Próspera. This Agreement of Coexistence explicitly commits residents to "knowingly and voluntarily" consent to the governance institutions of the Próspera ZEDE. Próspera is currently represented by a Technical Secretary, whose policy and managerial decisions and rulemaking require the review and approval of a local Council of Trustees. For instance, Ch. 3, Section 2, Article 12 of the ZEDE Organic Law describes the power and authority of the Technical Secretary as encompassing everything from legal representation of the ZEDE, to "managing the administration" of the zone, to "enacting legislation" within the zone, to "issuing resolutions" and "developing plans" for the zone (La Gaceta, 2013). This effectively gives the Technical Secretary near total control over all aspects of the ZEDE's governance, as the National Lawyers' Guild pointed out in a report (2014). This seemingly insignificant point is an illustrative example of how the Próspera legal team worked within the confines of the ZEDE Organic Law to apply international best practices as closely as possible.



It is intuitively clear that having power centralized in one singular figure is not conducive to catalyzing generalized prosperity, which is the ultimate goal of the Próspera ZEDE. As such, the Próspera ZEDE legal team worked with CAMP to develop an alternative body in the Council of Design, and Governance Systems section 2, Article 12 of the ZEDE Organic Law also gives the Technical Secretary the power to “appoint ad hoc secretaries to assist in the administration of the ZEDE,” as well as to “establish trusts” (La Gaceta, 2013). Using the combination of these two powers, the Próspera Charter and Bylaws created the Council of Trustees, each of whom is technically an ad hoc secretary, to manage the policymaking process. This simultaneously solved the problem of agglomeration of power by the Technical Secretary, introduced democratic compliance, and powerfully improved the policymaking process in the jurisdiction. This is but one of many examples of how the Próspera team worked within the unique contours of the ZEDE law to create best-practices based governance institutions. (avoid writing in a defending from future critiques tone)

Under the ZEDE Organic Law, local public policies are crafted as “rules” by Próspera’s Technical Secretary, with the approval of its Council of Trustees (and, in most cases, also with the review and approval of CAMP). Actual consent of the governed to these rules is secured in Próspera through the use of “Agreements of Coexistence” in which natural person or legal entity residents (both physical or e-residents) contractually agree to being governed by Próspera, to secure a minimum level of general liability insurance, and to resolve all civil disputes by private arbitration in exchange for competent municipal services, access to e-governance services, and, in the case of physical residents, legal stability guarantees by Próspera that future rules will not adversely impact them.¹² Natural person e-governance fees that must be paid when entering into a physical residency contract range from \$260 for

¹² Legal stability guarantees are reserved to physical residents to encourage permanent residency, as additional consideration for greater tax liability exposure, and to protect residents who, as a class, have the greatest stake in Próspera public policy. See ZEDE, 2020 and Próspera, 2019.



Honduran nationals to \$1,300 annually for non-Hondurans. E-resident fees for any person or entity as well as legal entity e-governance fees are \$130.00 annually. Agreements of coexistence for temporary income earners require payment of an e-governance fee of \$10 for each ten-day period. No fee is charged to visitors under their agreement of co-existence.

The reasoning behind these Agreements of Co-existence is straightforward. Honduras has a history of governmental oppression and land appropriation, forcing citizens into circumstances they would have never chosen voluntarily (Edelman & León, 2013). In particular, Honduras has been accused of using their expropriation power to forcibly take land for the purposes of creating a ZEDE in other areas of Honduras, which would mean citizens are being forced into a new governance regime they did not voluntarily choose. As such, Próspera ensures up front that any resident of Próspera has expressly and voluntarily consented to the governance structures therein prior to joining the jurisdiction. It is, in the purest sense, a mechanism for ensuring consent of the governed within the jurisdiction.

3.2. The Composition of the Próspera Council of Trustees

The ZEDE organic law authorizes the Technical Secretary to “[e]stablish trusts for the provision of all services, revenue management, procurement, property management, and other functions” (La Gaceta, 2013). Accordingly, as promulgated by the Technical Secretary, the Próspera Charter establishes a Council of Trustees as a public trust vested with governance authority alongside the Technical Secretary.

There are nine seats on Próspera’s Council of Trustees, one of which is filled by the Technical Secretary. To reinforce the governance power-sharing between the Office of the Technical Secretary and the Council of Trustees, the trustees holding the remaining eight seats on the Council have also been appointed as “ad hoc” Technical Secretaries pursuant to the Technical Secretary’s authority to “appoint ad hoc secretaries” under the ZEDE organic law, which is not conditioned on such ad hoc secretaries having Honduran nationality (La Gaceta, 2013).



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Journal of Special Jurisdictions



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The Council of Trustees includes members designated Council Treasurer and Council Secretary. The Council Treasurer is responsible for financial tracking, reporting and overseeing audits. The Council Secretary certifies the official record of proceedings, acts as revisor of rules for publication, and must be present for quorum of the Council to exist in all but emergency circumstances. Council members serve seven-year terms. Currently, seven of nine Council seats have been filled. The Technical Secretary and Council of Trustees currently meet publicly on every 2nd and 4th Thursday of each month.¹³

The composition of the Council of Trustees is designed initially to align incentives with the rapid development of Próspera consistent with the vision of its promoter and organizer, but it will eventually transition to invite robust democratic engagement by residents. One seat is reserved for the Technical Secretary who is appointed by CAMP. The promoter and organizer is entitled to appoint the occupants of four seats. Any resulting conflict of interest can be resolved by outside expert review for commercial reasonableness (Próspera, 2018).

