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CAFTA and Costa Rica: Now or Never?

[Thomas F. Morante](#) and [Cecilia Duran](#)

Costa Rica will soon hold a referendum on whether to ratify and thus enter into the Central American Free Trade Agreement (CAFTA). The referendum, known as a "consulta popular," was announced by President Oscar Arias last month and will likely dictate the success of the free trade agreement, which has been touted as one of the most significant trade initiatives led by the White House.

The U.S. Congress approved CAFTA in August 2005—and the Dominican Republic, El Salvador, Guatemala, Honduras, and Nicaragua have all ratified the agreement and adopted the necessary enabling legislation for CAFTA to take effect in those countries. Costa Rica, however, has yet to ratify or adopt the enabling legislation with respect to CAFTA. President Arias, who ran his campaign last year as a CAFTA-supporter-- winning the presidential elections by a slim margin, sought to expedite the approval process by declaring the referendum. Without Arias' declaration, the referendum would have required the collection of a threshold number of votes.

CAFTA is designed to open trade in goods and services between the U.S. and Central American countries, thus facilitating economic development in those countries. CAFTA proponents believe the agreement will lead to increased economic growth and foreign investment in these countries and will likewise benefit U.S. businesses, including those in the financial services sector.

CAFTA obligates each signatory party to liberalize trade in financial services and afford some modest cross-border trade. CAFTA would open Costa Rica's insurance market to foreign competitors—which market until now has been a government-controlled monopoly. CAFTA would allow each party the right to limit the scope of financial services and to define what constitutes "doing business" for the purpose of obtaining regulatory authorization. Further, CAFTA contains a National Treatment provision that requires signatory countries to treat the financial service providers of other member countries no less favorably than local companies in terms of establishing a financial institution in the territory of another party.

The Costa Rica referendum announcement came at the same time the Doha

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Round of the World Trade Organization (WTO) talks have floundered amidst disputes surrounding US subsidies and protectionist measures. A growing number of Costa Rican citizens and industries along with members of the Costa Rican legislature, have been vocal in their opposition to CAFTA; arguing that CAFTA would deal a blow to their local economies, and would devastate the most vulnerable citizens—poor local farmers. Many Costa Ricans consider any measures affecting government run industries—such as insurance and telecom -- as a threat not only to the institutions themselves, but also to the country's democracy.

Insurance business in Costa Rica is regulated by, among other laws, the Monopoly and National Insurance Institution Law (No. 12 of October 30, 1924), and subsequent amendments. This law established the monopoly in favor of the National Insurance Institute (INS), a government agency which operates on an autonomous basis. In accordance with this law, the transaction of insurance business in Costa Rica is reserved to the state monopoly (i.e., INS), although in a fairly recent amendment, private companies are permitted to broker INS insurance policies on certain terms and conditions. Recently, Costa Rica's insurance regulator authorized the National Bank (Banco Nacional) and the Bank of Costa Rica (Banco de Costa Rica) to engage in the marketing of INS insurance policies in Costa Rica. This move is the latest in several recent attempts to broaden insurance marketing by the INS - while maintaining the government monopoly - through the creation of strategic alliances with various governmental sectors.

In order to implement the necessary internal regulations that would be required to open the insurance industry in light of CAFTA, Costa Rica in August 2006, introduced a proposed law regulating the Insurance Market ("Ley Reguladora del Mercado de Seguros"). The proposed law follows on the heels of legislation introduced in 1998 to end the insurance monopoly, and is designed to foster competition by ending the monopoly that the INS has enjoyed in Costa Rica for the past 80 years. The proposal provides that the INS would still be a government-owned company and would have a predominant role in the industry due to its economic and technical power. In addition, the law would grant INS the legal means to diversify its investments and the possibility to participate in other markets, including foreign insurance markets.

Under CAFTA, the financial services sector in Costa Rica, and in particular, the insurance industry, would be opened-up for the first time. The agreement envisions that this liberalization would take place in phases, with modest cross-border activities being permitted upon the CAFTA entering into force in Costa Rica. The insurance products and services covered on a cross-border basis include marine, aviation and transportation insurance, along with reinsurance -- thus mirroring similar provisions in the Free Trade Agreements be-



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tween the United States and Chile and Singapore. Subsequently, the market would be open to most lines of insurance pursuant to joint venture operations and the establishment of a subsidiary or branch, although substantially longer timeframes would be in place for liberalization in automobile and workers compensation insurance.

Should the referendum not result in Costa Rica entering into CAFTA, there will be some ongoing challenges for the United States in the context of a bilateral FTA with Costa Rica - should one be pursued - not unlike the challenges currently faced with respect to the FTAs for Panama, Colombia and Peru. It seems unlikely that the US Congress will vote to approve these three FTAs until enhanced labor protections and a few additional items (perhaps environmental protections) are addressed in the agreements, either directly or via side letter; one of which would be the requirement that the FTAs incorporate the International Labor Organization standards into the agreements. CAFTA was approved by the US Congress (then controlled by Republicans) by only two votes, thus, should Costa Rica not approve entry into CAFTA, entering into a future bilateral FTA with the United States would inevitably prove to be a significant challenge.