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Tensions around a trade regime: The GATT/WTO banana story

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1. Introduction

On 1 July 1993, the European Union (EU) finally established a common market in bananas as part of the completion of the Single European Market (SEM). Previous national policies gave preferred market access to both some developing countries in Africa, the Caribbean and the Pacific (ACP) and EU regional suppliers. Hence, a major objective of the original Common Market Organization (CMO) for bananas was to maintain the preferential access to bananas produced in the EU and in ACP countries. However, giving preferential access to some supplying countries most often means restricting access to other supplying countries. Therefore in designing its new banana trade regime, the EU had to take care of keeping in line with the rules of the General Agreement on Tariffs and Trade (GATT), which restrict the use measures that discriminate between trading partners. Thus, the new CMO for bananas had to be a balanced solution between the interests of the EU regional supplying zones and the ACP producing countries on the one hand and other exporting countries (mainly Latin American countries) on the other hand.

Clearly, the original CMO for bananas implemented in 1993 did not succeed in finding such a balanced solution since from the beginning it became the target of complaints from numerous sources and challenged under the GATT/WTO (World Trade Organization) dispute settlement procedure.

The first objective of this paper is to give an overview of this trade banana dispute emphasizing the changes that the EU has progressively introduced in its CMO for bananas in response to the requests of the successive GATT/WTO panels. Following the historical sequence of events, we show how the successive reforms of the CMO for bananas have resulted in progressively eroding the preferential access that the EU had initially attempted to reserve to the ACP group as a whole, and within this group, to the least competitive ACP countries (mainly the Caribbean countries).



The second objective of this paper is to illustrate this view by assessing the likely impact of the final EU banana trade regime arrived at in May 2001, as a conclusion of the 8 years WTO banana dispute. The final EU banana regime is a two-step process towards a tariff-only system that should enter into force no later than 1 January 2006. During the transitional period, bananas will continue to be imported into the UE under a tariff-rate quota system through import licences distributed on the basis of past trade. How EU market shares of the main EU supplying countries will evolve during this transitional period is of major importance as regards to the likely impact of the future tariff-only step. Furthermore, the level of the future tariff, which will constitute the only preferential trade measure that the EU will be able to grant to ACP countries has still to be negotiated between the EU and its trading partners. It is likely that this tariff level will be sharply discussed and that an agreement will be difficult to reach between the EU and the major banana exporters, making possible a new start of the WTO banana story.

Using an up-dated version of a single-commodity, multi-country, partial equilibrium model of the world banana market (Guyomard et al. 1999a and 1999b), we assess the likely impact of the new EU banana trade regime on the structure of EU imports. Attention is focused first on the evolution of the respective position on the EU banana market of Latin American countries, ACP States and EU regional suppliers during the transitional period 2001-2005. In a second step, we provide an evaluation of the tariff equivalent that should be applied in 2006 on EU imports from non-preferred suppliers. The analysis shows that the most vulnerable ACP countries, mainly the Caribbean States, would suffer from the new regulation unless they were to receive direct aid to make their banana production more competitive.

The paper is organized as follows. Section 2 focuses on the GATT/WTO trade banana dispute. Section 3 deals with the quantitative assessment of the final 2001 EU banana regime. Finally, section 4 concludes.

2. The GATT/WTO banana story

2.1. The pre-1993 situation: Co-existence of disparate regimes

On 1 July 1993, the European Union (EU) adopted a unified banana policy as part of the completion of the Single European Market (SEM). Before that date, EU Member States pursued their own trade regimes. This resulted in three broad different regimes applied, making the EU banana market compartmentalized (cf. table 1).

As a result of historical relations, many EU Member States had obligations and arrangements with their former colonies in Africa and the Caribbean and Pacific regions (ACP). These arrangements were subsequently incorporated as a special protocol of the Lomé Convention, which formalised trade and aid relations between the EU and the ACP States. Hence, under the Lomé Convention, the EU was committed to give preferential access for banana imports from the ACP countries.

Therefore, the standard regime involved a 20% common external tariff on banana imports, ACP imports being exempt from this duty. Before 1993 however, this standard regime applied in five Member States only: Belgium, Denmark, Ireland, Luxembourg and The Netherlands.

As allowed through the banana protocol, other Member States applied additional protective measures aimed at giving preferential access targeted to imports from particular ACP countries. Furthermore, some of these Member States were themselves banana producers. Hence, these Member States were granted special provisions in order to protect their own production. These provisions applied to the French overseas departments (Guadeloupe and Martinique), the Portuguese island of Madeira, the Spanish Canary Islands and the Greek island of Crete.

Thus, the second regime involved, in addition to the 20% common external tariff, a complex system of import quotas aimed at preserving the shares of domestically produced bananas and/or imported bananas from specific ACP sources on concerned national markets. This second regime was applied by six Member States: Greece, Portugal and Spain (each reserving its market to its own banana production), France (reserving its market to its overseas departments and two ACP countries, Cameroon and Ivory Coast), Italy (granting preferential provisions to one ACP State, Somalia) and the United Kingdom (granting preferential provisions to four ACP States, Windward Islands, Jamaica, Belize and Surinam).

Finally, under a special protocol to the Treaty of Rome signed in 1957, Germany was granted a derogation allowing this Member State to import bananas duty free. This third regime was the one applied in Austria, Finland and Sweden as well before they joined the EU in 1995.