During a transitional phase, landowners are entitled to appoint the occupants of the remaining four seats; however, once urban population density is reached, residents will have the right to appoint occupants of those four seats. Moreover, once the population of Próspera reaches 1,000 natural person residents, CAMP is entitled to appoint an ombudsman to oversee compliance with governing law and the “Resident Bill of Rights,” which is a guarantee of liberties for residents that is closely modeled after the Bill of Rights of the United States; and so long as there are at least 1,000 natural person residents in Próspera, residents have the right to replace the ombudsman by referendum (Próspera, 2018). Further, once the natural person population of residents in Próspera reaches 10,000, then all rules will be subject to repeal by referendum of natural person residents.

¹³ All meeting minutes and publications can be viewed at <https://pzgps.hn/>.



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Journal of Special Jurisdictions



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This last point is crucially important. While Próspera has worked hard to ensure that the incentives of all council members are aligned with the prosperity and wellbeing of the residents of the jurisdiction, no system is perfect. If, by some series of unfortunate events, a counterproductive rule were passed by the council, approved by CAMP, and not found to violate the Charter and Bill of Rights, then residents still have one inviolable fail-safe option to effectively veto that rule via a direct popular vote. Equally as important, it shields direct proactive legal action from the negative influences of a potential mob mentality and all of the incentives at play when proactive referenda are introduced. Professor Tom Bell calls this “corrective democracy,” and it is a crucial governance innovation introduced in Próspera (Bell 2018).

Furthermore, once high population density is reached, residents will have the right to nominate the Technical Secretary, subject to approval by CAMP (Próspera, 2018 Section 4.03(3)). Lastly, if a charter amendment referendum has not been sooner authorized by the Council of Trustees, Próspera’s charter may be amended by referendum at the initiation of the ombudsman at any time after 2054 (Próspera, 2018).

The focus of this structure is the proper alignment of incentives. No matter how strongly worded or tightly constructed a constitution and bill of rights may be, public choice theory shows that special interest groups and internal incentives will not always be aligned with the well-being of the residents of the jurisdiction in question, which in turn leads to a whole host of bad outcomes—from logrolling and pork barrel legislation, to short term focus and excessive special interest group influence (Buchanan & Tollison, 1984). At its core, this is the result of the misalignment of incentives between legislators and those who they represent. Legislators have a strong incentive to take actions which maintain their position of prestige and power as a legislator, shifting their focus to being re-elected—an incentive which can corrupt, in small and sometimes unnoticeable ways, even the most implacable of legislators.



The structure of the Próspera Council of Trustees was specifically designed to solve this dilemma described by public choice theory. Four of the nine Trustees are appointed by the “Promoter and Organizer” (P&O) of the ZEDE—in this case, Honduras Próspera Inc. As mentioned previously, the Próspera ZEDE began as a total greenfield site, devoid of any residents at the time of ZEDE formation. The Promoter & Organizer currently owns all of the land within the jurisdiction, and expects to maintain a high level of land ownership in order to internalize the positive externalities of good governance. However, the process of land appreciation via catalyzing general prosperity takes considerable time—decades or more.¹⁴ Furthermore, the Promoter & Organizer can only profit from its landownership and jurisdiction formation efforts if the jurisdiction does, in fact, become prosperous. The appointment of four councilmembers by the P&O ensures this long-term view has a strong presence on the council without the short-term incentives created by democratic influences (Katz, 2014). However, recognizing the importance of democratic representation, five of the nine councilmembers will be elected—balancing short term and long-term incentives at the council level.

3.3. Rulemaking in Próspera

As indicated previously, the first rule of Próspera was its original August 23, 2018 charter, which was promulgated by its Technical Secretary with the express approval of CAMP and later amended and restated. Under the current Próspera Charter, rules can be created in five different categories, with each controlling of the next in the following order: (a) charter provisions/ amendments; (b) statutes; (c) regulations; (d) ordinances; and (e) resolutions (Próspera, 2018). All local rulemaking requires promulgation by the Technical Secretary with the prior approval of two-thirds of the Council of Trustees (a lower threshold

¹⁴ Consider the decades it took Singapore to become prosperous, or the 20 years it took Shenzhen to reach developed country GDP levels.



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may apply temporarily in emergency circumstances). Such promulgation and approval may be accomplished by public in-person or electronic meetings or by electronic vote.

This two-thirds vote threshold is crucially important. With five of the nine council members elected, and four of the nine appointed, this two-thirds majority ensures that neither the short-term-focused elected council members nor the long-term-focused appointed councilmembers can unilaterally enact rules without at least one or two members of the other group consenting. This is a forced conciliation measure, ensuring neither short term nor long term interests dominate the council, and ensuring neither the P&O nor the entire polity dominate the rulemaking process.

After promulgation by Próspera, CAMP review and approval is required for all Próspera rules (other than ordinances and resolutions). The Próspera Charter expedited this approval process (with CAMP's approval) by deeming all promulgated rules as approved by CAMP unless, after they are presented for CAMP's review, they are disapproved by CAMP within various deadlines (ranging from 15 to 60 calendar days after presentment) (Próspera, 2018). After approval by all relevant bodies, Próspera's rules are effective once published at <https://pzgps.hn/>. As of April 9, 2020, Próspera had promulgated 93 rules under the authority of its Charter.

This CAMP review process is an important facet of rulemaking in the Próspera ZEDE, and was extensively negotiated with CAMP. This aspect ensures constant oversight of the ZEDE by the central Honduran government, and permits third party validation and input in the rulemaking process. If CAMP vetoes a rule, it is amended per CAMP's guidance, voted upon again, and re-submitted for approval. This process acts as yet another check on the rulemaking powers of the Council.

Significantly, the Próspera Charter envisions the possibility of third parties establishing special districts within its boundaries by local rule (Próspera, 2018). Subject to certain minimum standards (to guard against the abuse of power), these districts are designed to operate under as much or as little of the general Próspera legal framework as



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Journal of Special Jurisdictions



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COMPETITIVE
GOVERNANCE

they wish to adopt. The concept behind the special district authority is to enable entrepreneurs, perhaps future ZEDE promoters and organizers, to experiment with different governance models safely within the already established and tested Próspera “sandbox” environment.

