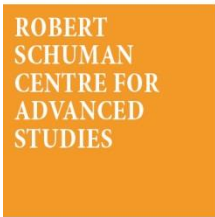




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Bananas, the longest transatlantic dispute in the World
Trading System: A post-mortem

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European University Institute
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Abstract

This paper revisits the celebrated conflict that lasted close to two decades and pitted the EU against the US and against MFN suppliers of bananas. This was a classic clash about the appropriation of large rents. The paper starts by recalling the major turning points in the dispute and argues that the EU-US conflict could largely be explained by the changing landscape on trade-policy making on both sides of the Atlantic. As to the EU-MFN grower dispute, as shown in the discussion of estimates put forth by the parties at conflict, it is largely explained by uncertainty on the distribution of quota rents and on the reluctance to use economic analysis in the panel decisions.

Keywords

Preferences, Tariff-rate quotas, bananas, political economy.

JEL: F11, F15

Bananas, the longest transatlantic dispute in the World Trading System: A post-mortem

«On a rarement vendu sous l'étiquette 'L'Europe Sociale' davantage de mensonges, de privilèges et d'injustices »

Patrick Messerlin,

«Mourir pour la Banane», Le Figaro, 19/9/1997

« Le cœur du conflit, exemplaire, reste que la production latino-américaine de la banane, outre des atouts physiques indéniables, trouve l'essentiel de sa compétitivité dans le niveau scandaleusement bas des salaires versés aux paysans, alors qu'aux Antilles les salaires versés sont au niveau du SMIC européen »

Michel Rocard

« Pour que Vive la Banane », Le Figaro 10/11/1997

1. Introduction*

After rice, wheat and maize, bananas are the world's fourth most important food crop. It is a staple food and a key export commodity for many low income countries. 'Bananas' was also the longest running dispute in the post WWII multilateral trading system. It started in 1991 when an MFN supplier, Costa Rica, expressed concerns that the EU's impending banana regime triggered by the Single Market Program would discriminate against Central American MFN suppliers. The ensuing unresolved disputes and claims (8 disputes and 5 claims according to W/T/L/784) took eighteen years to be brought to rest when in December 2009 agreement was reached calling for a progressive lowering of the (specific) import tariff on MFN bananas from 176€/ ton to 114€/ ton by 2017.

The banana case is interesting in several respects. First, it is a perfect textbook case of the economic effects of a tariff-rate quota (TRQ) regime as taught in the classroom since bananas is a homogenous product. Second, from the point of view of dispute settlement, while the functioning of the TRQ regime was not transparent, the agreed-upon decision on the move from a TRQ regime to a tariff-only (TO) regime was, in principle, easy to adjudicate as it was not hostage to litigation on interpretations about 'like product' litigation, or on technical barrier to trade. Third, the vagueness in the panel decisions, in the compromises among the parties and in the rules for tariffication all contributed to delays in reaching a denouement. Fourth, it is an interesting case of how the then two largest trading partners, the EU and the US, came to fight over a product that was not produced on either continent. Finally, straddling equally the GATT and WTO periods, the narrative of the dispute is a good example of the application of GATT rules of the progression in their application and in the progressively greater reliance on rules in resolving disputes.

In addition to a good illustration of the ascendancy of rules in trade conflicts between powerful and less powerful countries, the "banana split" in transatlantic trade relations is an interesting case study of how particularistic interests prevailed in the trade-policy decision-making in the EU and the US. As indicated by the above excerpts from an interchange in the Press between Patrick Messerlin and Michel Rocard (who had been Prime Minister at the time the TRQ regime was under elaboration), the debate was spirited. Not engaging in the debate would have been uncharacteristic of Patrick Messerlin who always stated his views with clarity and conviction.¹ It is therefore a pleasure to revisit this case now that the conflict was resolved.

* Revised version of a paper prepared for the conference "21st.Century Trade Policy, Back to the Past", Yale Center for the Study of Globalization", December 3,4 2011 I thank the FERDI for support and encouragement to write the paper. This paper draws on and summarizes Melo (2015).

¹ In the interchange, Michel Rocard cited Nobel prize winner Maurice Allais as espousing his views about the 'scandalously low' salaries in the Caribbean. Throughout the paper, I refer to the European countries as the EU even though it was initially the EC.

Section 2 provides some background on the sources of the dispute. Section 3 recounts the milestones in the conflict at the GATT and then at the WTO. Section 4 reviews the role of trade-policy decision-making in the EU and domestic politics in the US in shaping the transatlantic conflict until the launch of the Doha Round, at which time it had been resolved, then how the creation of the WTO contributed to the resolution of the settlement with the MFN suppliers. Sections 5 and 6 argue that greater reliance on straightforward economic analysis would have shortened the length of the conflict. Section 7 concludes.

2. The contours of the internal and external conflicts on the EU's banana's trade regime

I describe briefly the history of the conflict that proved so resistant to mediation within the EU, in transatlantic relations, and within the multilateral trading system (important dates and outcomes are summarized in table 1).² I start with some background, and then turn to the elaboration of the EU's banana's trade regime that was required by the formation of the Single European Market (SEM) in 1993.

2.1 Background

In the late 1980s, 75% of the world banana's exports originated from Latin America (Ecuador, Costa Rica, and Colombia, followed by Honduras, Mexico, Nicaragua, Panama, and Venezuela), all developing countries and henceforth the MFN suppliers. The EU consumed 40% of world's bananas, with 1/3 coming in equal proportion from MFN suppliers, EU overseas territories (Canary islands, Martinique, Guadeloupe) and from former British and French colonies (the ACP countries). The level of self-sufficiency in bananas in the EU was thus much lower than for most other agricultural products, including most fruits.

