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The Anatomy of the EU–US WTO Banana Trade Dispute¹

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This paper provides an overview of the banana dispute between the EU and the United States at the WTO which was finally resolved in July 2001. The paper outlines the origins of the dispute in the EU's legal obligations to its preferred suppliers, primarily former colonies, and the subsequent evolution of the EU banana trade regime. The Single European Act and subsequent complaints to the GATT and the WTO have necessitated successive reforms of the EU banana regime, culminating in a landmark WTO Panel decision in 1997. These successive regimes are summarised, along with the GATT and WTO complaints and the WTO Panel findings. The resolution of the trade policy issues concerning bananas opens the way for the serious competition issues to be more readily addressed.

Keywords: banana trade; banana dispute; EU trade dispute; WTO

The acrimonious WTO banana trade dispute between the European Union and the United States, which drew to a close in July 2001, was precipitated by the reorganisation of the EU banana market so as to conform with the Single European Act. Successive EU trade regimes for the creation and implementation of a single internal banana market encountered substantial opposition from many quarters; from consumers within the EU, from producing countries – both preferred and non-

preferred, as well as from the major firms involved in the international banana export trade. The origins of the EU–U.S. banana trade dispute lie in the long-standing commitments of EU Member States to banana imports from former colonies in Africa, the Caribbean, and Latin America. The difficulty for the EU was to accommodate these interests simultaneously with its obligations to internationally agreed rules on the conduct of trade under the GATT and the WTO.

The development, course, and ultimate resolution of the dispute are highly complex given the intricate application of international trade law under the GATT and the WTO. This paper provides an overview of the origins of the EU–U.S. banana trade dispute and covers the successive legal challenges at the GATT and the WTO in the context of the international banana economy.

The International Banana Economy

Trade in bananas is driven by the spatial separation of production in the tropics and consumption in the major industrial markets of North America, Europe, and Japan. Bananas are the third most important internationally traded foodstuff by value, with total exports worth \$US 4.7 billion in 1999, after wheat (\$US 14.4 billion), and coffee (\$US 11.2 billion) (FAO, 2000). Bananas are therefore a critically important cash crop for many developing countries as well as a local staple food source.

The international banana economy has a distinctly dualistic structure in terms of cultivation, technology, and distribution networks. The greater part of world trade in bananas is undertaken, directly or indirectly, by a small number of multinational enterprises (MNEs). The three largest of these MNEs – Chiquita (originally United Fruit Co. and later United Brands), Dole (originally Standard Fruit Co. and later Castle & Cooke), and Del Monte – currently control some 60 percent of world trade. Their distribution activities however, are concentrated in the largest and wealthiest consuming markets, so that their international market power is *significantly greater than their apparent trade share*. All three MNEs are highly vertically integrated, incorporating a chain of control from production, specialised refrigerated shipping and ripening facilities through, in some cases, to retail distribution. This integration is facilitated by significant economies of scale in both technological inputs for cultivation and shipping that takes into account the inherent perishability of bananas. Vertical control is a critical source of competitive advantage that has enabled the MNEs to assure consistent supplies of high-quality, low-cost, brand-differentiated bananas that command price premia in the main consuming markets (Read, 1985).

A large number of smaller-scale firms, grower organisations, and individual smallholders continue to be engaged in export-oriented banana cultivation, operating in parallel to the extensive operations of the MNEs. While these producers cannot supply such large quantities of high quality fruit on a regular basis, they compete with the MNEs in many of the principal consuming markets. This competition has generally been on the basis of lower prices (and margins) for their smaller, less standardised, but much wider varietal range of bananas, aided by preferential market access via discriminatory tariffs and quotas and the existence of independent supply chains.

The Historical Organisation of the EU Banana Market: the Mark I EU Regime

The historical organisation of the banana market in the EU took its form from the amalgamation of pre-existing obligations and arrangements of many Member States to their former colonies, primarily in Africa and the Caribbean, under the Banana Protocol. This protocol was subsequently incorporated as a special protocol (No. 5) of the Lomé Convention, which formalised trade and aid relations between the Members of the EU and their former colonies, the African, Caribbean, and Pacific (ACP) States. Article 1 of the Banana Protocol states that “no ACP exporter will be treated less favourably in its traditional European markets than it has been used to in the past”.

The Mark I EU Banana Trade Regime

Under the original (Mark I) regime, preferential access for banana imports from the ACP countries under the Lomé Convention comprised a zero-rated tariff, while imports from third countries, generally referred to as the Dollar Area, incurred the full Common Commercial Tariff (CCT) of 20 percent. The specific conditions and application of the Banana Protocol were determined by individual EU Member States in accordance with their long-standing obligations to particular ACP States. Member States therefore possessed the right to restrict or even exclude imports of bananas from “non-traditional” sources even though they were classified as preferred under the Lomé Convention.