Crucially, these districts must comply with the entirety of the Bill of Rights as well as a few other rights-protecting provisions of the Charter. While no special district has yet been initiated, the Próspera legal team envisions these as being an internally competitive force for the Próspera Council. If a special district is formed in which residents find the governance and rules superior, then residents can “vote with their feet” by shifting into that jurisdiction instead, consistent with the geographical locality necessary to make the Tiebout Theory function well as a mechanism to optimally distribute public goods (Banzhaf & Walsh, 2008). In this way, special districts apply further competitive pressures to the Próspera ZEDE to ensure an omnipresent alignment of incentives between ZEDE-level governmental action and the generalized well-being of the residents therein.

It should be noted that per CAMP regulations and Próspera Council regulations, expropriation of any land for the purposes of expanding the jurisdiction of the Próspera ZEDE is expressly forbidden under any circumstances (Próspera 2020).

3.4. Administration of Rules

Relative to administering local public policy and rules, Próspera retains direct control over core criminal law enforcement and investigative services and delegates the handling and disbursement of its finances to the Próspera Trust.¹⁵ However, in accordance with public-private-partnership best practices, Próspera outsources the administration of all

¹⁵ This is a second independent trust in the nature of an escrow, see Próspera, 2018, Sections 5.01, 10.01, 10.02.



other local public policies to a General Service Provider, which is currently North Bay GSP, Inc., the first Próspera ZEDE corporation (Próspera, 2019g).¹⁶

More specifically, the General Service Provider is responsible for furnishing standard municipal services, including e-Governance systems and associated registries of property, persons, and legal entities, as well as tax and fee assessment and collections in coordination with the Próspera Trust escrow services (Próspera, 2019g). Próspera has also promulgated a Civil Penalty Statute under which the promoter and organizer and the General Service Provider have supplemented residency agreements with side letter commitments to avoid engaging in the civil law equivalent of criminal behavior (battery, assault, fraud) or be subject to paying substantial civil penalties (this civil penalty authority is necessitated during the current phase in which criminal law enforcement has not yet been established within the ZEDE) (Próspera, 2019j). Additionally, the General Service Provider is responsible for furnishing the default Arbitration Service Provider, currently Próspera Arbitration Center LLC, which serves as the core civil dispute resolution institution for Próspera. Próspera is currently contracting with Jacobs Engineering, a firm with extensive experience in city management, to manage and scale these operations (Jacobs, 2020).

3.5. Adjudication of Rules

Under the ZEDE Organic Law, all commercial disputes arising within the jurisdiction of a given ZEDE are required to be resolved by private arbitration before resorting to the public court system (La Gaceta, 2013). In Próspera, this important legal requirement is addressed by Próspera's default Arbitration Service Provider, which serves by local rule both as the requisite private arbitration forum for commercial disputes mandated by the ZEDE organic law, and also as a general civil dispute resolution institution for Próspera residents as set forth in their standard residency agreement.

¹⁶ See also Próspera, 2018, Sections 2.04(15), 2.05, 3.09(5), 5.01(3), 7.01, 7.02, 7.03).



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Journal of Special Jurisdictions



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GOVERNANCE

Currently, Próspera Arbitration Center LLC (“PAC”) has been hired by the General Service Provider to furnish such arbitration services. The PAC is organized to provide a wide range of dispute resolution services through “Senior Judges” consisting of experienced retired Arizona State Supreme Court, appellate court, and trial court judges, “Judges” consisting of international legal scholars and accomplished litigators, and “Judicial Officers,” who are dispute resolution professionals overseen by Senior and Judges. Some of these judges include:

- Judge John Gemmill, former Arizona Court of Appeals Judge
- Judge John Pelander, former Arizona Supreme Court Justice
- Judge Kenneth Mangum, former Arizona Superior Court Judge
- Judge Martin Klapper, Senior Partner at HopgoodGanim
- Judge Illya Shapiro, leading constitutional law scholar and head of the Robert

A. Levy Centre on Constitutional Studies

Insofar as the PAC serves only as a “default” Arbitration Service Provider, the parties to any dispute are not contractually bound to use the PAC remain free to contract to use a different service. Unless the parties elect to bypass the default Arbitration Service Provider by contract, or otherwise opt for private arbitration or mediation conducted by the PAC (which involves an additional fee), the default Arbitration Service Provider is required by local rule to generate public precedent in the interpretation and application of Próspera law (Próspera, 2019e). This is a critical component of building out the rule of law within the Próspera common law legal system.

The precedential nature of the Próspera Arbitration Center’s rulings is another key governance innovation within Próspera. It is well known that arbitration is generally a faster and cheaper alternative to public courts, especially in a jurisdiction such as Honduras where the average time to resolve a case is 20 months. For many proceedings, the Próspera Arbitration Center is required by law to resolve a dispute in 60 days or less (IACHR, 2019).