Table 1. Banana I regime: the pre-1993 situation

Standard regime	20% common tariff for non-preferential bananas	Applied by Belgium, Denmark, Ireland, Luxembourg, The Netherlands
"Protective" regime	20% common tariff for non-preferential bananas, additional national import quota systems	Applied by France, Greece, Italy, Portugal, Spain, United Kingdom
Free trade regime	Free trade in bananas	Applied by Germany

The overall effects of these disparate arrangements were: i) to give rise to significant market segmentation within the EU; ii) to raise the cost to the EU consumers of all bananas and to cause prices to be different in each Member State and higher than the world market price (see, e.g., Borrell and Cuthbertson, 1991; Read, 1994; Matthews, 1992; Guyomard et al., 1999a and b); iii) to either deny or restrict substantially access to some Member States markets to banana imports from third countries, that is mainly Latin American countries, generally referred to as the Dollar area.

2.2. The original Common Market Organization for bananas (July 1993)

The SEM of 1992 provided the impetus to eliminate internal border restrictions since it would be no longer possible to enforce Article 115 of the Treaty of Rome to prevent intracommunity trade. However, as noted by Thagesen and Matthews (1997), replacing national policies by a unified market regime was far from an easy task, given the competing obligations and objectives, which the EU faced. Firstly, the Common Market organization (CMO) for bananas had to be consistent with all aspects of the SEM. Secondly, it had to be compatible with the GATT (General Agreement on Tariffs and Trade), particularly with the objective of maintaining or improving market access. Thirdly, EU commitments giving a preferential access to bananas produced in ACP countries, under the Lomé IV Convention, had to be honored. Finally, contradictory interests of EU regional suppliers and EU consumers had to be considered.

The original Common Market Organization for Bananas (CMOB) is laid down in Council Regulation (EEC) 404/93 of 13 February 1993. Extensive delay in drafting the necessary legislation meant that the new CMOB became effective only on 1 July 1993. Provisions of the original CMOB are summarized in table 2.

Trade provisions of the 1993 regime allowed traditional ACP bananas to enter the EU duty free up to 857,000 metric tons. Specific quotas for individual ACP countries were given in the annex to the Council Regulation. Bananas from third countries (i.e., mainly Dollar bananas and non-traditional ACP bananas, the latter meaning any amount of ACP imports beyond traditional levels) were subject to a levy of 100 green ECU per ton (non-traditional ACP bananas being exempt) within a Most Favored Nation (MFN) tariff quota of 2 million tons in 1993. Over-quota tariffs were 750 green ECU per ton for non-traditional ACP bananas and 850 green ECU per ton for other countries.

The MFN tariff quota was managed through a system of import certificates with 66.5% allocated to operators who marketed Dollar and non-traditional ACP bananas between 1989 and 1991 (category A operators), 30% to operators who marketed EU or traditional ACP bananas between 1989 and 1991 (category B operators) and 3.5% to newcomers (category C operators). The allocation of import licenses within the categories A and B was further regulated according to marketing activities along the distribution channel with 57% of import licenses allocated to primary importers (activity group a), 15% to secondary importers (activity group b) and 28% to ripeners (activity group c).

Finally, EU producers were guaranteed a minimum income through a deficiency payment of up to 854,000 tons. Specific quotas for individual EU territories were given in the Council Regulation.

Table 2. Banana II regime: the original CMOB (July 1993)

Categories of bananas	Provisions	Allocation of licenses
Traditional ACP	Quota: 857,000 tons Tariff: 0	Specific quotas for individual ACP countries
Dollar and non-traditional ACP	Quota: 2 million tons Tariff: 100 green ECU/ton, non-traditional ACP bananas exempt Over-quota tariffs: 750 green ECU/ton for non-traditional ACP; 850 green ECU/ton for other bananas	Category A: 66.5% Category B: 30% Category C: 3.5% Category A and B: operator a: 57%; operator b: 15%; operator c: 28%
EU	"Quota": 854,000 tons Deficiency payment	Specific "quotas" for individual EU territories

It is clear from table 2 that, with the original CMOB, the primary intention of the EU was to preserve the position of preferred suppliers. In addition to the whole quota system, aimed at protecting EU production, preserving ACP imports and limiting third country imports, two key elements of the system of license allocation among suppliers support this view. Firstly, within both traditional ACP and EU quotas, individual ACP countries and EU producing territories were granted specific quotas, ensuring them individual access to the EU banana market. Secondly, within the MFN tariff quota, traditional shippers of ACP and EU bananas (category B operators) were allocated with 30% of the import licenses, with the clear intent that the "extra" profits they could earn by shipping dollar zone bananas or selling import licenses to dollar zone shippers should be used to cross-subsidize their ACP or EU operations (Swinbank, 1996).

It is worth noted that this is this attempt of the EU to preserve the position of ACP countries on its banana market, which has been at the core of the GATT/WTO banana conflict. And all the changes to the original CMOB adopted by the EU in response to the requests of the successive GATT/WTO panels have resulted in eroding the whole ACP preferential access in favor of other third supplying countries (mainly Latin American countries).

2.3. The first GATT complaints

The first GATT panel (June 1993)

The first GATT complaint against the EU banana regime was made in February 1993, prior to the implementation of the original CMOB. A formal complaint was made by five Latin American producing countries (Colombia, Costa Rica, Guatemala, Nicaragua and Venezuela), with the support of the United States (US). As the original CMOB was not yet finalized and implemented, the complaint could only focus on the EU regime currently in force, that is the pre-CMOB regime which life had been extended on to the 30 June 1993.

The complaint raised two main points. On the one hand, it was argued that the preferential tariff was in contravention with GATT rules since it discriminated between imports from the ACP States and other developing countries (subject to the 20% common external tariff). On the other hand, the specific national quotas applied by some Member States were considered by plaintiffs, as contrary to the GATT rules on the use of discriminatory tariff quotas.