In addition, several Member States were granted special protective provisions for imports of bananas from their overseas departments (Départements d’Outre-Mer – DOMs). Initially, these provisions applied specifically to the French Caribbean DOMs of Guadeloupe and Martinique but, after the accession to the EU of Portugal and

Spain in 1986, they were extended to include Madeira and the Canary Islands respectively. DOM bananas have been eligible for price support payments under the EU's Common Agricultural Policy since 1993.

The nationally determined discriminatory measures in Member States were as follows. Two-thirds of the French market was reserved for its own DOM producers (Guadeloupe and Martinique) and the remaining third for CFA Franc Zone ACP States (Cameroun and Cote d'Ivoire). Only in the event of import prices exceeding a specified threshold were imports from alternative sources permitted, including those from other ACP States. Italy operated a global quota together with import licences, with special provisions reserving market share for imports from Somalia (an ACP state). The UK applied a global import quota but only issued import licences to Dollar Area suppliers when imports from the ACP failed to fulfill the overall quota. Portugal had a derogation to protect its own DOM producers in Madeira but permitted additional imports to supplement these supplies. The Spanish market was completely reserved for DOM shipments from the Canary Islands. Prior to enforced liberalisation by the EU, Greece imposed a blanket ban on all banana imports to protect its own (very limited) production in Crete, the only producing area within the EU itself. Finally, under a special protocol to the 1957 Treaty of Rome, (West) Germany was granted a derogation whereby all its imports of bananas, regardless of their source, were permitted to enter its market free of all trade barriers. The complex structure of the EU's original trade regime for banana imports is shown in table 1 using the structural typology of Read (1994).

Table 1 The Original Mark I EU Banana Trade Regime

Type I:	Complete free trade in bananas, applied to Germany under a special protocol of the Treaty of Rome.
Type II:	The standard CCT of 20 percent for non-preferential bananas, applied to imports of bananas by Belgium, Denmark, Ireland, Luxembourg, and the Netherlands.
Type III:	The standard CCT of 20 per cent for non-preferential bananas, applied together with additional specific nationally administered regimes by France, Italy, the UK, Portugal, Spain, and Greece.

The preferential tariff structure of the Mark 1 EU banana trade regime was therefore further complicated by additional discriminatory import measures in some

Member States, creating a highly complex hierarchical system of national preferences which favoured specific supply sources. Apparently incompatible with the fundamental objectives of creating free trade within a common market, this protectionist segmentation of individual EU national markets was sanctioned under Article 115 of the Treaty of Rome (now Article 134 of the Treaty of Amsterdam). This arrangement permitted a derogation from free trade in goods where national markets were subject to strict controls; the derogation for bananas remained in place for thirty-five years, until 1993.

The Implications of the Mark I EU Banana Trade Regime

The Mark I EU banana regime, underpinned by the Article 115 derogation, prevented the unrestricted movement of bananas within the EU and gave rise to significant market segmentation in accordance with the differing national import regimes. Table 1 reveals that eight separate and distinct EU trade regimes were applied to bananas in just twelve Member-State markets. Free trade was permitted solely in the German market and simple tariff protection prevailed in only the five relatively small Type II markets. In the Type III markets, Dollar Area bananas were effectively denied access to the large French and Spanish markets and greatly restricted in their access to the large UK market.

Market segmentation and restricted market access of this magnitude created sufficient scope for significant and persistent variation in national supply and demand conditions, with potentially adverse implications for both prices and competition. The mix of national regimes raised prices to consumers above the world level by guaranteeing market shares to preferred suppliers regardless of their relative efficiency, thereby generating quota rents for the ACP producing countries. This resulted in a distinctive pattern of banana imports which distorted the international pattern of production and trade.

The pattern of banana production and trade was further distorted by the impact of the EU's trade regime on the supply strategies of the MNEs. Chiquita, through its former UK subsidiary Fyffes, restructured its sourcing strategy so as to locate part of its production activities in several preferred ACP countries, notably Belize, Cameroun and Suriname. This strategy improved Chiquita's access to the EU market for bananas, in particular to the French and UK markets, enabling it to capture for itself some of the available quota rents.

The welfare effects of the Mark I EU trade regime for bananas are analysed in an extensive empirical literature. There is a general consensus that the regime generated

significant quota rents for producers in the many preferred countries at the expense of EU consumers. There is considerable disagreement as to the magnitude of these effects however, dependent upon the underlying assumptions concerning the elasticities of supply and demand and the impact of trade liberalisation (see in particular, Borrell and Yang, 1990, 1992; Borrell, 1994, 1996; Read, 1994; McCorriston and Sheldon, 1996; Guyomard et al., 1999).