The General Service Provider is required to operate the property, personal and legal entity registries in compliance with decisions of the default Arbitration Service Provider, and may suspend or revoke access to the same upon direction of a court, the arbitral tribunal or otherwise as a peaceful common law “self-help” enforcement measure to incentivize compliance with Próspera rules and residency agreements (subject to judicial review by the default Arbitration Service Provider or ZEDE court system).¹⁷

3.6. A Deeper Dive into the Property, Personal and Entity Registries

Among the three registries furnished by the General Service Provider on behalf of Próspera, only the property registry is available in all of its functionalities to the general public. The property registry currently consists of a repository for all recordings relative to land titles within the boundaries of Próspera. To predictability and reliability, the land title registry division of the property registry is governed by Torrens principles adapted from New Zealand and Australian statute law. Accordingly, what is maintained in the registry will be presumptively dispositive of the condition of titles and related legal rights in Próspera. Personal property and vehicular registries are divisions of the property registry by local rule.¹⁸

The personal and legal entity registries are generally accessible only by and to existing residents of Próspera, and are also linked to the e-governance application processes necessary to become a resident of Próspera. The application process for residents (other than visitors) entails a background check that requires a copy of a passport or other official

¹⁷ See Próspera 2019e, *see also* Próspera Land Title Law 2019, <https://pzgps.hn/2-codification-codificacion-§§-2-1-22-1-0-0-1-thru-2-1-22-5-12-0-135-land-title-law-2019/>; Próspera Entity Registry Statute (Section 4(e), <https://pzgps.hn/11-codification-codificacion-§§2-1-43-0-0-0-1-et-seq-prospera-entity-registry-statute-estatuto-del-registro-de-entidades-de-prospera/>); Próspera Personal Registry Statute, (Section 4(d)) <https://pzgps.hn/12-codification-codificacion-§§2-1-44-0-0-0-1-et-seq-prospera-personal-registry-statute-estatuto-del-registro-de-personal-de-prospera/>

¹⁸ The land registry division of the property registry is currently available online at <https://prospera.sure.hn/>, accessible with the following credentials: username/password: public/publico.



identification, proof of current national residency, as well as “know your customer” reviews of leading international criminal and sanctions databases. All residents of Próspera are assigned an identification number (designed to be compatible with the RTN numbering system of wider Honduras) when accepted for residency. If a resident is engaged in a “regulated industry” and has opted to operate under the regulatory framework of Honduras, one of the various OECD countries reciprocally recognized in Próspera, or a petitioned-for/tailored Próspera regulatory rule (discussed in detail below), that fact must be disclosed by filing an appropriate informational statement in the relevant registry.¹⁹

The personal registry is predominantly a repository of residency agreements and related information for natural persons, including physical residency agreements, e-residency agreements, visitor agreements, and temporary income earner agreements, as well as associated general liability insurance agreements and public arbitration outcomes arising from the use of the default Arbitration Service Provider. The legal entity registry is, likewise, a repository of resident agreement-related information for legal entities; but it is also, importantly, an e-governance service whereby, for a reasonable fee, nearly all popular and internationally-recognized legal entities can be organized, maintained, and redomiciled within Próspera (after securing a relevant residency and liability insurance). This includes limited liability companies, corporations, statutory trusts, limited partnerships and more (Próspera, 2019). The privacy of retained applicant and resident data is maintained in

¹⁹ For more details on industrial regulations, see ZNB Industrial Regulation Statute (Section 3(a)(iii)), <https://pzgps.hn/5-codification-codificacion-§§-2-2-28-0-0-0-1-through-2-2-28-0-0-0-7-znb-now-prospera-industrial-regulation-statute-znb-ahora-prospera-estatuto-de-regulacion-industrial/>, amended by Amendment to Industrial Regulation, <https://pzgps.hn/9-codification-codificacion-§2-2-41-0-0-0-1-enactment-of-amendments-to-znb-industrial-regulation-statute-§2-2-28-0-0-0-2ni-ii-and-7a-b-promulgacion-de-enmiendas-al-estatuto-d/>, Amendment to Industrial Regulation, <https://pzgps.hn/15-codification-codificacion-§§2-1-55-0-0-0-1-et-seq-promulgacion-de-enmiendas-al-estatuto-de-regulacion-industrial-del-znb-§2-2-28-0-0-0-0-2l-enactment-of-amendments-to-znbs/>, and PZ Roll Call Form-Amendment to Industrial Regulation Statute, <https://pzgps.hn/19-codification-codificacion-§§2-2-71-0-0-0-1-et-seq-enactment-of-amendment-to-znb-industrial-regulation-statute-§2-2-28-0-0-0-2ni-promulgacion-de-la-enmienda-al-estatuto-de-r/>.



accordance with Próspera rule; each resident’s “regulated industry” election, permitting status, and public precedential arbitration outcomes arising from the decisions of the default Arbitration Service Provider will be made available to all residents, as well as the general public upon request.

3.7. Próspera’s Tax and Regulatory Framework

Próspera’s tax and regulatory framework is designed to optimize the conditions needed to generate prosperity based on international best practices. The tax system consists exclusively of three tax types established by local rule: (1) a flat income tax on income earned within Próspera only; (2) a retail value added tax on sales within Próspera; and (3) a land value tax on property within Próspera (ZEDE, 2013).²⁰ The regulatory system is best characterized as minimally prescriptive—most regulation in Próspera consists of legal accountability under the common law and measures intended to enhance the effectiveness of such accountability, such as mandatory liability insurance requirements, which is enforceable in the PAC or ZEDE court system by the promoter and organizer, General Service Provider and residents (Próspera, 2020c).