As to the Banana Trade Regime (BTR) in the EU, prior to the creation of the SEM, it was segmented, as Spain and France had overseas territories growing bananas (Martinique, Guadeloupe and Canaries) and, along with Britain had colonial ties with the ACP countries enshrined in the Lomé (1975) convention. Bananas originating from the African and Caribbean states were 'beneficiaries' of the Lomé 1975 convention. The legally binding article 1 of the banana protocol under that convention stated that:

"In respect of its banana exports to the markets of the Community, no ACP state will be placed, as regards to its traditional markets and its advantages on those markets, in a less favorable situation than in the past or at present".

When the SEM was put in place, cost disparities across suppliers were substantial, with high-cost producers (EU territories and the Windward Islands) over twice as high as those in Latin American suppliers.³

Before the start of the dispute, the banana market in the EU was segmented in three parts. The largest and most dynamic was the German market fueled by German reunification where bananas were imported freely. In the middle was the Hanseatic market (Benelux, Denmark, Sweden) that applied the 20% Common External Tariff (75€ per ton, the level that was bound in the Dillon Round). At the other extreme, France, Britain and Spain had closed markets: all of Spain's bananas came from the Canary Islands, half of those consumed in France came from the Caribbean (Martinique and Guadeloupe) and

² This section is taken from Melo (2015, section 2)

³ Throughout, the conflict was about "Cavendish" or dessert bananas. These are homogenous and are always packed in boxes of 17 kilos. During the conflict, per-ton costs (FOR or FOT) of the low-cost suppliers were between 150-200 \$/ ton while those of the Windward islands were 500\$/ton and in Martinique 700\$/ton (Vanzetti et al. 2004, and Borrell, 1999). Chiquita sourced its bananas from MFN suppliers, while Dole, the second largest seller in the EU market sourced largely from ACP producers.

the rest from Cameroon and Côte d'Ivoire. Three-quarters of bananas consumed in Britain came from the Caribbean, with over half from the Windward Islands (Dominica, Santa Lucia, Saint Vincent, and Grenadines).

The trade in bananas from the EU overseas territories and the Caribbean was dominated by two firms, Geest (British) and Fyffes (Irish). The MFN bananas were marketed by Chiquita, Dole, and Del Monte. Chiquita, which sourced its bananas in Latin America, had almost two-thirds of the world market, and accounted for 90% of the German market, which was the most open (with zero tariffs).

Moving to a SEM created two problems, an internal and an external one. Internally, with the single market where bananas circulate freely in the EU, if a tariff-only (TO) rate at approximately the CET rate had been adopted, then the commitment under article 1 of the Lomé convention would have been undermined and the EU producers would have been shut out. As described below, the solution that was adopted was to create a system of quotas that restricted entry of all non-ACP bananas at a level that would maintain the marginal EU producers in the market. The result was that the Germans then had to pay higher prices.⁴

Externally, the problem was that the Lomé convention contradicted the principle of non-discrimination (GATT article I). However, three caveats under the GATT allowed countries to discriminate against third parties: (i) the 'enabling clause' or 'special and Differential Treatment (SDT) adopted in 1979 in the GATT'; (ii) Under article XXIV when creating an FTA or a CU; (iii) Under article XXV, countries can agree to a waiver for any rules, i.e. can permit discrimination. As the Latin American MFN exporters were developing countries, SDT was excluded, and since option (ii) did not apply, this left only option (iii) as the justification for article I of the Lomé convention. Indeed, throughout the conflict, no country objected to granting a waiver from article I.

At the time of the conflict to be described shortly, the most important issue was the extent of rents and who was going to get them since there was no open market for quota licenses and these licenses were distributed by the EU to the major operators described above. At the time, the price differential between the US internal price where bananas entered duty-free and the EU internal price was fairly constant (Vanzetti et al. 2004, figure 3)). Since the SEM in 1993 meant that imported goods could be re-exported to other member states, a comparison of prices in a tariff-free market like the US where the (homogeneous) bananas entered duty-free and any market in the EU (France in table 1) gives an estimate of the rents up for capture. According to table 1, the price was between 40% and 60%. Taking the lower figure, this amounts to \$400 or €300 per ton at the \$/€ exchange rate (\$1.3=€1 in 2004). Since the same quality bananas were sold in both markets and shipment costs were sensibly the same, with a market of about 4000 ton per year, rents (including tariff revenues and rents to suppliers and marketers) were at least € 1.2 billion per year.⁵

⁴ The Treaty of Rome almost collapsed as West Germany, which had no colonies, insisted on being exempt from applying the 20% bound tariff on bananas negotiated under the Dillon Round. This was possible prior to the SEM as Article 113 allowed countries to have their own quotas and in effect their own trade policy. Thus, the Benelux and other North European countries applied the CET, while Germany imported bananas at zero tariff under a special protocol of the Treaty of Rome that permitted the right to unrestricted imports of bananas. Interestingly, Germany (supported by Belgium and the Netherlands) lost a case challenging the BTR adopted in July 1993 (see table 2) denying the direct effect of GATT provisions. When the GATT was replaced by the WTO with its enhanced power of dispute settlement, WTO decisions could no longer be rejected as they could under the GATT.