The legal status of the Mark I EU banana trade regime can be queried under the GATT rules on two counts. First, in granting discriminatory preferences to the ACP States relative to the Dollar Area, the EU failed to apply the GATT principle of non-discrimination (Article XIII) under Part IV, the Generalized System of Preferences (GSP), with respect to imports from developing countries. This breach of Article XIII remained unchallenged for the duration of the Mark I banana regime, i.e., until 1993. Second, the derogation under Article 115 of the Treaty of Rome, permitting national market controls, was inconsistent with the *spirit* of GATT Article XXIV governing regional trade agreements (RTAs), since it was effectively permanent. Again, the status of this derogation remained unchallenged for the duration of the import regime. It might therefore be argued that many of the difficulties encountered in the reform of the EU banana regime could have been avoided if the status of the original regime had been subjected to earlier legal challenge.

The Single European Act & the Mark II EU Banana Trade Regime

The impetus for the reform of the EU's banana trade regime came from the Single European Act of 1986, which was intended to create a truly integrated market between EU Member States effective 1 January 1993. The Single Market legislation made obligatory "the right of third-country imports to circulate freely without restriction" (Commission of the European Communities, 1986), necessitating the abrogation of the Article 115 derogation for bananas. Further, it required a compatible new and unified EU external trade regime for bananas to be devised, regardless of its welfare implications. The new trade regime had to satisfy the legal requirement to establish a single internal market for bananas while simultaneously maintaining preferential access for imports from the ACP (and DOMs) in line with Article 1 of the Banana Protocol. Compatibility with the prevailing GATT rules for the conduct for international trade was therefore of only secondary importance, as per the Mark I regime.

The structure of the single banana market regime, generally referred to as the Common Market Organisation (CMO) for bananas, was subject to lengthy internal negotiations that exposed deep divisions *between* EU Member States (outlined in Stevens, 1996; Cadot and Webber, 2000). The extensive delays in drafting the necessary legislation meant that the new Mark II trade regime for bananas, under Council Regulation 404/93 (Commission of the European Communities, 1993), became effective only on 1 July 1993. This required the life of the Mark I regime to be extended for a further six months as a stop-gap measure. Because of the need to be compatible with the Single European Act, the new regime could only distinguish between imports by source and not by destination as well. The key elements of the Mark II regime are summarised in table 2.

Table 2 The Mark II EU Banana Trade Regime

Type M_I:	Imports from the DOMs, subject to general and specific quotas.
Type M_{II}:	Imports from the ACP, subject to a general “traditional” quota and specific quotas, all tariff-free.
Type M_{III}:	Dollar Area and “non-traditional” ACP imports, subject to a general quota of 2 million tonnes together with a fixed levy (tariff quota) of 100 Ecus (Euros) per tonne. Imports over the general quota were subject to a penalty levy of 850 Ecus per tonne. Further, the right to import under the general quota was allocated according to licences: A licences for “traditional” Dollar Area importers; B licences for DOM & ACP importers; and C licences for new entrants to the market.

There can be little doubt concerning the protectionist nature of both the Mark I and Mark II regimes. The primary intention of the EU was to create a new regime that left the position of the principal constituent interests, EU consumers, and preferred suppliers, unchanged. The restrictive rules for Type M_{III} imports of Dollar Area and non-traditional ACP bananas however, actually improved the relative position of the preferred (ACP) suppliers at the expense of all other interest groups (consumers, other suppliers, and the MNEs). For example, the equivalent *ad valorem* magnitudes of the tariff quota² on Type M_{III} imports were 21 percent and 24 percent, based upon figures for 1991 and 1992 respectively (Read, 1994), compared with the previous *ad valorem* external tariff of 20 percent. The *ad valorem* tariff equivalent magnitudes of the new

punitive penalty levy were 177 percent and 206 percent for 1991 and 1992 figures respectively (Read, 1994). The Mark II regime was therefore more protective than the Mark I, a view supported by more in-depth comparative empirical analyses of the two regimes (Borrell, 1994, 1996; Guyomard et al., 1999).

The Initial Legal Challenges to the EU Banana Trade Regime

The changes to the EU banana trade regime provoked a succession of legal challenges, not only at the international level with respect to contravention of the GATT rules but also from interest groups within the EU. This section outlines the legal case concerning the EU banana regime brought by the German Government against the European Commission, the two GATT complaints, and the subsequent evolution of the regime in response to the legal case and the complaints.

Germany Versus the European Commission

The six-month delay in implementing the Mark II EU banana regime in 1993 was partly a consequence of the German Government filing a case against the European Commission in the European Court of Justice after the publication of the detailed proposals. The German submission came in response to a vote by Deputies in the Bundestag (Lower House) regarding the loss of its national derogation under the special protocol and concern about the welfare impact of the Type M_{III} tariff quota on domestic consumers. Although there was little external support elsewhere in the EU for the first complaint, support for the second complaint also came from the Benelux countries. The strongest internal opposition to the Mark II EU banana import regime therefore came from those countries which had previously operated the most liberal import regimes (Types I and II under the Mark I regime).

The European Court of Justice decision in June 1993 ruled against the German and German/Benelux injunctions, so allowing the Commission to introduce the Mark II regime on 1 July. The final ruling was published in October 1994. With respect to the removal of the German derogation under the special protocol, the Court argued that the EU, through the European Commission, had the sole right to determine external trade policy. The joint complaint by Germany and the Benelux countries was rejected on the grounds that the Type M_{III} tariff quota was not fixed over time and did not cause “*serious and irreparable damage*”.