In its findings published on 3 June 1993, the GATT panel found that the EU's preferential tariff was covered by the annual derogation from the GATT, known as the Lomé Waiver. On the second point however, the GATT panel considered that the Lomé Waiver did not give the EU the right to use discriminatory tariff quotas. Hence, the GATT panel concluded that these tariff quotas should be brought into conformity with the GATT rules.

As noted by Read (2001), the weakness of the GATT dispute settlement procedure and the lack of enforceability of a panel decision, given the need for unanimity, implied that the EU was able to veto the verdict and ignore the adverse ruling.

The second GATT panel (February 1994)

The same five Latin American countries requested for a second GATT panel, once the original CMOB came into force in July 1993. This second complaint still focused on the discriminatory nature of the new EU tariff quota system while it added the point of the system of distribution of import licenses among banana suppliers.

This second GATT panel concluded on 11 January 1994 that regulation 404/03 was inconsistent with GATT rules because the new tariff quota system was excessively restrictive while the new licensing system unfairly restricted market access to some suppliers and was not covered by the Lomé Waiver (Read, 2001).

Once again, the EU was able to block the implementation of the panel's ruling. Meanwhile however, the Uruguay Round negotiations had made progress and the WTO's dispute settlement procedures had been strengthened. Given the adverse conclusions of the second GATT panel, the original CMOB became vulnerable to a WTO complaint.

2.4. The Framework Agreement on Bananas (December 1994)

In the context of the Uruguay Round discussions, the EU pursued negotiations with four of the original Latin American plaintiffs. In March 1994, Colombia, Costa Rica, Nicaragua and Venezuela accepted the so-called Framework Agreement on Bananas (FAB). By the terms of the FAB, the EU pledged to increase the size of the tariff quota to Dollar and non-traditional ACP bananas and to incorporate, within this general quota, specific national quotas for the four plaintiffs. In exchange, the four Latin American countries agreed to forego further action against the EU under the GATT/WTO during the life of the banana regime.

The FAB is laid down in Council Regulation (EEC) 3290/94 of 22 December 1994. Its main provisions are summarized in table 3. Specifically, the FAB expanded the MFN tariff quota level to 2.2 million tons and decreased the within-quota tariff rate to 75 commercial ECU per ton.¹ Part of the tariff quota (49.3%) was divided up into country-specific quota shares allocated to the four Latin American countries, Costa Rica receiving 23.4%, Colombia 21%, Nicaragua 3% and Venezuela 2%. Furthermore these four countries were allowed to issue export certificates for up to 70% of their specific quota with the clear objective to alter the distribution of the MFN tariff quota rent in their favor. Within the remaining 51.6%, 90,000 tons were reserved for the Dominican Republic (55,000 tons), Belize (15,000 tons), Ivory Coast (7,500 tons), Cameroon (7,500 tons) and other countries (5,000 tons).

Table 3. Banana III regime: the Framework Agreement on Bananas (December 1994)

Categories of bananas	Provisions	Allocation of licenses
Traditional ACP	Quota: 857,000 tons Tariff: 0	Specific quotas for individual ACP countries
Dollar and non-traditional ACP	Quota: 2.2 million tons Tariff: 75 commercial ECU/ton Tariff: 0 for non-traditional ACP bananas up to 90,000 tons Over-quota tariffs: 750 commercial ECU/ton for non-traditional ACP; 850 commercial ECU/ton for other bananas	49.4%: Costa Rica (23.4), Colombia (21%), Nicaragua (3%), Venezuela (2%) 50.6%: other third countries including 90,000 tons reserved for non-traditional ACP bananas: Dominican Republic (55,000), Belize (15,000), Ivory Coast (7,500), Cameroon (7,500) and other countries (5,000) Category A: 66.5% Category B: 30% Category C: 3.5% Category A and B: operator a: 57%; operator b: 15%; operator c: 28%
EU	"Quota": 854,000 tons Deficiency payment	Specific "quotas" for individual EU territories

One immediate consequence of the FAB relative to the 1993 regulation was to reduce the "advantages" and the EU market share reserved to traditional ACP countries (Guyomard et al., 1999a). Another important consequence of the FAB was that by introducing discrimination between non-ACP

¹ On 1 January 1995, the MFN tariff quota was increased up to 2.553 million tons following the enlargement of the EU to Austria, Finland and Sweden.

suppliers, it satisfied some third countries but strongly dissatisfied the others. Hence, as noted by Josling (2003), the FAB became the target for much of the complaint by other Latin American countries and made a solution much more complex.

2.5. The WTO complaint (September 1995 and February 1996)

A new dispute settlement procedure was initiated by the US, supported by Guatemala, Honduras and Mexico, in September 1995. Ecuador joined them in February 1996, after its WTO accession. This third complaint against the EU banana regime differed from the two previous ones in two main respects. Firstly it was the first one which subjected the EU banana regime to the discipline of the WTO procedures, including its new and more effective dispute settlement procedures (Read, 2001).² Secondly, it was the first complaint the US participated to as the main plaintiff.³

The five complainants mainly challenged the conformity with WTO rules of the category B import certificates and of the system of calculating reference quantities. The WTO Appellate Body (AB) issued its report in September 1997. It upheld some findings of the panel report issued in May 1997, i.e., the licensing system, the activity function rules (allocation of import certificates to primary importers, secondary importers and ripeners) and several aspects of the FAB considered inconsistent with non discrimination and national treatment provisions of the GATT and of the General Agreement on Tariffs and Services (GATS). Contrary to the panel, the AB concluded that the Lomé Waiver did not cover Article XIII of the GATT on the allocation and management of tariff quotas. However it also indicated that the EU could provide tariff preferences for traditional and non-traditional ACP exports covered by the Lomé Waiver. Finally it did not rule out the size of the tariff quota as bound in the Uruguay Round Agreement (2.2 millions tons for the 12-EU) and the income support scheme to EU domestic producers. The deadline for amending the regime was the 1 January 1999.