⁵ Several studies have calculated the rents accruing to license holders and the associated welfare costs to EU consumers of both the old BTR and the one adopted under the CMOB. Borrell (1999) estimated an annual welfare loss of \$2 billion per year of adopting the CMOB (an increase of 20% relative to the old regime) compared to free trade. Messerlin (2001) estimated a loss of ECU 582 million for 1990. Badinger et al. (2001) give estimates by categories of countries comparing the costs of the CMOB with the previous BTR regime based on trend projections. .

Table 1: Import and Retail Prices: US and France				
(Real US\$ per kilo)				
	USA		France	
	Import	Retail	Import	Retail
1990	0.66	1.19	1.19	1.41
1993	0.48	1.02	0.79	1.11
1998	0.46	1.01	0.73	1.72
2000	0.38	0.98	0.43	1.26
2001	0.50	0.96	0.51	1.40
2002	0.45	0.95	0.44	1.32

Source: Melo (2015, table 1) from FAO(2003, tab. 6)

2.2 Patching up the Common Organization of the Market for Bananas (COMB) Trade Regime

Because of the combination of a favorable climate, topography, soil and labor regulations in the Canary Islands, Guadeloupe and Martinique patterned on those in continental Europe, the creation of an open SEM would have had disastrous consequences for the banana industries in the French, former British Caribbean, and other EU territories. Representatives of these states and territories argued that climatic conditions prevented them from diversifying into other products and that the abolition of the prevailing BTR would lead to their economic ruin while politicians in EU countries with overseas banana production would face ‘political suicide’ if they abolished the BTR. Five years of negotiations in the EC led to the ‘Common Organization of the Market for Bananas’ (COMB), a hard-fought compromise that replaced the then prevailing BTR. This new regime was compatible with the requirements of the SEM and the obligations towards maintaining market share for ACP producers under the Lomé 1975 convention. As explained below, this compromise was entirely at the expense of MFN producers and the US sellers of MFN bananas in the EC.

Borell (1999) and others have argued that, on paper at least, the EU had several options that would have largely dominated the COMB. Besides establishing a single unified market, the most significant change of the COMB amounted to a new quota allocation scheme that would in effect result in the subsidies to inefficient ACP and EU suppliers being paid by MFN banana traders in the EU market (i.e. the US multinationals) in part because of the pressure on expenditures associated with the Common Agricultural Policy (CAP).⁶ In a series of studies summarized in his 1999 paper, Borrell estimated that a tariff of 17 percent would have sufficed. However, this option would not have been possible as EU budgetary law prohibits tariff revenues to be ear-marked for product-specific subsidies. Therefore the money for the subsidies for producers would have to be raised by EU finance ministers who, in the 1990s wanted to contain any rising costs in the Common Agricultural Policy. As to compensation for ACP States, as the WTO panels repeatedly confirmed, the “Lomé waiver” would have been GATT compatible. Yet, the CMOB was designed so that the burden of adjustment fell on banana traders of MFN suppliers.

The outcome under the COMB was exactly the opposite of the one predicted by the models of “interest-group” politics. As predicted by these models, by maintaining a high price, the CMOB passed the costs of protection to consumers. However, one would have expected that the MFN suppliers/operators would have obtained some of the rents. Initially, however, this was not the case (see tables 2 and 3) as all licenses were awarded to EU marketers (see section 4), an arrangement that

⁶ Under the COMB, banana suppliers were split under three quota categories with quotas going directly to established banana traders in the EC (see table 3) ACP suppliers were exempt from the tariff on their quota allocations. Traders of ACP bananas had to purchase the higher-priced ACP bananas to be able to sell their bananas in the EU market.

amounted to a ‘winner-takes-all’ outcome as EU traders and EU and ACP growers got all the benefits while growers and traders of dollar bananas got nothing.

3. The Conflict

Assembling the CMOB was a long process that lasted five years as a “qualified” majority was necessary in the EU since a “blocking minority” coalition of Hanseatic countries could have prevented the adoption of a new protectionist Banana Trade Regime (BTR). This explains why warnings surfaced at the GATT before the adoption of the CMOB. I start with a description of the conflict at the GATT, then turn to its evolution when the GATT was replaced by the WTO (for details of the chronology of the main events see Melo (2015, table II).

3.1 ... at the GATT

The conflict started when a group of banana producers expressed their concerns to the GATT council in 1991 as they anticipated that the new BTR would be unfavorable to them (“bananas I”). They hoped that these consultations would influence the design of the BTR prior to the conclusion of the Uruguay Round. Consultations failed so 5 GATT members requested a panel against the EU’s CMOB announced to be put in place in July 1993 (“Bananas II”). GATT-compatibility was objected to on three grounds, the most important being the allocation of quota licenses to companies (not to countries) that had traditionally traded EU and ACP bananas in the EU market. The ensuing “Banana Framework Agreement” (BFA) helped assuage Colombia, the largest MFN supplier that had no licenses accorded to it under the CMOB but not Guatemala who did not receive any licenses and hence refused to sign the BFA.

As the EU was failing to react to the panel decisions and Chiquita was not obtaining licenses, with the progressive capture of US trade policy decisions by interest-groups (see below), Chiquita obtained that the USTR file a 301 investigation against the EU.⁷ This was the first turning point since, regardless of the outcome at the GATT/WTO, the US had a credible threat to impose sanctions on EU imports, especially with the “carrousel” method which selected imports subject to sanctions on a rotation basis.

