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BANANAS, SUBJECT OF THE LONGEST TRANSATLANTIC DISPUTE IN THE WORLD TRADING SYSTEM

A POSTMORTEM

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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*****, SEPTEMBER 19, 1997**

Le coeur 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 SC européen

MICHEL ROCARD, "POUR QUE VIVE LA BANANE," ***LE FIGARO*** **NOVEMBER 10, 1997**

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 were also the topic of the longest-running dispute in the post–World War II multilateral trading system. It started in 1991 when a most favored nation (MFN) supplier, Costa Rica, expressed concern that the European Union's new banana regime triggered by the Single Market Act would discriminate against Central American MFN suppliers. The ensuing unresolved disputes and claims (eight disputes and five claims, according to W/T/L/784) took eighteen years to be brought to rest when, in December 2009, an agreement was reached calling for a progressive lowering of the (specific) import tariff on MFN bananas from €176 per ton to €114 per ton by 2017.

The banana case is interesting in several respects. First, since bananas are a homogeneous product, it is a perfect textbook case of the economic effects of a tariff-rate quota (TRQ) regime as taught in the classroom. Second, from the point of view of dispute settlement, although the functioning of the TRQ regime was not transparent, the decision to move from a TRQ regime to a tariff-only (TO) regime was, in principle, easy to adjudicate since it was not hostage to litigation over interpretations of "like products" or technical barriers 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 world's two largest trading partners at the time, the European Union and the United States, came to fight over a product that was not produced on either continent. Finally, straddling equally the periods covered by the General Agreement on Tariffs and Trade (GATT) and World Trade Organization (WTO), the narrative of the dispute is a good example of the application of GATT rules of progression and of the progressively greater reliance on rules in resolving disputes.

In addition to a good illustration of the ascendency 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 decisionmaking of the EU and the US. As indicated by the above excerpts from an exchange in the press between Patrick Messerlin and Michel Rocard (who had been France's 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 has been resolved.

THE CONTOURS OF THE INTERNAL AND EXTERNAL CONFLICTS ON THE EU'S BANANA 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 15-1).[2] I start with some background, and then turn to the elaboration of the EU's banana trade regime that was required by the formation of the Single European Market (SEM) in 1993.

Background

In the late 1980s, 75 percent of the world's banana exports originated in Latin America (Ecuador, Costa Rica, and Colombia, followed by Honduras, Mexico, Nicaragua, Panama, and Venezuela)—all developing countries and henceforth referred to here as the MFN suppliers. The EU consumed 40 percent of the world's bananas, with one-third coming in equal proportion from MFN suppliers, EU overseas territories (Canary islands, Martinique, Guadeloupe), and former British and French colonies—the African, Caribbean, and Pacific (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 for the Banana Trade Regime (BTR) in the EU, before the creation of the Single European Market, it was segmented, as Spain and France had overseas territories growing bananas (Martinique, Guadeloupe, and the Canaries) and, along with Britain, had colonial ties with the ACP countries enshrined in the 1975 Lomé Convention. Bananas from the African and Caribbean states were "beneficiaries" of the Lomé Convention. The legally binding article 1 of the banana protocol under that convention stated: "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 among suppliers were substantial: the costs of high-cost producers (EU territories and the Windward Islands) were more than double those of Latin American suppliers.[3]

Before the start of the dispute, the banana market in the EU was segmented into 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), which applied the 20 percent common external tariff (€75 per ton, the level that was bound in the Dillon Round of multilateral trade negotiations, 1959–1962). 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 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 the 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 percent of the German market, which was the most open (with zero tariffs).