2.6. The 1998 reform of the CMOB (July 1998) and the subsequent evolution

The 1998 reform of the CMOB

The 1998 reform of the CMOB is laid down in Council Regulations (EC) 1637/98 of 28 July 1998 and 2362/98 of 28 October 1998. Although the licensing system was significantly reformed with now only

² As noted by Clark (2002), with the "automaticity" procedure, a reverse consensus system under which panel rulings would take effect automatically unless rejected by a consensus of WTO members, "blocking" became effectively prevented because non single state, or bloc of States, could keep a panel report from being implemented.

³ According to some authors (e. g., Read, 2001; Josling, 2003; Taylor, 2003), this significant change in the policy stance of the US was precipitated by the shortcomings of Chiquita, the leading US banana firm, in dealing with the impact of the CMOB. In anticipating the single EU banana market, "Chiquita's European supply strategy was switched towards concentrating on Latin American Dollar area imports" (Read, 2001, pp. 269). The

two categories of operators defined on the basis of imports during the reference period 1994-96 (traditional and new market participants), the regime remained under heavy political pressure. Many plaintiff countries considered that proposed changes were not sufficient and that the reformed CMOB remained non-compliant with WTO rules.

The arbitration panel (January 1999)

Then, the WTO dispute moved on to an Arbitration panel, which confirmed that the new 1998 EU banana trade regime was not WTO-compliant. The decision of the Arbitration panel was published on April 1999. The Arbitration panel found that the new 1998 EU banana regime did not comply with WTO rules in three respects. First the preferential import rights for bananas from the ACP countries continued to constitute discrimination against other WTO members and were larger than the EU was allowed to grant to the ACP countries under the exemptions permitted by the WTO. Second the distribution of the tariff quota among supplier countries in Latin America was based on out-of-date and non-representative reference quantities. Third the distribution of import licenses was still based on the old, discriminatory system.

The Arbitration panel also stated that both the US and Ecuador had the right to impose sanctions against the EU totaling, respectively, to \$US 191.4 million and 201.6 million annually (which is far less than the originally \$US 520 million requested by the US and 450 million requested by Ecuador).

2.7. The 2001 reform of the CMOB: A two-step approach (May 2001)

On 10 November 1999, the EU proposed to modify, one more time, the CMOB. The proposal followed a two-step approach by defining a transitional tariff-quota system in a first stage and a tariff-only system in a second stage. The latter would enter into force no later than 1 January 2006. According to the European Commission, the proposal would allow “establishment of a more viable and stable banana import system that is fully compatible with WTO rules.” (European Commission, Directorate-general of Agriculture, Newsletter n° 17 of November 1999). As many important issues remained to be clarified, the European Commission invited “all interested parties to examine its proposal in order to continue consultations resulting in a satisfactory compromise.” (European Commission, Directorate-general of Agriculture, Newsletter n° 17 of November 1999). A new proposal was presented by the European Commission on 4 October 2000. It followed the main thrust of the November 1999 document and proposed to manage access to tariff-rate quotas on a First-Come, First-Served (FCFS) basis (European Commission, Directorate-general of Agriculture, Newsletter n° 28 of November 2000). This new revision of the EU banana import regime was still considered by

implementation of the CMOB thus had a negative impact on Chiquita's EU market share (cf. table XXX in the concluding section).

some interested parties as not having fulfilled the ruling of the Dispute Settlement Body. The US and some Latin American producing countries in particular opposed to the FCFS system by considering it were not WTO consistent. More prosaically, these opponents estimated that the new policy ignored the dominant position they had before the CMOB was implemented in 1993.

On 2 May 2001, the EU adopted a regulation to implement a new banana import regime in line with understandings arrived at with the US on 11 April 2001 and with Ecuador on 30 April 2001 (WTO, 2001). The new import regime is laid down in Commission Regulation (EC) 896/2001 of 8 May 2001. It continues to follow the main thrust of proposals presented in November 1999 and October 2000. However it supersedes the October 2000 approach for the management of the tariff-rate quotas on a FCFS basis. Under the 2001 agreement reached with both the US and Ecuador, the tariff-rate quotas will be managed on the basis of historical references. For its part, the US agreed to lift the punitive tariffs it had placed on certain European imports as a result of the long-running dispute over bananas.

The new banana import regime in the EU is a two-step process towards a tariff-only regime that should enter into force no later than 1 January 2006 in replacement of a transitional tariff-rate quota system effective from 1 July 2001. Table 4 gives an overview of the new trade regime.⁴

The Transitional Tariff-Rate Quota Regime

Each year from 1 January 2002, three tariff-rate quotas will be open, i.e., a bound tariff-rate quota of 2,200,000 tons net weight (quota A), an additional tariff-rate quota of 453,000 tons net weight (quota B) and an autonomous tariff-rate quota of 750,000 tons net weight (quota C). The tariff-rate quotas A and B will be managed as one (quota A/B) and will be open for imports of bananas originating in all third countries. The tariff applied to imports within the quota A/B will be 75 Euros per ton with a tariff preference of 75 Euros per ton granted to ACP bananas. The tariff-rate quota C will be open for imports of bananas originating in ACP countries. Imports under the quota C will enter the EU market at a zero duty.⁵

The import license system will still be managed on the basis of historical references. For the quota A/B, 83 percent of licenses will be allocated to traditional operators and 17 percent to non-traditional operators. For the quota C, 89 percent of licenses will be allocated to traditional operators and 11

⁴ We do not describe phase 1 of the transitional regime which applied from 1 July 2001 to 1 January 2002. Relative to phase 2, main differences concerned the sizes of the tariff-rate quota B (353,000 tons in phase 1 and 453,000 tons in phase 2) and of the tariff-rate quota C (850,000 tons in phase 1 and 750,000 tons in phase 2).