The last significant decision under the GATT was the waiver obtained by the EU in the last hours of the Uruguay Round negotiations in December 1994, waiver that allowed the continuation of the BFA until 2000 when the new Lomé IV convention had to be approved.

3.2 ...at the WTO

Thanks to the waiver granted at the conclusion of the Uruguay Round, the EU had until 2000 to make its banana policy GATT- compatible. Except for Ecuador, the important dollar suppliers were GATT members. Yet until the change from ‘consensus to accept’ to ‘consensus to reject’ with the creation of the WTO, it was still possible for EU policymakers or EU courts to reject GATT decisions and to ignore the GATT panel rulings, as evidenced by the decision of the European Court of Justice in 1994 which rejected the GATT panel ruling. This changed with the dispute settlement process at the WTO. Also, Ecuador, by far the dominant MFN supplier, had now joined the WTO. With the complaints now lodged under the Dispute Settlement Understanding (DSU), panel findings were acquiring traction.

⁷ Of course, in spite of the large campaign contributions by the banana traders to both Democrat and Republican parties, the then USTR denied any link between his decision and campaign contributions. In the late 1990s, Chiquita became the third largest contributor to political campaigns (Cadot and Webber (2002)).

In May 1997, a WTO panel ruled that the EU BFA violated GATT rules in three respects, ruling that was upheld by the Appellate Body in September 97 (“bananas III”). An important decision in the ruling indicating the move towards rule-based resolution of trade conflicts regarded the interpretation of the wording in the waiver from art. I. The wording referred to “preferential Treatment in general” and not to “Preferential tariff treatment”, but the panel concluded that the wording did not allow the EU to interpret its meaning as it wished, i.e. to decide on the allocation of quotas⁸. The panel also found that BFA countries were allowed to manage their own export certification system while non-BFA countries were not.

Importantly, the panel ruled against the 30% allocation from the MFN quota (857 KT; see table 2)) given to historical importers of the EU and traditional ACP bananas (the allocation under category B in table 2). This allocation was between 50 and 100 KT greater than the best-ever export volume prior to 1991. In sum, the decision required the EU to provide the same treatment to ACP and non-ACP suppliers in its quota allocations implying that it would not be allowed to cross-subsidize ACP bananas via the quota allocation mechanism. This meant that if the EU was to give legally quotas to the ACP on a basis other than in proportion to market shares in its BTR, it would need a waiver to art. XIII. This, in turn, would require a three-quarter support at the WTO (50% at the GATT).

A new banana regime announced by the EU in January 1999, failed once more to be WTO-compatible and the WTO granted the application of compensatory sanctions to Ecuador and to the US (“bananas IV” in entry 7). Most importantly, the panel granted Ecuador sanctions that could be applied on imports of services in recognition that sanctions on goods would not be sufficiently punitive. Even though in the end these sanctions were never applied (it would have been difficult to estimate damages in services), this was a landmark in the conflict and, more broadly, to those who wished to see the World Trading System moving towards becoming rule-oriented.

During the dispute settlement procedures under “banana IV”, the panel heard representations from third parties that included the Caribbean states. Among these, the Windward islands (Dominica, St. Lucia and St. Vincent) were high-cost producers depending heavily on exports of bananas at the then prevailing prices in the EU. The prosperity created by the TRQ led to bananas being called “green gold” in these vulnerable islands. The Caribbean Banana Exporting Association that represented 7% of the EU market rejected financial aid that would, according to them, amount to “subsidy idleness”. They wanted “to be traders not beggars”. They argued that moving to a TO regime would require at least a ten-year adjustment period to avoid the total collapse of the vulnerable Windward islands.⁹ With the adverse panel finding, it had become clear that the BTR would not be able to serve as development assistance to the ACP through cross-subsidization by MFN producers and traders.

Faced with the prospects of these sanctions, the EU consulted with the US and with the Colombia and Costa Rica, the major MFN exporters who had what they considered fair quota shares under the BTA. It was clear from “bananas IV” that a Tariff Only (TO) regime would be WTO-compatible and easier than the alternative requiring a waiver to art. XIII on the rules about quota allocation. While the EU would have envisaged moving to a TO regime, the ACP and Ecuador were satisfied with their quota shares based on a post-1993 reference period, and the US also preferred the maintenance of a TRQ, though one based on a pre-1991 period when Chiquita had a much larger share. The US also made it clear that it would not lift sanctions unless the new BTR was found to be WTO-compatible. The EU also found out that the two options about license-allocation methods (first-come-first-serve

⁸ Article XIII on the allocation of quotas stipulates that these should be on a proportional basis to all members with a ‘substantial interest’ –defined on the threshold of a 10% market share---. The panel found that quota allocations had been fair only for Colombia (21%) and Costa Rica (23%) but not to other suppliers with substantial interests. The EU was also found to be unfair in its allocation towards countries with ‘non-substantial’ interests.

⁹ This position was reflected in the report submitted by NERA Economic Consulting on behalf of Oxford Policy Management to DFID (see their TO equivalent estimates in table 3 below).

(FCFS) or by auction) other than the use of a historical reference period--where the US and Ecuador disagreed on the reference period-- had no support among the banana operators.