Moving to an SEM created two problems, an internal one and an external one. Within the EU, where bananas circulate freely, if a tariff-only (TO) rate at approximately the common external tariff (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. The solution that was adopted was to create a system of quotas that restricted entry of all non-ACP bananas to 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 nondiscrimination (GATT Article I). However, three qualifications under the GATT allowed countries to discriminate against third parties: (1) the "enabling clause" or "special and differential treatment" (SDT) adopted in 1979 in the GATT; (2) when creating a free trade agreement (FTA) or a customs union (CU) (Article XXIV); (3)

TABLE 15-1. Import and Retail Prices of Bananas: United States and France, 1990–2002

Real US$ per kilo

	United States		*France*	
Year	*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); FAO (2003, table 6).

countries can agree to waive any rule—that is, to permit discrimination (Article XXV). Since the Latin American MFN exporters were developing countries, SDT was excluded, and since option 2 did not apply, this left only option 3 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, 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. 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, Fernandez, and Chau 2004, figure 3). Since the SEM in 1993 meant that imported goods could be reexported to other member states, a comparison of prices in a tariff-free market like the United States where the (homogeneous) bananas entered duty-free and any market in the EU (France in table 15-1) gives an estimate of the rents up for capture. As shown in table 15-1, the price was between 40 percent and 60 percent. 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 ostensibly the same, with a market of about 4,000 tons per year, rents (including tariff revenues and rents to suppliers and marketers) were at least €1.2 billion per year.[5]

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 Commission of the European Community led to the Common Organization of the Market for Bananas (COMB), a hard-fought compromise that replaced the BTR. This new regime was compatible with the requirements of the SEM and the obligation to maintain market share for ACP producers under the Lomé Convention. This compromise was entirely at the expense of MFN producers and the US sellers of MFN bananas in the EC.

Borrell (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 resulting from the COMB was 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] Using a series of studies, Borrell (1999) estimated that a tariff of 17 percent would have sufficed. However, this option would not have been possible because EU budgetary law prohibits tariff revenues from being earmarked 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. Regarding compensation to ACP states, the WTO panels repeatedly confirmed that the “Lomé waiver” would have been GATT-compatible. Yet the COMB was designed so that the burden of adjustment fell on banana traders using 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 COMB passed the costs of protection to consumers. However, one would have expected the MFN suppliers and operators to have obtained some of the rents. Initially, however, that did not happen (see tables 15-2 and 15-3) because all licenses were awarded to EU marketers, an arrangement that amounted to a winner-take-all outcome: EU traders and EU and ACP growers got all the benefits, while growers and traders of dollar bananas got nothing.

THE CONFLICT

Assembling the COMB was a long process that lasted five years because 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. This explains why warnings surfaced at the GATT before the adoption of the COMB. 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).

. . . at the GATT

The conflict started when a group of banana producers expressed their concerns to the GATT council in 1991 about the anticipated new BTR, which they believed would be unfavorable to them ("Bananas I"). They hoped that these consultations would influence the design of the BTR before the conclusion of the Uruguay Round. When consultations failed, five GATT members requested that a panel against the EU's COMB be put in place in July 1993 ("Bananas II"). They argued that the COMB was incompatible with the GATT 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 COMB, but not Guatemala, which did not receive any licenses and hence refused to sign the BFA.

Because the EU was failing to react to the panel decisions and Chiquita had not succeeded in obtaining any licenses, Chiquita used political tactics to persuade the Office of the US Trade Representative to file a GATT

Section 301 investigation against the EU.[7] This was the first turning point since, regardless of the outcome at the GATT/WTO, the United States had a credible threat to impose sanctions on EU imports, especially given the "carousel" method of selecting 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, a waiver that allowed the continuation of the BFA until 2000, when the new Lomé IV Convention had to be approved.

. . . 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 implementation of 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.

In May 1997, a WTO panel ruled that the EU BFA violated GATT rules in three respects, a ruling that was upheld by the Appellate Body in September 1997 ("Bananas III"). An important decision in the ruling indicating the move toward rule-based resolution of trade conflicts was the interpretation of the wording in the waiver from Article 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—that is, to decide how quotas would be allocated.[8] The panel also found that BFA countries were allowed to manage their own export certification system and that non-BFA countries were not.