⁵ At the Fourth Ministerial Meeting in Doha in November 2001, waivers were granted regarding obligations under GATT Article I (permitting continued tariff preference for ACP imports) and Article XII (permitting the reservation of the quota C to ACP producers).

percent to non-traditional operators (Official Journal of the European Communities, 2002). However the definition of traditional and non-traditional operators has changed relative to previous regulations.

Traditional operators are now economic agents established in the EU who have purchased a minimum quantity of bananas (250 tons) originating in third countries. Traditional operators A/B are traditional operators who have carried out the minimum quantity of imports of third-country and/or non-traditional ACP bananas, while traditional operators C are traditional operators who have carried out the minimum quantity of imports of traditional ACP bananas. Non-traditional operators are economic agents established in the EU who have been engaged in the commercial activity of importing bananas into the EU for a declared customs value of at least 1.2 million Euros, and who do not have a reference quantity as a traditional operator under the tariff quota for which they are applying for registration. For each category of operators, import licenses are allocated on the basis of historical references. For a traditional operator A/B for example, licenses will be distributed through 31 December 2003 on the basis of the average of imports during 1994, 1995 and 1996 taken into account in 1998 for the purposes of administering the tariff quota for imports of third-country and non-traditional ACP bananas. Thereafter, the share of import licenses will be allocated based on usage of licenses issued since 1 January 2002.

The Tariff-Only Regime

The tariff-only regime will replace the transitional tariff-rate quota system from 1 January 2006. The rate of the tariff has still to be negotiated. It will be defined to provide a level of protection and trade as close as possible to the system of tariff-rate quotas of the transitional period.

Table 4. Banana V regime: The new banana trade regime in the European Union (May 2001)

Transitional tariff-rate quota regime (phase 2 from 1 January 2002)

Tariff-rate quota (TRQ) system with three quotas:

A bound TRQ A of 2,200,000 tons net weight

An additional TRQ B of 453,000 tons net weight

An autonomous TRQ C of 750,000 tons net weight

TRQ management:

Quotas A and B managed as one (quota A/B) and open to all suppliers

Quota C reserved to ACP suppliers

Historical references (1994-96 through 31 December 2003)

Quota A/B: 83 percent of licenses to traditional operators and 17 percent to non-traditional operators

Quota C: 89 percent of licenses to traditional operators and 11 percent to non-traditional operators

Tariffs:

Quota A/B: 75 Euros per ton for non-ACP countries and 0 for ACP countries

Quota C: 0 for ACP countries

Over-quotas: 680 Euros per ton for non-ACP countries and 380 Euros per ton for ACP countries (tariff preference of 300 Euros per ton for ACP countries)

Tariff-only system (from 1 January 2006)

Tariff rate still to be negotiated

WTO, WT/DS27/58, 2 July 2001; Commission Regulation (EC) 896/2001 of 7 May 2001; Council Regulation (EC) 2587/2001 of 19 December 2001; Commission Regulation (EC) 349/2002 of 25 February 2002; FruiTrop, various issues.

3. Quantitative assessment of the transitional tariff-rate quota system

The effects of the tariff-rate quota system are analyzed on the basis of simulations carried out with a partial equilibrium model of the world banana market. We briefly present the model and then simulation results.⁶

3.1. Model Outline

The model consists of constant-elasticity demand (import) and supply (export) equations. Transportation costs and constant-margin equations link CIF import prices in importing zones and FOB export prices in exporting zones. Market-clearing equations guarantee the supply-demand equilibrium in "relevant" markets. The number of market-clearing equations closely depends on the

⁶ The model is detailed in Guyomard et al. (1999a, 1999b). The current version of the model includes a larger number of exporting zones (decomposition of LA and ACP zones), as well as time shifters in supply and demand equations.

EU import policy. If EU imports from non-preferred suppliers are constrained, as it will be the case in the transitional tariff-rate quota regime (see below), two market-clearing equations have to be specified, one equation for the EU market to determine CIF prices in the EU as well as FOB prices in EU territories and ACP countries, and one equation for the Rest of the world (ROW) to determine CIF and FOB prices on ROW import and export markets. Volume and value of bilateral trade flows (i.e., imports of purchaser *i* from exporter *j* and exports of supplier *j* to importer *i*) are based on EUROSTAT (COMEXT) and FAO (FAOSTAT) data. CIF and FOB unit values are derived from volume and value data. Base period data used for model initialization and calibration correspond to the 1996-98 average.

Supply (export) and demand (import) functions include time shifters. Growth trends of supply and demand were estimated from data over the past fifteen years. These growth trends were then separated from price-trend impacts assuming independence of price and time effects. This assumption implies that policy changes have no effect on the magnitude of supply and demand shifters. This is certainly restrictive, in particular because technical change in supply equations is then constrained to be purely deterministic without taking into account the possibility of price-induced innovations. A similar procedure was adopted in the “Newcastle” (Thompson, 1984) and MISS (Guyomard et al., 1991) models of the Common Agricultural Policy (CAP).