3.7.1. The Nuts and Bolts of Taxation in Próspera

The General Service Provider currently furnishes personnel serving as Tax Commissioner. The tax system is presumptively based on the calendar year. Payment is due to the Próspera Trust on April 1st of each calendar year or as otherwise may be specified for the applicable tax year by notice of assessment from the Tax Commissioner. Significantly, on the latter of

²⁰ For detailed tax information, see also Próspera Tax Statute, <https://pzgps.hn/8-codification-codificacion-§§2-1-38-1-0-0-1-through-2-1-38-12-12-0-136-prospera-tax-statute-2019-estatuto-tributario-de-prospera-2019/> , as amended by §2-1-51-0-0-0-1, <https://pzgps.hn/13-codification-codificacion-§§2-1-51-0-0-0-1-et-seq-enactment-of-amendments-to-tax-statute-2019-§§2-1-38-10-0-0-701-3-4-711-731-promulgacion-de-las-enmiendas/>



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Journal of Special Jurisdictions



INSTITUTE FOR
COMPETITIVE
GOVERNANCE

January 1, 2030 or the date the population of natural person physical residents exceeds 50,000, all tax revenues will be subject to an aggregate cap of 7.5% of gross domestic product, with any excess refunded to taxpayers pro rata in proportion to their contribution (La Gaceta, 2013). Similarly, to minimize the risk of indirect pressure to tax excessively, beginning on the latter of January 1, 2030 or the achievement of urban population density, Próspera will be subject to a debt limit of the greater of 105% of the nominal amount of the then-outstanding debt or 20% of the 5 year trailing average of annual GDP within Próspera (La Gaceta, 2013).

3.7.2. Income Taxes in Próspera

Próspera's statutory income tax is designed to be incapable of easy evasion or abuse, and is imposed in lieu of any income taxation otherwise authorized by the Próspera Charter or the Honduran national government. For natural person income, 50% of revenues (what would be called "gross income" under the U.S. Internal Revenue Code) earned within Próspera is deemed "presumed income" subject to the statutory tax rate of 10% (also capped at the same rate by the Próspera Charter) (Próspera, 2018). For legal entities, 10% of all revenues earned within Próspera is deemed presumed income subject to the statutory tax rate of 10%. The Próspera income tax is thus effectively a 5% gross income tax on natural persons and a 1% gross income tax on legal entities. To avoid double taxation, income tax paid by a legal entity is credited against the income tax that would be owed by that entity's owner in proportion to that owner's ownership interest. There is no withholding requirement for Próspera residents. But if income is earned within Próspera by non-residents, the payor must withhold on a monthly basis 10% of 50% of revenues earned within Próspera during the immediately preceding month (effectively 5% of gross income earned within Próspera in the immediately preceding month), and such amount must be deposited with the Próspera Trust within 15 days after the end of each month.



This particular Charter provision involved extensive negotiations with CAMP. In line with the broad economics literature, Próspera's initial intention was to create a strong Land Value Tax (LVT), and Value Added Tax (VAT), and nothing else. However, CAMP was concerned the lack of an income tax would create issues with the national government and potentially result in Próspera being officially on the European Union's Tax Haven Blacklist. This was despite the fact that Próspera could demonstrate substantial revenues from the simple combination of a higher LVT and VAT, and the wealth distribution impacts of the VAT in particular along with the positive incentives created by the LVT (Maxwell and Vigor 2005). As such, at the behest of CAMP, Próspera adopted the income tax system described above.

3.7.3. Retail VAT and LVT in Próspera

The Próspera retail value added tax is 5% of the retail value add, which is deemed 50% of the final retail sales price (the rate of any VAT is capped at 5% by the Próspera Charter) (Próspera, 2018). This is effectively a 2.5% sales tax on all retail goods and services within Próspera. The land value tax rate is 1% of land value (the rate is capped at 2.5% by the Próspera Charter), which may be fixed by the Tax Commissioner based on the taxpayer's choice of any of the following methodologies: (1) recent sale of the property in question; (2) a recent professional appraisal supplied by the taxpayer at the taxpayer's cost; (3) the sales price specified by the taxpayer at the beginning of the relevant tax year in a standing option to sell the property which must be registered publicly in the Próspera property registry at the beginning of the relevant tax year and remain binding capable of acceptance by any third party without rescission for the entire tax year, subject only to a leaseback of improvements for 20 years (on such forms as the Tax Commissioner may provide); and (4) a default valuation based on a reasonable methodology adopted by the Tax Commissioner.



3.7.4. Tax Exemptions and Credits in Próspera

An exemption from any or all of these taxes can be requested if demonstrably necessary (and only to the extent necessary) for Próspera to compete with another tax jurisdiction, as determined either by local rule or the Tax Commissioner and set forth in a legal stability agreement. If granted, the exemption must be written in general and uniform terms to apply and be available to all similarly situated taxpayers. Finally, under a variety of programs which Próspera may offer from time to time, marketable tax credits may be purchased by taxpayers directly from Próspera (or from holders of previously issued marketable tax credits), whereby between \$1.1 and \$5 of marketable tax credits can be bought for each \$1 paid to Próspera to purchase the credit (Próspera, 2018).²¹ This provides for a mechanism by which the Próspera ZEDE can fund public works projects in the short term by providing a tax break in the long term for firms operating within the jurisdiction. Crucially, these marketable tax credits are legally allowed to be traded on the secondary market, potentially creating a market for these dependent on the expected future success of the jurisdiction.

3.8. How Próspera Regulates

Próspera's regulatory system consists of ten major public policies: (1) adoption of U.S. common law and uniform commercial code principles as the baseline source of legal rights and obligations (Próspera, 2019); (2) adoption of model U.S. business codes as the baseline source of legal entity formation and maintenance authority; (3) decentralized land use regulation; (4) codification of best practices in tenant eviction and mortgage proceedings

²¹ For more details about tax credits, see Próspera Marketable Tax Credit Resolution (Type 1), <https://pzgps.hn/prospera-marketable-tax-credit-resolution-resolucion-sobre-el-credito-fiscal-negociable-de-prospera/> and Próspera Marketable Tax Credit Resolution (Types 2 and 3), <https://pzgps.hn/resolution-approving-marketable-type-2-and-3-tax-credit-offerings-resolucion-por-la-que-se-aprueban-las-ofertas-de-creditos-fiscales-tipo-2-y-3/>.