The EU was then in a difficult position. On the one side, it was faced with the desire by operators to keep the opacity of a TRQ where ‘obfuscation’—to use the description by Magee, Brock and Young (1978)—would allow them to keep rents unnoticed, and on the other side it was being held ‘hostage’ by MFN suppliers who would not grant the waiver on art.1 necessary for the approval of the Cotonou agreement that was to replace Lomé IV. With the prospect of a new round at Doha in sight, the EC finally reached an agreement with the US, then after further negotiations with Ecuador. Licenses were to be allocated on a historical basis (1994-6) with a reduction of 100KT licenses to the ACP. The EC also promised to implement a Tariff Only (TO) regime by January 1, 2006 in return for the promise by Ecuador and the US to suspend sanctions (entry 8).¹⁰ Table 2 shows the two steps that the EU was proposing to carry out during phase I between July 2001 and 2006 (the next steps were not specified).

At the Doha Ministerial where the agreement was formalized (entry 9), the Decision specified that:

“[...] any rebinding of the EC tariff on bananas under the relevant GATT Article XVIII procedures should result in at least maintaining total market access for MFN banana suppliers and its willingness to accept a multilateral control on the implementation of this commitment.”

Article XVIII stipulates that the country undertaking tariffication should consult with supplying countries and that if no agreement can be found, the latter may seek arbitration at the WTO. That the maintenance of market access for dollar banana exporters was a central aspect of the transition was further clarified in the Decision’s Annex, which stated that

“[...] if the rebinding would not result in at least maintaining total market access for MFN suppliers, the EC shall rectify the matter. [...] If the EC failed to rectify the matter, this waiver shall cease to apply to bananas upon entry into force of the new EC tariff regime.”

Note that market access was purposely left vague: was it in volume rather than in value terms, what was the choice of base years for calculations and, most importantly, was it applicable to all MFN suppliers rather than to individual MFN suppliers?¹¹

¹⁰ This agreement was to be formalized at the Doha Ministerial: it linked formally the EU’s pledge to move to a TO regime by 2006 with obtaining waivers from GATT Articles I (MFN) and XIII (how to apply non-discriminatory QRs) requested by the EU to cover special treatment for ACP countries under the Cotonou Convention as part of a transitional arrangement extending to 2007. Read (2004) states clearly the issues surrounding the waivers. He also points out that if the EC has not reached agreement with the MFN suppliers on market access, and it wanted to rebind its TRQ at a level above 75€ per ton, it would have to compensate the MFN suppliers. As pointed out by Read, even though the MFN suppliers could withdraw “substantially equivalent concessions”, it is unlikely it would have been a desirable outcome because the MFN countries would have had to impose such high tariffs on EU imports that they would have been substantially hurting themselves in the process. Furthermore since article XVIII on rebinding does not provide derogation from article I, compensatory concessions would have had to be applied to all countries.

¹¹ The WTO summed up Doha’s ministerial decision as follows:

“The Doha Ministerial decision essentially transformed a bilateral agreement into a binding multilateral commitment. In accordance with the terms of the April agreement, the US and Ecuador supported the EU’s waiver request.” (WTO, WT/MIN(01)/15).

Table 2: Transition from TRQ to TO regime

Event /Date	Quota type	Quantity (tons)	Tariff rate (€/ton)	Tariff type	ACP tariff preference
1993 COMB	ACP ^a	857KT	NO		
	A ^b	1.3MT	100 ECU		
	B ^c	600KT	100 ECU		
	C ^d	70	100 ECU		
	Out-of-quota (MFN)		850 ECU		
	Out-of-quota ACP & European ^e		750 ECU		
EU/US Phase 1 April Step 1 2001 (July 01)	A	2.2 MT	75	Bound	75
	B	353 KT	75	Aut.	75
	C	850 KT	300	Aut.	300
	Out-of-quota		680	Aut.	300
EU/US Phase 1 April Step 2 2001 (Jan. 02)	A	2.2 MT	75	Bound	75
	B	453 KT	75	Aut.	75
	C	750 KT	n.a.		n.a.
	Out-of-quota		680	Aut.	300

Source: Melo (2015, table 2).Elaboration on the basis of Messerlin (2001), Badinger et al. (2001, tables 1 and 2) and Vanzetti et al. (2004, table 1). One Ecu was approximately equivalent to one Euro. KT= 1000 kilos, MT= million tons.

During the period, all bananas were sold in-quota because the out-of-quota tariff was prohibitive. Quota B was created in 1995 to reflect the enlargement of the EU to include Austria, Finland and Sweden. Quotas A and B are managed as if they formed a single quota and are often referred to as quota A/B. Tariffs under quotas A are bound, Tariffs under quotas B and C are not bound

^a Traditional ACP (Cabo Verde, Cameroon, Côte d'Ivoire, Belize, Dominica, Jamaica, Surinam, Somalia, Windward islands (Dominica, Santa Lucia, Saint Vincent, Grenadines)

^b Category A: Licenses for established operators of MFN and non-traditional suppliers in EC (65% of quota). Licenses are transferable within the category.

^c Category B: Licenses for established European companies in EC (30% of quota). Licenses are transferable within the category.

^d Category C: New operators (post 1992) (3.5% of quota). Licenses cannot be sold.

^e. Non-traditional ACP: (Dominican Republic and Ghana) plus European producers (French overseas departments, Balearic islands and Crete).

Between 1993 and 2001 the major change was the allocation of 49% of quotas in category A away from established operators to Colombia, Costa Rica, Nicaragua, and Venezuela under the BFA (See table 2, entry 4).