3.2. The simulated impacts on the EU banana import structure

Analysis with the model shows that both the quota A/B of 2.653 million tons and the quota C of 750,000 tons would be constraining in 2005. It also shows that the tariff preference of 75 Euros per ton would be insufficient to allow ACP bananas to compete with non-ACP bananas within the quota A/B. As a result, the quota A/B would be filled with non-ACP banana imports only. Over-quota tariffs would be prohibitive and over-quota imports would be zero. Once the quota A/B is filled, it would be more profitable for non-ACP country suppliers to export to ROW markets than to incur the over-quota tariff applied on non-ACP banana imports.⁷

Table 5 presents the structure of the EU banana import market in 2005. EU imports from non-ACP countries would be equal to the binding level of the quota A/B (2.653 million tons). This represents an increase of 239,400 tons (9.9 percent) with respect to 1996-98 (2.414 million tons). The fill rate of the quota C would be 100 percent. EU imports from ACP countries would be equal to 760,523 tons, an

⁷ The quota C was open to all suppliers in phase 1 of the transitional tariff-rate quota regime. This is no longer the case in phase 2 where it is reserved to ACP suppliers. But even in phase 1, the quota C tariff of 300 Euros per ton applied on non-ACP bananas would be too high to allow non-ACP banana imports within the quota C.

increase of 59,052 tons (8.4 percent) with respect to 1996-98 (701,471 tons).⁸ Supplies of EU territories would be equal to 797,090 tons, an increase of 6.2 percent relative to 1996-98 (750,671 tons). ACP country exports to the EU would represent 18.1 percent of EU consumption in 2005, the same share than in 1996-98. Exports of non-ACP countries and EU territories would represent 63.0 and 18.9 percent, respectively, of EU consumption in 2005. Table 5 shows that EU imports from ACP countries and EU territories would be close to import levels observed in 2000. As a result, the increase in EU consumption between 2000 and 2005 (from 4.067 million tons to 4.210 million tons) would mainly benefit non-preferred country suppliers. Their exports would increase by 125,000 tons over the five-year period 2000-2005.

Table 5. The Structure of the EU Banana Import Market in 2005 (Quantities in Tons)

	1996-98 (1)	1999 (2)	2000 (3)	2005 (4)
EU territories	750,671 [19.4]	730,000 [18.6]	782,176 [19.2]	797,090 [18.9]
ACP countries (5)	701,471 [18.1]	678,000 [17.3]	756,808 [18.6]	760,523 [18.1]
Other countries	2,413,603 [62.4]	2,513,000 [64.1]	2,528,172 [62.2]	2,653,000 [63.0]
Total	3,865,745 [100]	3,921,00 [100]	4,067,156 [100]	4,210,613 [100]

(1) Base period data. (2) Source: ODEADOM (2001) and FAO (2001a). (3) Source: FruiTrop, October 2001. (4) Simulation results. (5) In 2005, ACP country exports to the EU are slightly greater than the quota C level of 750,000 tons (10,500 tons). There is no significant change in the results if ACP country exports to the EU are constrained to be strictly equal to the quota C level.

Table 6 shows that distribution of export changes would vary significantly among ACP countries. Exports from Ivory Coast and Cameroon to the EU would increase by 22.0 percent (from 168,410 tons in 1996-98 to 205,466 tons in 2005) and 17.0 percent (from 146,490 tons in 1996-98 to 171,374 tons in 2005), respectively. By contrast, exports from the Windward Islands and Jamaica to the EU would decrease by 5.7 percent (from 230,953 tons in 1996-98 to 217,802 tons in 2005). Table 6 also shows distribution of world export changes among Latin American (LA) countries. Ecuador would export 4.841 million tons in 2005, i.e., about 793,000 tons (19.6 percent) more than in the base period 1996-98. The world's largest exporter would profit from an increased access to the EU market thanks to a quota A/B level set a 2.653 million tons as well as an increased demand in ROW markets, in particular

⁸ ACP country exports to the EU would be slightly greater than the quota C level of 750,000 tons in 2005 (10,500 tons). There is no significant change in the results if ACP country exports are constrained to be strictly equal to the quota C level.

in the US. Exports from other Central American (CA) countries would increase by about 7.6 percent for Costa Rica and Guatemala, and 12 percent for Panama and Honduras (with respect to 1996-98).

Table 6. World banana exports of ACP and LA countries in 2005 (quantities in tonnes)

	1996-98 (1)	2005 (2)
Total ACP countries	701,471	760,523
- Ivory Coast	168,410	205,466
- Cameroon	146,490	171,374
- Windward Islands and Jamaica	230,953	217,802
- Other traditional ACP countries	96,956	100,717
- Non-traditional ACP countries	58,662	65,165
Total LA countries	10,081,782	11,566,320
- Ecuador	4,048,000	4,840,573
- Costa Rica	1,956,000	2,104,571
- Colombia	1,451,000	1,623,884
- Panama	566,000	633,438
- Guatemala	688,000	740,258
- Honduras	545,000	609,936
- Other LA countries	827,782	1,013,660

(1) Base period data. (2) Simulation results.

3.3. Quota A/B rent and tariff equivalent

The transitional tariff-rate quota regime would lead the average CIF price in the EU to decrease by about 33 Euros per ton, from 593 Euros in 1996-98 to 560 Euros in 2005. It would lead the average FOB price in dollar zone countries to decrease by about 20 US Dollars per ton, from 292 US Dollars in 1996-98 to 272 US Dollars in 2005. As a result, the quota rent on EU banana imports from the dollar zone would decrease by about 57 Euros per ton, from 239 Euros in 1996-98 to 182 Euros in 2005.⁹

⁹ The quota rent on EU banana imports from the dollar zone is calculated as follows: Average CIF price in the EU, minus transportation costs between the EU import market and the dollar export zone, minus average commercial margins, minus average FOB price in the dollar zone. It is worthwhile to remember that the EU import market clears in Euros while the ROW market clears (to a large extent) in US Dollars.