(Próspera, 2019b)²² (5) reciprocity for Honduran and major OECD country regulation of typically “regulated industries” or, alternatively, tailored local rule regulation or enhanced common law liability in such industries (Próspera 2019g); (6) optional permitting to confirm Próspera’s exclusive regulatory jurisdiction (Próspera, 2019d); (7) ecological protection of Roatan’s world class coral reefs (Próspera, 2019i); (8) hazardous condition and activity regulation; (9) labor regulations concerning minimum wages, employer benefits, and unions (Próspera, 2020d); and (10) mandatory minimum liability insurance requirements for regulated industries. These policies maximize individual freedom while enforcing the personal and social responsibility required by best practices as well as Honduran and international law.

3.8.1. The Bedrock

Inspired by the innovative “Ulex” code developed by Professor Tom Bell of Chapman University Law School, the “Roatan Common Law Code” is the name given to the Próspera rule adapting common law and uniform commercial code principles from certain of the American Law Institute’s restatements and the U.S.-based Uniform Law Commission’s model commercial codes (Próspera, 2019a). They establish liability for personal injuries, contractual breach, and property rights violations, as well as family law governing adoption and inheritance; all subject to interpretative first principles expressly favoring freedom of contract and self-responsibility. The business codes governing the formation and maintenance of legal entities are largely adapted from model legislation published by the American Bar Association. Taken together, the legal principles and mechanics adopted by the “RCLC” form the bedrock of the Próspera regulatory framework and should be very

²² See also §2-3-29-0-0-0-1, et seq., Landlord Tenant Statute, <https://pzgps.hn/6-codification-codificacion-§§2-3-29-0-0-0-1-enactment-of-the-znb-landlord-tenant-statute-promulgacion-del-estatuto-de-arrendador-inquilino-del-znb/>, amended by §2-3-42-0-0-0-1, <https://pzgps.hn/amendment-to-prospera-landlord-tenant-statute-enmienda-al-estatuto-prospera-de-propietario-inquilino/>



familiar to investors who do business in any common law country, such as the United States, Canada, the United Kingdom and Australia.

3.8.2. Decentralized Land Use Regulation

Inspired by the regulatory environment of Houston, Texas, land uses are not regulated by zoning laws in Próspera. Instead, the promoter and organizer is establishing a system of decentralized land use regulation by leveraging the RCLC and Próspera's innovative Land Title Law. This decentralized regulatory system is premised on an initial framework of covenants, conditions and restrictions that are recorded against title to all real property within Próspera. Included among this initial set of "CCRs" is authority for attaching and severing certain air space rights, pollution exclusion rights, and development rights in connection with the use of real property, separate title to which is recognized by Rule. (Próspera, 2019f). In essence, coordinated by Próspera's e-governance platform, landowners and entrepreneurs will be able to buy, sell and trade the right to occupy or exclude the occupation of air spaces, the right to emit or exclude noises and other noxious pollutants, and the right to build or not to build to certain densities. Very much like development rights are currently traded in Manhattan, this will allow for voluntary trade and the market to coordinate the ultimate use of land within Próspera, subject to rules against trespass and nuisance under the RCLC, which will certainly tend to ensure the highest and best use of land will prevail.

3.8.3. Commercial, Industrial and Financial Regulation

The Landlord-Tenant Statute and Mortgage Foreclosure Sale Statutes are adapted from statutes of Texas and dozens of other U.S. states. The former statute is a default set of rules for eviction proceedings which require clear and fair notice for evictions, peaceful self-help, and remedies for abuse of process (Próspera, 2020b). As a default setting for leases, the parties to a lease can freely displace its provisions by contrary agreement.



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Journal of Special Jurisdictions



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The mortgage statute implements a non-judicial mortgage foreclosure process that the Federal Reserve credits with significantly increasing access to loanable funds (Pence 2003). Essentially, the statute provides that mortgages containing power of sale clauses will authorize the lender on breach to retain a trustee to conduct a public sale of the property without court action or engaging the default Arbitration Service Provider. The defaulting debtor can only respond by redeeming the debt, purchasing at auction or suing for fraud. The time frame for conducting the non-judicial sale is 45 days after notice, allowing the debtor an opportunity to redeem the debt before the property is sold, up to 30 days after notice of default.

The Industrial Regulation Statute is the rule that implements reciprocity for Honduran and major OECD country regulation of what are deemed “regulated industries,” namely, the Finance and Insurance Industry, Energy Industry, Manufacturing Industry, Mining and Subsurface Industry, Waste Management Industry, Health Industry, Food Industry, Construction Industry, and the Agricultural Industry (Próspera, 2019g). Covered persons engaged in “regulated industries” are prohibited from engaging in any activity that could cause personal injury, breach of contract or property rights violations, as defined by the Roatan Common Law Code. If this prohibition is violated, any resident may seek injunctive relief in the default Arbitration Service Provider or ZEDE court system against the regulated person to remedy the prohibition, as well as seek treble damages for any resultant injury and litigation expenses. Any limited liability enjoyed by a shareholder, board member or officer of a legal entity is pierced to the extent of their investment or previous year’s compensation. However, the regulation provides two safe harbors from such exposure (reducing it to standard 1x common law liability).

The injunctive relief provision is worth focusing on in more detail. Within Próspera, any resident has the legal right to sue any other firm found to be violating its elected regulatory code and receive the damages and fines which would result from a ruling in the Próspera Arbitration Center in favor of the plaintiff. Essentially, every resident of Próspera



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Journal of Special Jurisdictions



INSTITUTE FOR
COMPETITIVE
GOVERNANCE

has the legal right to enforce the legal and regulatory code of Próspera on all other firms. A loser-pays rule applies to prohibit frivolous or excessive litigation. This decentralized regulatory regime was created specifically to simultaneously prevent a large, economically costly regulatory force from forming at the governmental level as has happened in the US and elsewhere at great cost to the global economy, while also ensuring all rules, regulations, and statutes are being complied with to the highest degree possible (Coffey, McLaughlin, & Peretto, 2016). Of course, the Próspera ZEDE retains the right to enforce regulations as well, but expanding the pool of potential enforcers to the entire population ensures that both regulations will be enforced and the incentive for budget-maximizing governmental entities to putatively enforce regulation is reduced because they are now in a competitive rather than monopolistic enforcement environment (Niskanen, 1994).