Importantly, the panel ruled against the 30 percent allocation of the MFN quota (857,000 tons) given to historical importers of the EU and traditional ACP bananas (the allocation under category B in table 15-2). This allocation was between 50,000 and 100,000 tons greater than the best-ever export volume before 1991. In sum, the decision required the EU to pro-

TABLE 15-2. Transition from a Tariff-Rate Quota to a Tariff-Only Regime for Bananas

	Event/Date	*Quota type*	*Quantity (tons)*[f]	*Tariff rate (€ per ton)*[g]	*Tariff type*	*ACP tariff preference*
1993		ACP[a]	857 KT	0		
		A[b]	1.3 MT	100 ECUs		
	COMB	B[c]	600 KT	100 ECUs		
		C[d]	70	100 ECUs		
		Out-of-quota (MFN)		850 ECUs		
		Out-of-quota ACP & European[e]		750 ECUs		
EU/US	Phase 1 Step 1	A	2.2 MT	75	Bound	75
April 2001	(July 2001)	B	353 KT	75	Aut.[i]	75
		C	850 KT	300	Aut.	300
		Out-of-quota		680	Aut.	300
EU/US	Phase 1 Step 2	A	2.2 MT	75	Bound	75
April 2001	(Jan. 2002)	B	453 KT	75	Aut.	75
		C	750 KT	n.a.[h]		n.a.
		Out-of-quota		680	Aut.	300

Source: Melo (2015, table 3). Elaboration based on Messerlin (2001), Badinger, Breuss, and Mahlberg (2001, tables 1 and 2), and Vanzetti, Fernandez, and Chau (2004, table 1).

Notes: One Ecu was approximately equivalent to one Euro. 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 quota A are bound; tariffs under quotas B and C are not bound.

[a] Traditional ACPs (Cape Verde, Cameroon, Côte d'Ivoire, Belize, Dominica, Jamaica, Suriname, Somalia, Windward Islands (Dominica, Santa Lucia, Saint Vincent, Grenadines).

[b] Category A: Licenses for established operators of MFN and nontraditional suppliers in EC (65 percent of quota). Licenses are transferable within the category.

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

[d] Category C: New operators (post-1992) (3.5 percent of quota). Licenses cannot be sold.

[e] Nontraditional ACPs: (Dominican Republic and Ghana) plus European producers (French overseas departments, Balearic Islands, and Crete).

[f] KT = 1,000 kilos; MT = million tons.

[g] One euro was approximately equivalent to one European Currency Unit (ECU).

[h] n.a. = not available.

[i] Aut. = autonomous.

vide 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 quotas to the ACP legally on a basis other than in proportion to market share in its BTR, it would need a waiver to Article XIII. This, in turn, would require three-quarters support at the WTO (50 percent 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," Melo 2012, table 2, entry number 7). Most important, 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, for those who wished to see the World Trading System become more rule-oriented.

During the dispute settlement procedures under "Bananas IV," the panel heard representations from third parties that included the Caribbean states. Among these, the Windward Islands were high-cost producers depending heavily on exports of bananas at the prevailing prices in the EU. The prosperity created by the tariff-rate quota led to bananas being called "green gold" in these vulnerable islands. The Caribbean Banana Exporting Association that represented 7 percent 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 tariff-only (TO) regime would require at least a ten-year adjustment period to prevent the total collapse of the 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 prospect of these sanctions, the EU consulted with the US and with 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 TO regime would be WTO-compatible and easier than the alternative that required a waiver to Article XIII on the rules about quota allocation. While the EU would have envisioned 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 to maintain a TRQ, though one based on the 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 for license allocation (first-come, first-serve or by auction) other than the use of a historical reference period (if 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 one side it was faced with the desire by operators to keep the opacity of a TRQ where "obfuscation" (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 Article 1 necessary for the approval of the Cotonou Agreement, which 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 (1994–1996) with a license reduction of 100,000 tons to the ACP. The EC also promised to implement a tariff-only regime by January 1, 2006, in return for the promise by Ecuador and the US to suspend sanctions (Melo 2012, table 2, entry number 8).[10] Table 15-2 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 (Melo 2012, table 2, entry number 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 or in value terms? What was the choice of base years for calculations?" And most important, was it applicable to all MFN suppliers rather than to individual MFN suppliers?[11]

Between 1993 and 2001 the major change was the allocation of 49 percent of quotas in category A away from established operators to Colombia, Costa Rica, Nicaragua, and Venezuela under the BFA (Melo 2015, table 2, entry number 4).