The First GATT Complaint

The first GATT complaint against the EU banana regime was made in February 1993 (i.e., before the creation of the WTO), prior to the publication of the EU's proposals during the final negotiations of the structure of the Mark II banana regime. The complaint was the outcome of a joint declaration at a Latin American Heads of Government Meeting in Ecuador by the presidents of seven Dollar Area exporting countries to the effect that the proposed new banana regime was “*protectionist, discriminatory and restrictive*” (see Sutton, 1997). A formal complaint was made by five Latin American producing countries – Colombia, Costa Rica, Guatemala, Nicaragua, and Venezuela – with the support of the United States. The complaint was, in effect, a shot across the bows of the EU in that it could only be considered in the context of the current banana regime, the stop-gap extension of the original Mark I regime (1 January to 30 June 1993). A complaint against the proposed Mark II regime, which had yet to be finalised and implemented, could not be sustained in that there was no *actual* contravention of the GATT rules. The first GATT complaint had two distinct elements:

- That the temporary regime (and by implication the Mark I and proposed Mark II regimes), was contrary to GATT Article I.1 on the application of Most-Favoured-Nation (MFN) to Special & Differential (S&D) Treatment under the GSP. This was because it incorporated a preferential tariff which discriminated between imports from the ACP States (zero-rated) and other developing countries (liable to the full CCT of 20 percent).
- That the restrictive tariff quotas in the temporary regime (and by implication the Mark I and the proposed Mark II regimes) were contrary to GATT Article XIII.1 on the use of discriminatory tariff quotas.

The first element of the complaint had potentially wide-reaching ramifications in that it challenged the principle of granting discriminatory preferences to selected developing countries, such as under the Lomé Convention. The EU however, was permitted to favour the ACP States over other developing countries under Lomé, under what was then an annual derogation from the GATT known as the Lomé Waiver. The EU argued that its banana regime was consistent with the GATT rules and other undertakings and that any inconsistencies were covered by the Lomé Waiver. In its findings, published on 3 June 1993, the GATT Panel found that there was no case to answer regarding the EU's discriminatory preferential tariff since this was fully covered by the Lomé Waiver (GATT, 1993).

The second element of the GATT complaint referred to the use of discriminatory tariff quotas in the Type III national markets of the EU. Article X of the GATT regulations generally requires tariff quotas and penalty levies to be tariffed so as to provide greater transparency, although they may be permissible if applied to all imports. The use of a simple tariff however, would have made explicit the EU's deliberate objective of restricting general market access and discriminating between alternative supply sources via administered regulations in the Type III national markets. The GATT Panel decided that the Lomé Waiver did not give the EU *carte blanche* in its use of discrimination. The derogation was considered to apply specifically to tariff discrimination under Article I and not generally to include the use of tariff quotas under Article XIII. The Panel required that the tariff quotas should therefore be brought into conformity with the GATT rules (GATT, 1993).

The two GATT complaints concerning the EU banana trade regime were subject to GATT disciplines and dispute settlement procedures since the WTO and its constituent agreements had not, as yet, been finalised (they came into effect on 1 January 1995). The weakness of the GATT dispute settlement procedures and the lack of enforceability of a Panel decision, given the need for unanimity, meant that the EU was able to veto the verdict and effectively ignore the adverse ruling. The GATT Panel decision was therefore unenforceable. The EU also argued that it did not need to respond to the adverse GATT Panel ruling on Article XIII because it applied to the temporary regime, which was to be superseded by the Mark II banana regime on 1 July 1993.

The Second GATT Complaint

The GATT complaint by the five Latin American countries was renewed in July 1993 after the expiry of the EU's temporary banana regime and the belated introduction of the Mark II trade regime. The grounds for the second GATT complaint were similar but not identical to those of the first. The Mark II regime formalised the general EU-wide application of discriminatory tariff quotas to Type M_{II} and M_{III} imports in place of the specific national quotas used in the Type III markets under the Mark I and temporary regimes. Further, the Mark II regime introduced new special distribution import licences for M_{III} imports under the general quota. The second GATT complaint argued that these licences were in contravention of Article III.4 on National Treatment in that they discriminated against non-EU banana distributors and therefore affected market access, especially given the market dominance of established EU distributors.

The general (EU-wide) tariff quota in the Mark II banana regime applied to all “non-traditional” imports, regardless of source. It was designed to enable Dollar Area imports to continue to supply their own “traditional” markets, so allowing the banana MNEs to maintain their pre-existing EU market shares. The tariff quotas however, were highly restrictive in that they were set in excess of best-ever levels of ACP banana exports to the EU, and so contravened Article XIII on discriminatory tariff quotas. The setting of the tariff quota at two million tonnes therefore effectively prevented the MNEs from using Dollar Area imports to penetrate the newly liberalised Type III national markets. Market penetration could only be achieved, and the penalty levies avoided, by switching the supplies away from the MNEs’ “traditional” markets.