In the following years, the EU inched towards the TO regime, but the negotiations lasted another eight years essentially doubling the time required to resolve the conflict. As discussed below, this was partly due to the incompatibility of guaranteeing market access to MFN and ACP suppliers in an unchanging market with changing preferences that would elicit supply response and hence changing market shares. It was also partly because of the typical vagueness in the 'diplomatic' language described above and in the tariffication procedures described below.¹²

¹² As shown in the bottom part of table 2, a succession of MFN tariff rates to replace the TRQ were found to be WTO-incompatible, principally because MFN suppliers were not going to preserve previous market access. FAO (2004, table 4)

In July 2004, the EU Commission notified the WTO of its intention to enter Article XXVIII negotiations (required to rebind the EU tariff on bananas).¹³ A succession of consultations and panel decisions followed, starting in late 2004. On one end, MFN suppliers said that the EU tariff should be the MFN tariff of €75/ton and, at the other end, an ACP Council of Ministers indicated that they considered €275/ton as the lowest acceptable limit for the tariff. In December, outgoing Commissioner Lamy announced €230/ton as an initial negotiation position for the EU, although in October Germany had publicly voiced its desire to see the tariff re-bound at a low level. This figure was announced by the EU in January 2005. Following other adverse panel rulings, the EU lowered the proposed tariff to 178€/ton by the end of 2005, a level that continued to be unacceptable to the MFN suppliers.

Exasperation with the EU's lack of compliance at the Hong-Kong ministerial resulting in further disputes filed by the US and MFN suppliers, leading to yet another panel ruling that the duty-free quota for ACP violated articles I and XIII on non-discriminatory allocation of quotas. A facilitator was assigned to help confidential negotiations that finally led to the December 15 2009, comprehensive agreement. Not only were EU trade in bananas to be fully WTO compatible at the substantially lower tariff of 117€ by 2017 (giving nearly a ten-year period to find alternative compensation for the very vulnerable Windward suppliers, but all other pending disputes (8) and claims (5) at the WTO were finally settled after eighteen years of litigation.

4. The Political Economy

This prolonged dispute had two components, the transatlantic trade conflict between the EU and the US, and the WTO dispute with the MFN suppliers. I examine both below, arguing that the transatlantic dispute was largely explained by domestic politics in the EU and the US while the dispute with the MFN suppliers that lasted for another 8 years following the 2001 Doha agreement, could have been resolved earlier by greater acceptance of economic analysis by WTO panels.

4.1 EU Decision-making and US Domestic Politics¹⁴

Since the implementation of the SEM did not result in a move towards a significantly more protectionist stance, why was this so with the adoption of the CMOB? As argued by Cadot and Webber and others (see e.g. Barfield (2003)), three traits of the agricultural and trade policy-making in the EU contributed to the outcome. First, the lead Directorate-General (DG) for agricultural trade was DG agriculture (under scrutiny for CAP expenses). Compared to DG trade which is required to balance domestic political exigencies with external political obligations, DG agriculture gives greatest priority to domestic agricultural interests. Second, the absence of an EU cabinet contributed to sectoral policy-making that was also reflected in intergovernmental relations (e.g. Kohl deferring to French leadership on bananas to avoid a Franco-German trade conflict). As inter-DG conflicts on bananas could not be resolved within the college of Commissioners, DG agriculture alone was to solve the conflict. This was made possible by the practice of issue-linkage or package-making.

The constituency for bananas was concentrated in the Mediterranean with British and Irish trading companies that coalesced with Mediterranean growers. As there was no banana constituency in the

(Contd.) _____

shows the huge variation in claims by the various stakeholders when they submitted their estimate of the TO: at one end, MFN suppliers wanted a tariff inferior to €75 per ton and at the other, to over €300 for EU banana importers

¹³ If the EU intended to set the new tariff at €75/ton, no rebinding would be necessary and Article XXVIII negotiations would not be called for. Any higher level involves a rebinding and must accordingly follow Article XVIII procedures. These involve: (i) providing of information by the EU on the method used to calculate the new tariff level and, following the announcement of its intentions; (ii) allowing any interested party to request arbitration should a negotiated solution fail to be reached. This is the current situation at the time of writing this report (March 2005).

¹⁴ What follows draws on Cadot and Webber's (2002) excellent review of the politics behind the EU-US transatlantic dispute.

Hanseatic states, these were compensated with victories in other agricultural policy issues in the council at the time. Realizing that it would never get its way in Europe (i.e. get licenses to sell to the Hanseatic states), Chiquita decided that it would have “to go to Washington” to get the regulation changed (Cadot and Webber P. 16 and table 2, entry 4).¹⁵ In Washington, such a course of action was getting increasingly likely to succeed, especially if one had a big ‘war chest’ as in the case of bananas and otherwise costly lobbying (in terms of resources expended) could be avoided.¹⁶

Again three traits of trade-policy making, this time in the US, increased the likelihood of conflict. First, the Congress was reasserting its constitutional prerogatives over foreign trade policy as the Executive was finding it increasingly hard to get “fast-track authority”. Second, the 1988 Trade Act with its controversial revised section 301 that made the administration more accountable to the interests of the private sector reduced greatly the leeway for the executive branch to protect consumer interests. The revised 301 institutionalized the growing practice of giving the decision on unfair foreign trade practices to the president of the USTR (where firms had direct access). Third, was the “buying of electoral outcomes” by private-sector donations as the 1990s saw a sharp increase in electoral campaign contributions. Cadot and Webber (table 1) report that, over Clinton’s presidency Chiquita contributed 6\$ billion and Dole 660\$million. Traditional old-fashioned trade politics on both sides of the Atlantic were playing out, but the conflict was one where particularistic interests were increasingly preventing Brussels and Washington from formulating more moderate positions.