In the following years, the EU inched toward the TO regime, but the negotiations lasted another eight years, essentially doubling the time required to resolve the conflict. This was partly because of the incompatibility of guaranteeing market access to MFN and ACP suppliers in an unchanging market with changing preferences, which would elicit supply response and hence changing market shares. It was also partly because of the typical vagueness in the diplomatic language and in the tariffication procedures.[12]

In July 2004, the European 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 per ton and, at the other end, an ACP Council of Ministers indicated that they considered €275 per ton to be the lowest acceptable level for the tariff. In December, outgoing commissioner Pascal Lamy announced €230 per ton as an initial negotiation position for the EU, although in October Germany had publicly voiced its desire to see the tariff rebound 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 per ton at 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, led to yet another panel ruling that the duty-free quota for ACP violated Articles I and XIII on nondiscriminatory allocation of quotas. A facilitator was assigned to help with confidential negotiations that finally led to the December 15, 2009, comprehensive agreement. Not only was EU trade in bananas to be fully WTO-compatible at the substantially lower tariff of €117 by 2017 (allowing a nearly ten-year period to find alternative compen-

sation for the Windward suppliers), but all other pending disputes (eight) and claims (five) at the WTO were finally settled after eighteen years of litigation.

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 next, 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 eight years following the 2001 Doha agreement could have been resolved earlier if the WTO panels had been more willing to accept economic analyses.

EU Decisionmaking and US Domestic Politics

Since the implementation of the SEM did not result in a move toward a significantly more protectionist stance, why did it happen with the adoption of the COMB?[14] As argued by Cadot and Webber (2002) and others (see, e.g., Barfield 2003), three traits of agricultural and trade policymaking in the EU contributed to the outcome. First, the lead Directorate-General (DG) for agricultural trade was DG agriculture (under scrutiny for CAP expenses). Unlike 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 policymaking that was also reflected in intergovernmental relations (e.g., German chancellor Helmut Kohl deferring to French leadership on bananas to avoid a Franco-German trade conflict). Since inter-DG conflicts on bananas could not be resolved within the college of commissioners, DG agriculture alone was left to resolve 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 Hanseatic states, they were compensated with victories on other agricultural policy issues in the council at the time. Realizing that it would never get its way in Europe (i.e., it would not 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 2002, 16, and Melo 2012, table 2, entry number 4).[15] In Washington, that course of action was becoming increasingly likely to succeed, especially if one had a big "war chest" as in the case of bananas and otherwise costly lobbying could be avoided.[16]

Again three characteristics of trade policymaking, this time in the United States, 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, which made the administration more accountable to the interests of the private sector, greatly reduced the leeway for the executive branch to protect consumer interests. Revised 301 institutionalized the growing practice of giving the decision on unfair foreign trade practices to the head of the USTR (where firms had direct access). Third was the "buying of electoral outcomes" by private sector donations; the 1990s saw a sharp increase in electoral campaign contributions. Cadot and Webber (2002, table 1) report that, during Bill 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 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 new US administration, and the upcoming Doha negotiations.

The Dispute over Market Access for MFN Suppliers

As was 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 European Commission relied on the price-gap conversion method, proposing a "tariff-equivalent" to the TRQ of €230 per ton in January 2005 (Melo 2012, table 2, entry number 10). The assumption was that this tariff rate, calculated as the difference between a suitably defined internal price index and a suitably defined

external price index—a cost, insurance, and freight (CIF)-landed price—would maintain the internal price unchanged and leave the market unaffected. The EC however, acknowledged that there would be a supply response by ACP producers under a higher preferential margin (three times higher than previously).