Table 7 illustrates the sensitivity of the quota A/B rent to policy parameters and/or exogenous variables. The benchmark experiment corresponds to the simulation of the transitional tariff-rate quota system which results have been described previously. Experiment 1 aims at illustrating the sensitivity of the rent to the Euro/US Dollar exchange rate. Results of this experiment suggest that the quota rent decrease of 57 Euros per ton observed in the benchmark experiment is mainly due to the change in the Euro/US Dollar exchange rate that was assumed to occur between 1996-98 and 2005. In the benchmark simulation, the Euro is assumed to strengthen vis-à-vis the US Dollar over the medium term, from a parity of 0.85 in 1996-98 (0.85 Euro = 1 US Dollar) to a parity of 1 in 2005 (1 Euro = 1 US Dollar). In experiment 1, the Euro/US Dollar exchange rate is assumed unchanged at the 1996-98 parity. In that case, the quota rent in 2005 would be equal to 227.4 Euros per ton and the quota rent decrease would thus be limited to about 12 Euros per ton relative to 1996-98. Starting from experiment 1, experiment 2 shows that an exogenous increase (i.e., not induced by price effects) in EU demand would lead the quota rent to increase (a doubling of EU demand shifters would increase the rent by about 31 Euros per ton in 2005, other things being equal). In the same way, starting from experiment 2, experiment 3 shows that an exogenous increase in dollar zone supply would lead the quota rent to increase (if annual supply shifters in percent are increased by 2 points in dollar zone countries, the quota rent would increase by about 12 Euros per ton, other things being equal).

According to Table 7, a tariff of about 182 Euros per ton with a tariff preference of the same amount granted to ACP bananas would be “equivalent” to the transitional tariff-rate quota system in 2006. A tariff equivalent of that order of magnitude would keep the average CIF price in the EU at its 2005 level, and it would leave dollar zone exports to the EU as those from ACP countries largely unaffected in 2006 (relative to 2005). Of course, this result is contingent upon parameter choice and policy assumptions adopted in the simulation exercise. In particular, a tariff of that order of magnitude would be underestimated (i.e., less than “equivalent”) if the Euro weakens vis-à-vis the US Dollar, if productivity gains are larger in dollar zone countries and if demand shifters are higher in EU member states. Furthermore, the “equivalence” applies strictly for the year 2006 alone. As autonomous productivity and production increases are likely to be greater in the dollar zone than in ACP countries, in particular the Windward Islands and Jamaica, the tariff equivalent would have to be gradually increased to permit ACP country suppliers to maintain a long-term EU market share comparable to that of 2005 (other things being equal, in particular without reflux of tariff revenues to ACP producers).

The analysis incorporates certain simplifying assumptions and the empirical results are subject to several caveats. In particular, a pertinent and complete analysis of the quota A/B rent issue does need

careful modeling of all the operators involved in the banana industry and of all the aspects of the market structure, including operator strategies and expectations. These aspects have to be correctly represented and modeled to obtain consistent estimates of the rent sharing.¹⁰ Unfortunately no data are available to perform such a modeling exercise since only country data exist. This is a particularly important point because the new licensing import scheme in the transitional tariff-rate quota regime remains, to a large extent, a system of company quotas.

Table 7. Sensitivity of the quota A/B rent to policy parameters and/or exogenous variables

	Quota A/B rent in 2005 (Euros per tonne)
Benchmark experiment	182.1
Sensitivity experiments:	
Experiment 1: Euro/US Dollar exchange rate unchanged at 0.85	227.4
Experiment 2: (1) + increase in EU autonomous demand shifters	258.3
Experiment 3: (2) + increase in dollar zone exogenous supply shifters	270.0

The benchmark experiment assumes that the Euro/US Dollar exchange rate increases from 0.85 in 1996-96 to 1 in 2005. Experiment (1) assumes this exchange rate remains unchanged over the simulation period. Experiment (2) assumes in addition to (1) that demand shifters (in percent) in the EU are multiplied by 2. Experiment (3) assumes in addition to (2) that annual supply shifters (in percent) in the dollar zone are increased by 2 points.

4. Final Comments

From a country point a view, the transitional import regime in the EU may largely be viewed as a continuation of a managed market with two tariff-rate quotas and an import licensing system based on past trade. The choice of the 1994-96 reference period does not take into account the dynamic changes and investments that have taken place since that period by many operators. From Table 8 and despite many uncertainties about data, it clearly appears that the EU and world market shares of one multinational company, Chiquita Brands International, have substantially decreased since 1992 while Dole Food Company has significantly increased its EU and world market shares. Causes of market share changes are difficult to evaluate. They may reflect variations in investment activities but may also be attributed to other factors, e.g., outbreaks of banana disease, bad weather, strikes by workers and shipping and operating disruptions. Furthermore, taking 1992 as a reference point may be

¹⁰ Three multinational firms account for about 70 percent of the world import-export banana market and most national markets in the EU are dominated by a small number of firms/operators, including these three multinational firms. This suggests that the perfect competition assumption is questionable (McCorriston, 2000). However, this does not imply automatically that the world banana import-export market is not competitive. Hermann and Sexton (1999) have shown that the German banana market cannot be characterized by the exercise of market power despite the very low number of firms that compete in that market (the four-firm concentration ratio is greater than 80 percent for Germany).

somewhat misleading insofar as banana exporters from the dollar zone began to increase their shipments to the EU in the years immediately preceding the original 1993 CMOB, in anticipation of the new trade regime to come. The fact remains that the transitional tariff-rate quota regime gives Chiquita Brands International a significant advantage by allocating it a “fixed” EU market share much greater than its current share.