The special distribution licences were intended to improve the market access and competitiveness of DOM and ACP exporters by linking Type M_{III} imports to the internal distribution system via licence quotas. The licensing system was devised to encourage EU banana distributors to diversify their sources of supply, particularly the taking-up of ACP supplies by traditional distributors of Dollar Area bananas. In addition, the system also encouraged distributors of “traditional” imports in former Type III markets to penetrate Type I and II markets, previously dominated by the MNEs. Because the licences were allocated according to the past distribution and marketing activities of the licensees, only 3.5 percent of the quota was reserved for C licences, which were freely available to new entrants to market “non-traditional” ACP and/or Dollar Area bananas (see table 2). The licences therefore did not determine the source of supply under the general and specific quotas but rather imposed restrictions on the competitive structure of distribution in the EU market. A draft proposal that licences be used to enforce the parallel marketing of ACP and Dollar Area bananas was dropped after encountering substantial opposition from the MNEs and distributors. The new licensing arrangements had important competitive implications for the market structure under the Mark II banana trade regime because they greatly inhibited the contestable impact of entry by new competitors.

The second GATT Panel announced its decision on 11 February 1994. It found against the EU with respect to the use of the new tariff quotas in contravention of Article XIII because they were excessively restrictive and therefore not allocated broadly according to market share. In addition, the new licensing system was found to contravene Article X on National Treatment because it unfairly restricted market access and was not covered by the Lomé Waiver (GATT, 1994). Again, the inherent weaknesses of the GATT dispute settlement procedures enabled the EU to veto the

adoption of the Panel decision. By this time however, the Uruguay Round negotiations had made significant progress in strengthening the WTO's dispute settlement procedures. Given the adverse second GATT Panel verdict concerning the use of tariff quotas and licences, the Mark II EU banana trade regime became vulnerable to a WTO complaint.

***The Mark III EU Banana Trade Regime:
the Framework Agreement on Bananas***

The threat of a further complaint against the Mark II banana regime under the new WTO dispute procedures led the EU to enter into negotiations, brokered by the United States, with four of the original Latin American plaintiffs (excluding Guatemala) in an attempt to head off such a legal challenge. These negotiations took place in the context of the Uruguay Round discussions on market access in the Agreement on Agriculture and resulted in the drawing-up of the Framework Agreement on Bananas in early 1994. Under the Framework Agreement, the EU agreed to increase the Type M_{III} general quota for Dollar Area and "non-traditional" ACP imports to 2.2 million tonnes and incorporate specific national quotas within the general quota for each of the four plaintiff countries (Commission of the European Communities, 1994). In return, the four plaintiff countries agreed to suspend any WTO complaint against the EU's banana regime until December 2002 (*Europe/Caribbean Confidential*, 1994).

The Framework Agreement and the subsequent withdrawal of the threatened GATT complaint by four of the plaintiff countries had two distinct effects. The new Mark III EU banana trade regime further complicated the Mark II regime by extending the provisions for restrictive tariff quotas in the general Type M_{III} quota. It also increased the likelihood of a WTO legal challenge under Article XIII from excluded Dollar Area exporting countries by enabling the signatory countries to increase their banana exports to the EU at the expense of other Dollar Area exporters. The Framework Agreement weakened the existing legal threat, but Guatemala persisted with its Article XIII complaint, supported by the remaining Dollar Area exporting countries.

On 1 January 1995, an additional quota was created within the Mark III regime to take account of the EU accession of Austria, Finland, and Sweden. This autonomous quota of 353,000 tonnes was added to M_{III} imports (Dollar Area and non-traditional ACP imports) with the same tariff rates applied and with quota allocations to all substantial suppliers.

The WTO Complaint

The third complaint against the EU's banana trade regime was filed in September 1995 and resubmitted in February 1996 and was the first complaint which subjected the EU banana regime to the discipline of WTO procedures, including its new and more effective dispute settlement procedures (DSP). The WTO complaint differed significantly from the two GATT complaints in that the United States participated as the lead plaintiff. It was supported by Guatemala, Honduras, Mexico and, after its WTO accession in 1996, Ecuador. The United States was not a direct party to the dispute in that only trade between the Dollar Area exporting countries and the EU was affected. In addition, the Framework Agreement, and therefore the Mark III regime, had actually been drawn-up partly at the behest of the U.S. Government as part of the Uruguay Round negotiations.

This significant change in the policy stance of the United States was precipitated by the strategic shortcomings of Chiquita, the leading U.S. banana firm, in dealing with the impact of the Mark II and Mark III EU banana regimes. In anticipating a single EU banana market, Chiquita's European supply strategy was switched towards concentrating on Latin American Dollar Area imports. In addition, Chiquita disposed of its UK and Ireland subsidiary Fyffes, which possessed ACP-based plantation and contract supply operations in Belize and Suriname (as well as Cameroun). The implementation of the restrictive tariff quotas for Dollar Area (Type M_{III}) imports under the Mark II and Mark III banana regimes therefore had an adverse impact on Chiquita's EU market share. Its major competitors such as Dole however, retained their diversified (Dollar Area and ACP) supply sources and/or acquired traditional distributors.