All sides expended energy interpreting a mechanical application of the price-gap (PG) methodology to compute the tariff equivalent of the TRQ regime (Melo 2015). For the bananas under dispute (so-called dessert or Cavendish bananas sold in boxes of seventeen kilograms each), being homogeneous, country *i* will sell in the EU if unit production costs (say per box), c_i, augmented by all additional transaction costs (unit transport costs to the EU, θ_i; unit packing costs, φ_i; 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}:

$$c_i + \theta_i + \varphi_i + \lambda_i + \tau \leq P^{EU}$$
$$EP + \lambda_i + \tau = IP \Rightarrow PG = IP - EP$$

If this condition is not met, then supplier *i* will not sell in the EU. Since all bananas can be considered of the same quality, the same condition prevails in the US except that the "cost less than price" condition is expressed as a unit price in the US, P^{US}. This condition also allows the expression to calculate the tariff-equivalent of the TRQ by the price-gap (PG) method (Melo 2015, table 4). The condition shows that if we have reasonably accurate estimates of unit production costs (freight and packaging costs are relatively easy 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 (MFNs, ACPs, and the EU) to the EU. Tariffication should lead to a reduction in the equilibrium price in 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 (see Melo 2015, figure 1).

ESTIMATING THE TARIFF EQUIVALENT TO THE TRQ

I apply three different approaches ("triangulation") to estimate the tariff equivalent of the TRQ (Melo 2015). All three lead to similar results that I summarize here. The first is the PG conversion method chosen by the European Commission. The PG method ignores the 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 a "conversion method," the EC 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 twenty-five EU members in order to account for the new members using an average over the period 2000–2002. Though straightforward 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 or World Bank "pink sheets"), 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 COMB. This gives an estimate of the determinants of banana trade and helps isolate the effects of the COMB. 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. Results of this second method give a range of very plausible estimates for all coefficients, including the tariff equivalent of the quota regime (Melo 2015, table 5). 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 be used to determine what TO regime would allow MFN suppliers to retain their market share. A transparent and minimalist model that calibrates demand and supply elasticities and transport costs provides plausible estimates (see Melo 2015, table 6). These estimates also point out 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 suppliers' desire to maintain confidentiality about cost data.

Three cases were simulated:

Case 1: Individual countries receive *nontransferable 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 tariff-only regime.

The estimated rents implied by these data applied to the demand-supply model indicate an average rent of €125 per ton for MFN producers and €67 for ACP producers. If the landed price in the EU were €500, the corresponding rents would be €53 for MFNs and €5 for ACPs, implying that the ACPs would not be in business. The modeling approach is useful because it helps narrow the discussion.

Recall that, at the time, the conflict was about the TO scheme 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 for the sharing of 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 15-3 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; 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 for 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 per ton would have maintained the shares of all MFN suppliers. Now the pattern of adjustment across suppliers is different because the cost advantage of the high-rent suppliers (e.g., Ecuador for the MFNs) is diminished relative to others (e.g., Costa Rica).

Taken together, the results of the simulations reported in table 15-3 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

TABLE 15-3. Alternative Tariff-Only Simulation Scenarios

Rents equalized within quota categories

Tariff	*Tariff rate (€ per ton)*	*EU price (€ per box)*	*MFN share*	*CR (% change)*	*ECUA (% 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

Rents equalized across quota categories

Tariff	*Tariff rate (€ per ton)*	*EU price (€ per box)*	*MFN share*	*CR (% change)*	*ECUA (% change)*
Base (quotas)	75	10.4	0.77	0.0	0.0
EU proposal	230	10.7	0.70	–9.00.0	0.014.0
	150	9.8	0.76	5.0 0.0	0.08.3
	75	8.9	0.81	18.6	31.0

Source: Melo (2015, table 7).

Note: In all simulations, $\varepsilon_P = 1.0$, $\varepsilon_s = 1.0$.

among the main banana producers. This "basic result," which is robust to a wide range of changes in ingredients in this minimalist model, was not 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 descriptive rather than informative.