Table 8. World and EU market shares of banana companies

	Market shares (in percent)							
	World				European Union			
	1992 (1)	1992 (2)	1998 (1)	1997 (2)	1992 (1)	1992 (2)	1998 (1)	1997 (2)
Chiquita	34	34	26	24-25	> 30	> 30	< 20	15-16
Dole	20	20	25	25-26	12	12	16	18-19
Del Monte	3	15	8	16	5	7-8	16	10-11
Fyffes	Na	2-3	8	6-7	Na	4-5	18	16-17
Noboa	7-8	Na	7-8	13	7-8	Na	7-8	Na

(1) Ledemé F. quoted in *FruiTrop*, October 1999. (2) Van de Kastele A., February 1998, from various sources. Na: Not available.

Since the original CMOB in 1993, EU producing regions have benefited from income support in the form of direct aids. The growth rate of EU territory supply was positive over the eight-year period 1993-2000, and it is likely that this favorable trend is a consequence of the income support scheme.¹¹ Lack of reliable data does not allow evaluation of the extent EU producing regions have used the income support scheme to reduce unit production costs and improve their cost competitiveness. Simulation results conclude that EU territory supply would expand during the transitional tariff-rate quota regime (Table 5). EU territories would supply 797,090 tons in 2005, about 46,000 tons more than in 1996-98, at a price 33 Euros lower than the 1996-98 average. Since we assumed that the effective price (FOB price per ton plus direct aid per ton) considered by EU producers remained unchanged at its 1996-98 level, this implies extra compensation of 24 million Euros in 2005 relative to 1996-98. This corresponds to an extra compensation of 30 Euros per ton of bananas.¹² On the other hand, EU producers would lose from the suppression of the category B of operators.

¹¹ However, it is worth noting that quantities supplied in 1991-92 (about 703,000 tons) were significantly higher than volumes marketed in the four first years of the CMOB (1993 to 1996).

¹² In 1996-98, the unit direct aid granted to EU producers was around 260 Euros per ton (three-year weighted average). It increased significantly in 1999 (297 Euros per ton) and 2000 (383 Euros per ton). This increase is essentially due to the increase in historical reference earnings used for compensation calculation (from 592.9 Euros per ton for the years 1993 to 1997 to 622.5 Euros per ton in 1998 and 640.3 Euros per ton in 1999 and

ACP exports to the EU remained below 857,000 tons, the size of the traditional ACP quota, over the eight-year period 1993-2000. However, distribution of changes varied substantially among ACP countries. While Cameroon and the Ivory Coast increased their production and exports, supply from the Caribbean producing countries decreased. In the case of the Windward Islands for example, exports decreased from 280,000 tons in 1992 to 131,000 tons in 1999. This decline has had devastating effects on the banana industry in these countries with a decrease in the number of active banana growers by 26 percent between 1992 and 1998. Since the modification of the CMOB in 1998, the traditional ACP quota was no longer allocated between ACP countries. This is still the case in the transitional tariff-rate quota regime. Our simulation results suggest that Caribbean country exports to the EU would continue to decline in the transitional tariff-rate regime (Table 6). Welcoming agreement reached in April 2001, both the EU and the US recognized that they had shared objectives, notably to protect the vulnerable ACP producers. It appears that it would be very difficult to reach this objective for the Caribbean country producers. By contrast, the transitional tariff-rate quota regime could benefit West African countries where production costs are lower and where some multinationals (Dole and Del Monte) now run large plantations. West African countries have welcomed the new EU import banana regime. However, the quota C level could limit their future exports to the EU. Furthermore, as their historical import rights are smaller than expected exports, licenses would have to be purchased to export additional bananas.

There are no certainties that the tariff-only regime will enter into force on 1 January 2006. The setting of the appropriate tariff is likely to be a point of considerable discussion until the deadline. The banana industry in ACP countries, notably in Caribbean states, is clearly at a competitive disadvantage with respect to LA suppliers. An EU policy that combines a simple tariff on dollar banana imports with direct aid to preferred suppliers presents several advantages relative to a multiple tariff-rate quota regime with cross-subsidization of non-preferred suppliers through allocation of import licenses within the preferred suppliers' quota. It reduces distortionary impacts and eliminates the quota rent problem. The acute dependence of many ACP countries upon the exports of bananas to the EU means that any change of the European policy is of crucial importance to these economies. However, as noted by van de Kastele (1998) in the case of the Windward Islands, "the need for diversification is repeatedly mentioned but given the conditions on the Islands, it is far from an easy task to find alternatives [to banana production] which guarantee reasonable income and employment levels."

Our simulation results show that many ACP producers will need some form of support in both the transitional tariff-rate quota system and the tariff-only regime to obtain viable returns. The higher the

2000). Preliminary estimates suggest that the unit direct aid should be substantially lower in 2001, between 230 and 280 Euros per ton (FruiTrop, March 2002), due to banana price increase on the EU market.

dollar zone import tariff in the tariff-only regime, the higher EU imports from ACP countries. However, the increase in EU imports from ACP countries will be more than offset by the decrease in EU imports from non-preferred country suppliers. As a result, the higher the dollar zone import tariff in the tariff-only regime, the higher the EU banana price and the lower total EU imports and consumption. This implies that the tariff should be set at a level sufficiently low to ensure supplying of the EU market at a reasonable price for EU consumers. This is in the interest of EU consumers and, obviously, non-preferred suppliers. EU territory producers would require extra compensation (in the form of increased direct aid) to maintain their returns. In the same way, ACP producers would need direct aid. The reflux of tariff revenues to ACP producers does pose legal problems, but they are likely not insurmountable. Part of the aid program should be targeted to modernize ACP country banana industries. However, it is more than likely that many ACP countries would have difficulties to improve significantly their cost competitiveness. This means that modernization and investment aid programs should be complemented by long-term income support schemes to maintain returns of ACP banana producers. This income support program should be differentiated among ACP countries and producers to take into account differences in production costs and conditions.

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