Resolution of the transatlantic dispute in April 2001 was helped by Chiquita’s bankruptcy, a change of government with the Bush administration that wished to start on a clean slate and by the upcoming Doha negotiations.

4.2 The Dispute over Market Access for MFN Suppliers.

As made clear at the Doha ministerial, the EU would only benefit from the waiver needed to give preferential access to ACP countries if the rebinding of the tariff maintained the market shares of the MFN suppliers. At the same time, the EU had to maintain market access to ACP countries (to honor its legal commitment to maintain market access under the Banana protocol). To move to the TO regime, the EU Commission relied on the price-gap conversion method (PG), proposing a ‘tariff-equivalent’ to the TRQ of €230 per ton in January 2005 (entry 10). The presumption was that this tariff rate, calculated as the difference between a suitably defined internal price index and a suitably defined external price index (i.e. a cif-landed price) would maintain the internal price unchanged and would leave the market unaffected. The Commission, however, acknowledged that there would be a supply response by ACP producers under a higher preferential margin (three times higher than previously).

As reviewed in Melo (2015), energies on all sides were expended on interpreting a mechanical application of the Price-Gap (PG) methodology to compute the tariff equivalent of the TRQ regime. Bananas under dispute (so-called dessert or “cavendish” bananas sold in boxes of 17 kgs each), being homogenous, then country i will sell in the EU if unit production costs (say per box), c_i , augmented by all additional transaction costs (i.e. unit transport costs to the EU, θ_i , unit packing costs, ϕ_i , and by tariffs (for MFN suppliers only), τ , and rents accruing to supplier i , λ_i) do not exceed the unit market price in the EU, P^{EU} :

¹⁵ Cadot and Webber note that Geest, the large British banana importer participated in British banana policy since the 1950s. The European Court of Justice rejected an attempt by the German government (supported by Belgium and Netherlands) to have consumer interests prevail.

¹⁶ Contributing directly to electoral funding is less costly and less uncertain in terms of resources than expending resources on legal spending to change domestic legislation. Also, there were at most three contestants which also reduces spending for a given probability of success. (In a Cournot model where n symmetric contestants vie for a rent of amount R with equal probability of success, per-contestant expenditure will be given by $X=R(n-1)/n$.)

$$\begin{aligned} c_i + \theta_i + \phi_i + \lambda_i + \tau &\leq P^{EU} \\ EP + \lambda_i + \tau = IP &\Rightarrow PG = IP - EP \end{aligned} \tag{0.1}$$

If condition (0.1) is not met, then supplier i will not sell in the EU. Since bananas can be considered of same quality, the same condition prevails in the US except that the cost less than price condition is expressed in terms of the unit price in the US, P^{US} . Condition (1.1) also gives the expression to calculate the tariff-equivalent of the TRQ by the price gap (PG) method (see de Melo table 4). The condition shows that if we have reasonably accurate estimates of unit production costs (freight and packaging costs are easier to obtain) which is not too difficult to obtain, it is straightforward to use this expression to compute rents. Likewise, if there had been a market for licenses, the computation of the PG would have been less controversial.

A graphical analysis assuming that bananas from different origins are perfect substitutes can be used to analyze equilibrium in the market under the quotas applying to the three distinct groups of suppliers (MFN, ACP and EU) to the EU. Tariffication should lead to a reduction in the equilibrium price on the EU market, and market access could improve for MFN countries since quantities consumed would increase, although this is not necessarily so because the tariffication also elicits a supply response from ACP producers and redistributes supply between MFN and ACP producers in a way that can penalize the former.¹⁷

5. Estimating the tariff equivalent to the TRQ

In Melo (2015, section 5), I apply three different approaches (“triangulation”) to estimate the tariff equivalent of the TRQ. All three lead to similar results that I summarize here. The first is the PG conversion method chosen by the Commission. The PG method ignores supply response which had to be important given that the many estimates were around three times the MFN bound rate of €75 per ton. In its choice of ‘conversion method’, the Commission felt that a PG conversion would be less controversial than a simulation analysis. The EU chose to justify its proposed TO rate of 230€ by using the PG method which it applied to the EU-25 to account for the new members using an average over 2000-2. Though straight-forward in principle, the application turned out to be complicated and controversial, leading to a wide range of estimates depending on the author’s selection of time-series (FAO time series of World Bank ‘pink sheets’) and who was the sponsor of the study and the accompanying modifications that were made to series to obtain a suitable tariff equivalent of the TRQ regime. The wide range of Price Gap estimates and blatant inconsistencies are summarized in Melo (2015, table 4).

The large discrepancies in the estimates generated by price-gap analysis raise questions about the methodology, the choice of prices and the possibility of fruit quality effects. An alternative then is to “let the data speak” and exploit all the data on banana trade over a long time period straddling the period of the CMOB. This gives an estimate of the determinants of banana trade and helps isolate the effects of the CMOB. Application of the popular gravity model of trade over the period 1988-2003 in which dummy variables are used to detect the effects of the TRQ provides such estimates. This second method results summarized in Melo (2015, table 5) gives a range of very plausible estimates for all coefficients including the tariff equivalent of the quota regime. The combined effect of the quota and in-quota tariff is estimated at €158 + €75 = €233.