Under the first safe harbor, the regulated person can essentially elect to seek reciprocity for outside regulation by electing within Próspera to comply with the governing regulations of Honduras or any of the following “Best Practice Peer” countries: Australia, Austria, Belgium, Canada, Chile, Denmark, Dubai, Estonia, Finland, France, Germany, Hong Kong, Iceland, Ireland, Israel, Italy, Japan, Korea, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Poland, Singapore, Spain, Sweden, Switzerland, United Kingdom, and United States of America (which election must be filed in the relevant registry for public view and guaranteed in all relevant contractual undertakings within Próspera).

Under the second safe harbor, the regulated person can petition the Technical Secretary and Council of Trustees to adopt a rule creating a tailored regulatory environment, accessible to all similarly situated regulated persons, during the pendency of which enhanced liability exposure is suspended, and, upon promulgation, good faith compliance yields a complete defense to enhanced liability exposure. Under this same statute, only licensed members of certain professions, such as doctors or lawyers, may use those terms to market themselves irrespective of their regulatory election.



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Journal of Special Jurisdictions



INSTITUTE FOR
COMPETITIVE
GOVERNANCE

Próspera recognizes that officials and agencies of the Honduran national government and local governments, or even international agencies or bodies, may attempt to exert regulatory jurisdiction within its boundaries. Accordingly, as a complement to the Industrial Regulation Statute, Próspera has adopted a permitting resolution that allows regulated persons to declare their regulatory election and also clearly invoke the exclusive regulatory authority of Próspera within its boundaries (Próspera, 2019d). Such permitting is intended to minimize the risk of interference by outside agencies that wrongly claim regulatory jurisdiction within Próspera. Permitting is thus prudent and highly recommended, but optional. Related fees for most permit types range between \$50 and \$200.

In addition to the Industrial Regulation Statute, special protection is given to the irreplaceable coral reef surrounding the Island of Roatan. The Coral Reef Protection Statute currently provides that any activity that tends to damage coral reefs is prohibited and subject to civil liability by suit brought before the default Arbitration Service Provider for the cost of remediation, injunctive relief, and litigation expense shifting (Próspera, 2019i). A committee of local residents and experts is being organized by Próspera to review international best practices and adopt a safe harbor regulatory framework for permitting coral-threatening or damaging activities. Similarly, the Hazard Precaution Statute regulates activities and conditions that represent an existential threat or risk to public health, safety and the political stability of Próspera, such as radiologics, biohazards, hazardous waste disposal, precursors to illegal drugs, and human cloning; subject to the right to secure a no-action letter from the General Service Provider or Próspera Council, or confirmation of an exemption from the Hazardous Activity Division of the default Arbitration Service Provider (decided within 60 days of an application) (Próspera, 2020e).

The Próspera Labor Statute implements governing Honduran constitutional and treaty obligations relative to international labor standards and human rights in the most efficient and fair manner possible (Próspera 2020d). The Labor Statute recognizes the right of employees to organize in a union and peaceably strike as well as the right of employees not



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COMPETITIVE
GOVERNANCE

to be unconscionably forced to join a union. Further, the statute requires a labor division to be established in the default Arbitration Service Provider to handle labor disputes. It establishes a minimum wage equal to 110% of the general Honduran minimum wage. It requires the employer to pay overtime equal to 125% of base compensation for hours worked by covered employees above 48 or days worked in excess of 6 in a week. And it requires employers to fund a trust account with an amount equal to 8% of a covered employee's salary, which the employee has the right to invest, retain for retirement and permanent disability, or spend on medical, educational, housing and legal expenses. At the same time, family and small business employees, interns and entry level hires are deemed non-covered employees to mitigate the commonly recognized negative economic impact on overall employment from the minimum wage and enhanced compensation requirements.

These minimum wage provisions were not a result of central government pressure upon Próspera, but rather are voluntarily adopted provisions. Próspera chose to do this for a simple reason: anyone working in the Próspera ZEDE should be demonstrably and clearly better off working and living in the Próspera ZEDE than anywhere else in Honduras. This provision was a simple way to demonstrate and enforce that claim in law.

3.8.4. The Capstone: General Liability Insurance

As the capstone of financial accountability to buttress the regulatory principles of the foregoing rules, Próspera also adopted the Financial Responsibility Statute (Próspera, 2020c). This rule requires residents and regulated industry persons to secure general liability coverage for awards of the default Arbitration Service Provider. To ensure the maximum cost associated with compliance is known in advance, the statute imposes a maximum premium for any mandatory coverage, such as a cap of \$260 per year for residents. The specific limits and coverage requirements are determined by the Financial Responsibility Resolution, and range from \$20,000.00 to \$3,000,000 USD annual loss limits depending on the industry involved (Próspera, 2020d). Such insurance can be purchased freely from any insurance



company willing and able to do business in Próspera (to qualify to offer mandatory insurance within Próspera, insurance companies will need to maintain a minimum level of capital reserves and reinsurance to cover issued policies). The General Service Provider or, if none, Próspera, will offer liability insurance as the insurer of last resort; and is authorized to make the market by adjusting terms otherwise required by Rule, which can then be adopted by any other insurance company.

