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THE OPPENHEIMER REPORT

Ecuador takes a risk in its dealings with U.S.

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GUAYAQUIL, Ecuador -- When I interviewed President Alfredo Palacio earlier this week, the big question in this country was whether Ecuador would move toward Venezuelan radical leftist leader Hugo Chávez's camp.

Ecuador's relations with Washington have nose-dived in recent weeks, and Chávez -- not surprisingly -- has come to the rescue. Oil-rich Venezuela is not only offering emergency economic help but has also invited Ecuador to join a "People's Trade Agreement" recently signed by Venezuela, Cuba and Bolivia.

Ecuador's crisis with the United States, by far its largest trade partner, started earlier this year when Palacio's government -- facing financial difficulties and massive protests from leftist groups -- sponsored a law demanding that foreign oil companies leave a larger share of their profits in this country. Later, on May 15, Ecuador revoked a contract with Occidental Petroleum for an alleged contract violation and seized its assets.

The Bush administration has since suspended ongoing free-trade negotiations with Ecuador, and U.S. officials have said that this country may lose its trade benefits under a U.S. Andean Trade Promotion Drug Eradication Act (ATPDEA), which expires at the end of this year.

In a 90-minute interview, Palacio, a cardiologist by training, went out of his way to stress that he wants to revamp the trade talks with Washington. But, at the same time, he said his government is exploring alternative trade plans with Europe and Venezuela.

"Our government has never walked out of the [U.S.-Ecuador] trade negotiations. Never," Palacio said. "I want a free-trade agreement with the United States. We want it. This country needs it. But this country wants an even-handed free-trade deal, where they don't impose policies on us or mix other issues with trade."

Palacio said that Ecuador's oil-related decisions are "totally unrelated" to the free-trade negotiations and should be treated as legal issues among private companies.

OK, I said. But the fact is that time is running out for a free-trade deal, because President Bush's congressional authority to expedite free-trade negotiations expires in July 2007. Will Ecuador backtrack on its Occidental decision or fall into Chávez's orbit? I asked. Palacio paused and responded that Ecuador will "behave with dignity, with a position of national sovereignty."

Mr. President, I interrupted, those are very nice words, but the fact remains that Ecuador stands to lose a lot. How are you going to make up for that?

Palacio said he will seek a trade agreement with the 25-member European Union, although he acknowledged that this will be a difficult task because the Europeans demand to negotiate with all Andean nations as a bloc, and the Andean bloc is deeply divided.

On the trade preferences expiring this year, Palacio said they affect \$400 million worth of Ecuadorean exports, but the real impact would be only \$26 million in U.S. tariffs that Ecuadorean firms would have to start paying once the trade benefits expire.

Of Venezuela, he said Chávez has "offered the possibility" of refining Ecuadorean oil in Venezuela, exploring building a joint Ecuadorean-Venezuelan oil refinery in Ecuador, and buying Ecuadorean foreign-debt bonds.

Chávez did not ask Ecuador to abandon its quest for a deal with the United States, but invited Ecuador to join the Venezuela-Cuba-Bolivia "People's Trade Agreement" if talks with Washington don't lead anywhere, Palacio said. He suggested that he is more interested in a bilateral trade deal with Venezuela.

Ecuador's business leaders say Palacio's estimate that this country stands to lose only \$26 million in tariff exemptions at the end of this year is ridiculous. If Ecuadorean exporters of flowers and vegetables have to begin paying U.S. import tariffs, they will not be able to compete with their Colombian and Peruvian counterparts, who will continue to enjoy ATPDEA benefits, they say.

"We are going to lose \$300 million, easily," says María Gloria Alarcón, president of the Guayaquil Chamber of Commerce. "Palacio's math is that of a physician."

My conclusion: Ecuador is in limbo and playing with fire. Europe will not be an option in the short term, and Venezuela may be promising more than it can deliver.

The only thing going for Ecuador is that it will hold elections in October, and a new government may allow this country and the United States to resume commercial talks without either side losing face.