These two sets of estimates do not take into account supply response under the new tariff regime so they cannot inform on what TO regime would keep MFN suppliers market share. A transparent and minimalist model where demand and supply elasticities and transport costs are calibrated provides plausible estimates. These are summarized in Melo (2015, table 6). These estimates also point out

¹⁷ See the discussion in Melo (2015, figure 1).

what information would have been needed to progress more rapidly in the negotiations. The model also lays bare the arbitrariness in the discussion due to the confidentiality about cost data on the part of suppliers.

Three cases were simulated:

Case 1: Individual countries receive *non-transferable quotas* (more representative of the situation prevailing before 2001).

Case 2: Quotas are transferable within categories (more representative of the situation post 2001 when quotas became transferable within MFN and ACP categories).

Case 3: Fully transferable quotas across all categories. Then rents are equalized as they would be under a TO only regime.

The estimated rents implied by this data (Melo 2015, table 6) applied to the demand-supply model indicate an average rent of €125 per ton for MFN producers and €67 for ACP producers, estimate close to the fragmentary estimates mentioned above. If the landed price in the EU were €500, the corresponding rents would be €53 for MFN and €5 for ACP, implying that the ACP would not be in business. The usefulness of the modeling approach is clear since it helps narrow down the discussion.

Recall that at the time, the conflict was about the TO that would maintain supplies for all MFN producers. Crucial to this task is the supply response that, for equal supply elasticities, will depend on the assumed estimate of rents across countries. Three options about the sharing of the rents across suppliers allows one to bracket the range of likely supply response estimates. On the assumption that the cost data are accurate, results in table 3 show that if rents were not equalized within categories, a tariff of €150 would have maintained the aggregate share of MFN suppliers at the 2004 level while the EU proposal would have led to a loss of market share of 5 percentage points. However, most of the adjustment would be by Ecuador, the low cost producer, a reason the fears expressed at the time by other MFN suppliers, (e.g. Costa Rica). Starting from a situation where rents are equalized within MFN and ACP groups, a tariff of €150/ton would have maintained the shares of all MFN suppliers. Now the pattern of adjustment across suppliers is different as the cost-advantage of the high-rent suppliers (e.g. Ecuador for the MFN) is diminished relative to others (e.g. Costa Rica).

Table 3: Alternative tariff only simulation scenarios

3a: Rents equalized within quota categories

tariff	Tariff rate € per ton	EU price € per box	MFN share	CR ECUA (percent change)
Base (quotas)	75	10.4	0.77	0.0 0.0
EU proposal.	230	10.5	0.72	-13.5 4.5
	150	9.6	0.77	-2.0 23.0
	75	8.9	0.81	11.0 43.0

3b: Rents equalized across quota categories

tariff	Tariff rate € per ton	EU price € per box	MFN share	CR ECUA (percent change)
Base (quotas)	75	10.4	0.77	0.0 0.0
EU proposal	230	10.7	0.70	-9.0 -14.0
	150	9.8	0.76	5.0 8.3
	75	8.9	0.81	18.6 31.0

Source: Melo (2015, table 7) Notes: In all simulations, $\varepsilon_p = 1.0$; $\varepsilon_s = 1.0$

Taken together, the results of the simulations reported in table 3 confirm that a low tariff would favor MFN producers at the expense of ACP producers and that no single tariff would have maintained the status quo among the main banana producers. This ‘basic result’ that is robust to a wide range of changes in ingredients in this minimalist model, failed to be recognized in the debate. Indeed, in the eight-year debate that ultimately led to the December 2009 agreement, model results were rarely used and, when used, their underpinnings were never spelled out. In sum, like the PG calculations, the models were prescriptive rather than informative.

6. Conclusions

The banana conflict was the longest running trade conflict in the current World Trading System. Its resolution confirmed that tariffication of quota regimes is difficult to carry out as it was with the negotiations on agriculture during the Uruguay Round. In the end, the prolonged period of negotiations corresponded to the amount of time that the high-cost Windward producers said would be necessary to adjust since at the hearings on the “banana IV” panel in 1999, producers’ association requested at least a ten-year adjustment period which is close to the eight-year period of adjustment that was finally agreed-upon in 2009. This outcome also resembles the outcome on the removal of other quota regimes like the MFA which took place over a ten-year period.

For the transatlantic component of the dispute, the substantial vested interests over annual rents of around \$2 billion dollars annually by a handful of powerful banana traders on each side of the Atlantic along with the decision-making processes in the EU and in the US explains why it occurred even though no bananas were grown on either continent. Regardless of the evolution trading system from the GATT to the WTO, this dispute would have been solved by threats.

For the MFN suppliers however, absent the transition towards a more rule-oriented system, the stalemate that characterized the conflict under the GATT would have likely continued. Its resolution would have been difficult if MFN suppliers could not have held the EU hostage on the renewal of the Lomé Convention at the Doha ministerial. The EU then would have found a way to maintain a TRQ allowing the cross-subsidization of ACP (especially small Caribbean) producers by MFN producers even though the preferential access under negotiation was already losing in significance.

The economics of the dispute was straightforward and even though the rents were cleverly hidden, it would have been relatively easy to recognize early on that any tariffication would have altered market shares and engaged in negotiations for a tariff-only (TO) regime in the range of €100-150/ton. As shown by a ‘triangulation’ of estimation methods, even (with the minimum of available information, this range could have been easily established by an independent panel mandated by the WTO.

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