Recall that Próspera's regulations are enforced in a decentralized manner. This general liability insurance requirement is an express requirement that all residents and businesses have insurance able to cover adverse rulings as a result of that decentralized regulatory enforcement. It completes the other side of the regulatory enforcement equation: that enforcement is decentralized and therefore abundant, while the ability to pay is legally required for all residents and firms.

3.9. E-Governance System

Próspera is implementing all of the above via an E-governance platform, to be known as E-Próspera. This system will electronically administer all of the ZEDE's various administrative and governance responsibilities, from registries to company formation and taxation. The system is based upon the Estonian government's E-governance system, and Próspera has brought Ott Vatter, the former Managing Director of Estonia's E-governance system, to build this software platform.

4. Distinctions between the Original and Amended Charter

With a clear understanding of the amended charter as currently enforced in hand, we can now show and explain the differences between the two. The main improvements of the amended Charter were: the introduction of special districts, strengthening of the ombudsman and clarification of the ombudsman's role, the financial limiting mechanisms of income caps



and debt caps pegged to GDP, clarifying the rules around potential conflicts of interest, and general “housekeeping” in the clarification of terms. Each will be discussed in turn below, with the exception of the special districts, which have already been discussed at length above.

4.1. The Ombudsman

While the ombudsman existed in the charter from the beginning, its role, funding sources, and specific duties were ambiguous. Furthermore, the examples from recent history show that in the Latin American context, if not properly structured, the Ombudsman role can be easily corrupted and abused (Uggla, 2004). As such, the role was amended to be democratically elected rather than appointed by Próspera, to avoid a situation wherein Próspera appointed an Ombudsman who might not pursue cases against Próspera. The amended charter gives the ombudsman the responsibility of producing a report on compliance with human rights on a yearly basis once the jurisdiction has residents, and grants the Ombudsman access to confidential documents in order to properly fulfill their role. The importance of this role and its careful structuring is paramount in the Honduran context, where corruption is endemic and human rights abuses are widely reported (Human Rights Watch, 2020).

4.2. Financial Limitations

As previously mentioned, the amended charter implemented total debt and total tax revenue limitations which are tied to per capita GDP. This was an intentional effort to keep taxation low and competitive with other jurisdictions, while also creating a bulwark against fiscal excesses by the Próspera ZEDE. These provisions take effect in 2030, or when the population reaches 50,000, whichever is sooner. Implementation of this provision is delayed because in the early years, the jurisdiction will almost certainly be running large deficits to overcome the startup costs associated with building new institutions and a new community.



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Journal of Special Jurisdictions



INSTITUTE FOR
COMPETITIVE
GOVERNANCE

4.3. Conflicts of Interest

Because of the unique relationship between the P&O and the Council of Trustees, stronger conflict of interest provisions were introduced. The operative text is: “A conflict of interest in relation to a proposed action may be resolved conclusively by demonstrating that the proposed action is commercially reasonable, equivalent to what would result from an arm’s length transaction, or otherwise consistent with the council member’s official duties and responsibilities.” It further allows residents to object to a council vote at any of the regular council meetings if they have evidence of a conflict of interest, but it will only be upheld if injury as a result of this undeclared conflict of interest can be specified. These provisions were meant to walk the fine line between ensuring conflicts of interests are properly highlighted and resolved without stymying all activity of the council in the process.

4.4. Linguistic Housekeeping

Upon requesting review of the charter by a number of international legal experts, many small wording ambiguities, phrasing ambiguities, and other linguistic issues which bear legal weight were illuminated. The amended charter resolved all of these small issues, which taken individually were not of paramount importance, but cumulatively could have created unforeseen issues in the future. This process also resulted in better grounding of the charter and the council in the express language and processes highlighted in the ZEDE Organic Law.

5. Lessons Learned

The process of creating from scratch new governance structures was a years-long and expensive process. However, Próspera’s objective is and remains to create the best-governed and most prosperous jurisdiction on Earth, so this time and effort were warranted. Despite



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JURISDICTIONS

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Journal of Special Jurisdictions



INSTITUTE FOR
COMPETITIVE
GOVERNANCE

Próspera's best efforts, some mistakes were made along the way which will be highlighted here.

First, Próspera underestimated the time and difficulty of obtaining intergovernmental agreements with Honduran agencies. Because the Próspera ZEDE is a part of the Honduran governmental hierarchy, it was necessary to create intergovernmental cooperation agreements with a number of agencies, including the Property Institute, the customs agency, the Honduran Revenue Administration Service, and many others. These took almost as long, if not longer, than creating the initial institutions. These delays were not a result of any ill will from the Honduran government, but simple confusion about how such processes should be carried out and what they should entail because Próspera was the very first organization to pursue the process.

Secondly, Próspera was surprised to find that firms and entrepreneurs were less enthusiastic about regulatory flexibility than was initially anticipated. While some who understood the concept fully found the concept worth shifting operations to Próspera, entrepreneurs are not public policy experts, and they often simply didn't know which regulatory environment was truly best for their industry. As such, the organization has adjusted its marketing and communication approach to more plainly explain and assist in the selection of a regulatory election for firms.

Finally, Próspera has been attacked on partisan political grounds in Honduras. As a special jurisdiction project, we underestimated the degree to which internal Honduran political dynamics would impact the project from a public relations perspective, and did not initially put adequate resources into properly enrolling the local community as a strong base of support to defend against partisan political attacks. While we did make some political inroads early on across the political spectrum, not enough weight and therefore resources were put toward this effort.



6. Conclusion

This paper was an attempt by the Próspera team to shed light on how the first ZEDE was formed, how its governance institutions were created, and the public policy reasoning behind it all. We hope that the information contained herein can inform future jurisdiction-building efforts and contribute to the overall literature on institution building from the perspective of those who have gone through the entire process of building new governance institutions from scratch.

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