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 by the Bananas IV panel in 1999, the producers' association requested at least a ten-year adjustment period; an 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 such as the Mulfi-Fiber Arrangement, 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 by a handful of powerful banana traders on each side of the Atlantic, along with the decisionmaking 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 of the trading system from the GATT to the WTO, this dispute could have been solved by threats.

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

The economics of the dispute were 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 led to negotiations for a tariff-only regime in the range of €100–150 per ton. As shown by a triangulation of estimation methods (even with available information), this range could have been easily established by an independent panel mandated by the WTO.

NOTES

I thank the FERDI for support and encouragement to write this chapter. It draws on and summarizes Melo (2015).

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

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

3. Throughout, the conflict was about Cavendish or dessert bananas. These are homogeneous and are always packed in boxes of seventeen kilograms. During the conflict, the per-ton costs of bananas—free on rail (FOR) or free

on truck (FOT)—of the low-cost suppliers were between $150 and $200 per ton; the costs of the Windward Islands suppliers were $500 per ton and in Martinique $700 per ton (Vanzetti, Fernandez, and Chau 2004; Borrell 1999). Chiquita sourced its bananas from MFN suppliers; Dole, the second largest seller in the EU market, sourced largely from ACP producers.

4. The Treaty of Rome almost collapsed when West Germany, which had no colonies, insisted on being exempt from applying the 20 percent bound tariff on bananas negotiated under the Dillon Round. This was possible before the SEM since Article 113 allowed countries to have their own quotas and in effect their own trade policies. 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 unrestricted imports of bananas. Interestingly, Germany (supported by Belgium and the Netherlands) lost a case challenging the banana trade regime adopted in July 1993 (see table 15-2) denying the direct effect of GATT provisions. When the GATT was replaced by the WTO with its enhanced dispute settlement power, 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 Common Organization of the Market for Bananas (COMB). Borrell (1999) estimated an annual welfare loss of $2 billion per year associated with the COMB (an increase of 20 percent relative to the old regime) compared to free trade. Messerlin (2001) estimated a loss of 582 million European Currency Units (ECUs) for 1990. Badinger, Breuss, and Mahlberg (2001) give estimates by categories of countries comparing the costs of the COMB with those in the previous BTR regime based on trend projections.

6. Under the COMB, banana suppliers were put into three quota categories, with quotas going directly to established banana traders in the EC (see table 15-3). ACP suppliers were exempt from the tariff on their quota allocations. Traders of ACP bananas had to purchase the higher-priced ACP bananas in order to sell their bananas in the EU market.

7. Of course, in spite of the large campaign contributions by the banana traders to both Democrat and Republican parties, the 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).

8. Article XIII on the allocation of quotas stipulates that they should be applied on a proportional basis to all members with a "substantial interest"—defined as at least a 10 percent market share. The panel found that quota allocations had been fair only for Colombia (21 percent) and Costa Rica (23 percent)

but not for other suppliers with substantial interests. The EU was also found to be unfair in its allocations to countries with "nonsubstantial" 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).

10. This agreement was to be formalized at the Doha Ministerial: it formally linked 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 nondiscriminatory QRs) requested by the EU to cover special treatment for ACP countries under the Cotonou Agreement as part of a transitional arrangement extending to 2007. Read (2004) clearly explains the issues surrounding the waivers. He also points out that if the EC did not reach 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. Even though the MFN suppliers could withdraw "substantially equivalent concessions," it is unlikely to have led to 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 the 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).

12. As shown in the bottom part of table 15-2, 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) 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 of less than €75 per ton and at the other over €300 for EU banana importers.

13. If the EU intended to set the new tariff at €75 per ton, no rebinding would be necessary and Article XXVIII negotiations would not be called for. Anything higher would involve a rebinding and must accordingly follow Article XVIII procedures. These are: (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.

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

15. Cadot and Webber note that Geest, the large British banana importer, had participated in British banana policy since the 1950s. The European Court of Justice rejected an attempt by the German government (supported by Belgium and the 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 $X = R(n-1)/n$.)

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