Chiquita, together with the Hawaiian Banana Association, filed a Section 301 application in September 1994 alleging that the Mark III EU banana regime was detrimental to their own commercial interests and those of the United States. Chiquita's intensive lobbying, including substantial donations to both the Democratic and Republican Parties, produced a cross-party alliance of support from U.S. Senators and Representatives. This pressure led to a Section 301 investigation of the EU banana regime being launched by U.S. Trade Representative (USTR) Mickey Kantor on 17 October 1994 on the grounds of possible discriminatory treatment of U.S. companies.

After a preliminary investigation, USTR Mickey Kantor announced on 9 January 1995 that the structure of the Mark III EU banana regime, particularly its licensing

system and specific quotas, was adversely affecting U.S. economic interests through its discriminatory treatment of U.S. firms. The completed Section 301 investigation confirmed this view when, on 27 September 1995, Kantor announced that the United States would file a WTO complaint against the EU with respect to the use of the restrictive tariff quotas and distribution licences. The formal announcement of the U.S. WTO complaint is alleged to have been made less than a day after a donation to the Democratic Party of some \$US 500,000 from the chairman of Chiquita, Carl Lindner (Chiquita's lobbying activities are outlined in Cadot and Webber, 2000). This initial WTO complaint was resubmitted on 7 February 1996 after Ecuador became an additional party to the dispute upon its acceding to the WTO.

In a further development, Mickey Kantor announced on 10 January 1996 that both Colombia and Costa Rica, as signatories of the Framework Agreement, had also been found to be harming U.S. interests through the allocation of their EU tariff quotas. In return for not imposing trade sanctions, the United States successfully demanded that these two (Dollar Area) exporting countries agree to support their WTO case and reallocate some of their EU import licences to Chiquita and Dole.

The WTO banana complaint contained many elements similar to those of the first two GATT complaints but was filed according to the more complex rules of the new Uruguay Round Agreements, including the General Agreement on Trade in Services (GATS), which provided much greater scope for challenging the legality of the distribution licences. The key elements of the WTO complaint were as follows (presented according to the typology adopted by the WTO Panel):

Tariff Issues

That the Mark III EU regime (and by implication the Mark I and II regimes) contravened Article I.1 of the GATT 1994 with regard to non-discrimination and the application of MFN with respect to the use of discriminatory tariffs favouring "non-traditional" imports from ACP countries (WTO, 1997a, IV.2). Guatemala and Honduras also alleged that the Mark III regime (and the Mark II regime) contravened Article II of the GATT 1994 with regard to the schedule of concessions in that *ad valorem* equivalent duties were, either actually or potentially, higher than the 20 percent bound *ad valorem* CCT rate (WTO, 1997b, IV.96).

Tariff Quota Allocation Issues

That the Mark III EU regime (and by implication the Mark I and II regimes) contravened Article XIII.1 of the GATT 1994 with regard to non-discriminatory quantitative restrictions through the use of discriminatory tariff quotas. Guatemala and

Honduras also alleged that it contravened Article I.1 of the GATT 1994 with regard to non-discrimination and the application of MFN with respect to the use of discriminatory tariff quotas favouring the ACP countries.

Import Licensing Regime Issues

That the allocation of special distribution licences under the Mark III (and Mark II) regime and hurricane licences under the Mark III regime (and Mark II and Mark I regimes) contravened the GATT 1994 Articles I, III.4, X.3, XI and XIII; the Agreement on Import Licensing Procedures Articles 1.2, 1.3, 3.2 and 3.5; TRIMS Articles 2 and 5; the Agreement on Agriculture Article 4.2; and the GATS Articles II and XVII. More specifically, these articles are as follows:

- GATT 1994 Article I on Non-Discrimination and MFN, Article III.4 on National Treatment, Article X.3 on the impartial administration of trade regulations, Article XI on the general elimination of quantitative restrictions (included only in the plaintiffs' joint submission), and Article XIII on discriminatory quantitative restrictions (Guatemala, Honduras, and Mexico only).
- the Agreement on Import Licensing Procedures Article 1.2 on conformity with GATT 1994 (Ecuador and Mexico), Article 1.3 on neutrality in the allocation of import licences, Article 3.2 on the non-restrictive effects of non-automatic import licences, and Article 3.5 on the administration of non-automatic import licences (Mexico and the United States).
- TRIMS Article 2 on the consistency of national treatment and quantitative restrictions with GATT 1994 Articles III and XI and TRIMS Article 5 on the notification of TRIMS (Ecuador, Guatemala, Honduras, and the United States).
- the Agreement on Agriculture Article 4.2 on the tariffication of quantitative restrictions (Ecuador only).
- GATS Article II on Non-Discrimination and MFN and Article XVII on National Treatment (both articles Ecuador, Mexico, and the United States only).

The WTO Complaint & the DSP

The new Uruguay Round Agreements provided much greater scope for a legal challenge to the special distribution licences in the Mark II/III EU banana regimes at the WTO, evidenced by the greater sophistication of the complaint. In addition, one of the principal developments in the Uruguay Round was the introduction of a more effective fast-track DSP under the auspices of the WTO for resolving international

trade disputes from 1 January 1996. The resubmitted WTO complaint against the EU banana regime Mark III therefore fell within the provisions of the new DSP. This imposes a 60-day limit on consultation between the disputing parties, after which they may request the establishment of a Dispute Panel (for details, see Hoekman and Kostecki, 2001, Box 3.1). The failure of the parties in the banana dispute to agree upon a resolution within this time limit led to the convening of a WTO Dispute Panel in May 1996.

The WTO Panel Decision

The WTO Dispute Panel for bananas published its four reports, one for each of the main plaintiffs (Guatemala and Honduras share a Report), on 22 May 1997. Its principal findings were as follows:

Tariff Issues

The WTO Panel noted that the EU's discriminatory tariff preferences for ACP bananas were inconsistent with GATT 1994 Article I.1 but found that there was no case to answer since its obligations were fully covered by the Lomé Waiver (WTO, 1997a, 7.136). The Panel agreed with the second GATT Banana Panel on the Article II complaint by Guatemala and Honduras that the EU duties were inconsistent with the Article (WTO, 1997b, 7.138) but rejected it on the grounds that this inconsistency was cured by the EU's Uruguay Round Schedule (WTO, 1997b, 7.141).

Tariff Quota Allocation Issues

The WTO Panel's findings concerning the Article XIII.1 complaint were based upon the successive analysis of points relating to the structure and allocation of the restrictive tariff quotas in the Mark III regime, i.e., including the provisions of the Banana Framework Agreement. The Panel found that the EU's claim to be operating two distinct import regimes – one for traditional ACP imports based on tariff preferences and one for non-traditional imports (from the ACP and third countries) based on tariff quotas – was contrary to Article XIII.1 and circumvented the non-discrimination provision of Article XIII (WTO, 1997a, 7.82).

The Panel members were satisfied on the issue of substantial interest regarding the Framework Agreement since Colombia and Costa Rica were the only GATT Contracting Parties with EU market shares over 10 percent in the reference period (WTO, 1997a, 7.85). However, the Panel found against the EU with respect to its allocation of tariff quota shares to WTO Members without substantial interest

(Nicaragua and Venezuela) under the Framework Agreement but not to others, i.e., Guatemala (WTO, 1997a, 7.90). Further, the Panel found against the EU with respect to its failure to allocate a tariff quota to Ecuador under this agreement after its WTO accession in 1996 (WTO, 1997a, 7.93).

The Panel then considered the obligations of the EU under the Lomé Convention to allocate ACP tariff quota shares on the basis of pre-1991 best-ever exports. The Panel agreed that these tariff quota shares were acceptable under Article XIII.1 and therefore covered by the Lomé Waiver but that tariff quota shares in excess of best-ever exports were not (WTO, 1997a, 7.110).

The Panel also found that the inclusion of the Framework Agreement tariff quota shares in the Uruguay Round Schedule and the Agreement on Agriculture did not permit the EU to act inconsistently with the requirements of Article XIII (WTO, 1997a, 7.118, 7.127) (see McMahon, 2001). The Panel made no finding on the Article I complaint by Guatemala and Honduras relating to tariff quota shares since it preferred to tackle the issue under Article XIII (WTO, 1997b, 7.130).

Import Licensing Regime Issues

The WTO Panel's analysis of the import licensing issues is complex and covers more than 200 paragraphs of legal arguments. The Panel found that the EU licensing procedures were subject to the scope of the Agreement on Import Licensing Procedures and that the GATT 1994 and Article 2 of TRIMS were applicable (WTO, 1997a, 7.156, 7.163). The Panel investigated four principal elements of the EU licensing procedures:

Operator Categories

This refers to the EU's distinction between importers of Type M_{III} imports in the Mark II and Mark III banana regimes in the allocation of licences according to origin, i.e., non-traditional DOM and ACP imports (B licences) and non-traditional Dollar Area and third-country imports (C licences). The WTO Panel agreed with the second GATT Panel that the allocation of B licences was inconsistent with Article III.4 because it required importers to market DOM and ACP bananas if they wished to be allocated import licences for third-country banana imports (WTO, 1997a, 7.182). For the same reasons, the Panel found that the allocation of B licences in particular was inconsistent with Articles I.1 and X.3(a) and that the Lomé Waiver did not apply to the EU's use of discretionary licences (WTO, 1997a, 7.204, 7.207, 7.212). The Panel found that the allocation of B licences created less favourable conditions for

competition for like service suppliers of the complainants' origins such that it was inconsistent with GATS Articles XVII and II (WTO, 1997a, 7.341, 7.353).

Activity Functions

This refers to the EU's allocation of A and B licences to operators according to their activity, i.e., primary importers, secondary importers, and ripeners. The plaintiffs argued that this required operators to change their pattern of economic activity so as to maximise their licence allocation, while the EU countered that it limited the potential for vertical control of the distribution chain. The WTO Panel found that, because the EU treated all operators consistently regardless of category, the regime was consistent with Article III.4 but that the differential allocation of licences for traditional ACP imports was inconsistent with Articles I.1 and X.3(a) and that the Lomé Waiver was not applicable (WTO, 1997a, 7.219, 7.223, 7.226, 7.231). The Panel also found that the effect of the licences was to reallocate market share and provide less favourable conditions for competition and so was inconsistent with GATS Article XVII (WTO, 1997a, 7.368).

Export Certificates

These were required by holders of A and C licences for Type M_{III} imports from Colombia, Costa Rica, and Nicaragua (Framework Agreement countries), i.e., to be matched with import licences. The Panel found that this was inconsistent with GATT 1994 Article I.1 and GATS Articles XVII and II (WTO, 1997a, 7.231, 7.380, 7.385).

Hurricane Licences

The EU used these licences to permit compensatory non-traditional and third-country imports when DOM and traditional ACP supplies were adversely affected by hurricanes. The Panel found that the EU treated non-traditional and third-country imports less favourably in the allocation of these licences even though their actual impact was to increase imports from these sources. The allocation of the licences was therefore inconsistent with GATT 1994 Articles III.4 and I.1 and Article 1.3 of the Agreement on Import Licensing Procedures, although the Panel agreed that the Lomé Waiver was applicable to Article I.1 (WTO, 1997b, 7.250, 7.256, 7.263, 7.259). The Panel also found that the allocation of these licences was inconsistent with GATS Articles XVII and II for similar reasons to those that applied to the operator categories and export certificates (WTO, 1997a, 7.393, 7.397).

WTO Panel Conclusions

The WTO Panel therefore found that the EU was in violation of its WTO commitments regarding the allocation of import licences and the use of tariff quotas, including the Framework Agreement on Bananas, but that the preferential tariff treatment of ACP exporting countries was permitted under the Lomé Waiver. The EU was therefore required to reform its banana import regime by January 1999 so as to comply with the WTO Panel decision.

The Subsequent Evolution of the EU Banana Trade Regime

The EU engaged in stalling tactics after this adverse WTO Panel decision by appealing against the ruling. The appeal was based primarily upon the Panel's interpretation of the Agreement on Agriculture in relation to Article XIII and the Lomé Waiver. The WTO Appellate Body Report, published in September 1997, supported the Panel decision in the main and thus rejected the EU's appeal (WTO, 1997c).

The Mark IV EU Banana Trade Regime

After the failure of its appeal, the EU began the process of initiating changes to its banana trade regime in order to ensure compliance with the WTO Panel decision. These changes were published in July 1998 in preparation for the 1 January 1999 deadline (Commission of the European Communities, 1998a). The principal changes are shown in table 3; there were few substantive differences between the Mark II, Mark III and Mark IV EU banana regimes. The Mark IV regime considerably eased the licensing conditions, a particular source of concern to both the Dispute Panel and the Appellate Body, and introduced an autonomous quota. Very little was changed with respect to the critical issue of the use of restrictive tariff quotas and, as such, the Mark IV EU banana trade regime did not appear to comply with the WTO rules either.

The tariff quota issue was again identified as a problem by the plaintiff countries in August 1998. The EU then sought a Panel decision in December 1998 concerning the WTO-compliance of its Mark IV banana trade regime. Ecuador retaliated by requesting the re-establishment of the WTO Panel to determine the legality of the EU's changes to the Mark III regime. A further complaint was also made by the original plaintiffs (minus Ecuador but including Panama) concerning the EU's revisions to the Mark III regime in light of the original Panel decision. The Panel convened at the request of the EU could not confirm that the Mark IV regime was

WTO-compliant (WTO, 1999a, 5.1), a decision supported by the Panel for Ecuador (WTO, 1999b, 7.1).

Table 3 The Mark IV EU Banana Trade Regime: Revisions to the Mark II & III Regimes

Type M_{II}:	The general ACP quota set at 875,000 tonnes tariff-free, with a preferential tariff for imports above this tariff quota.
Type M_{III}:	<p>The “non-traditional” GATT-bound tariff quota to remain at 2.2 million tonnes but with a tariff rate of 75 Ecus (Euros) per tonne.</p> <p>The tariff rate for “non-traditional” ACP imports to be reduced to zero.</p> <p>A new and more transparent licence system granting rights to all importers active in the reference period 1994-6. Pure traders in import licences were excluded from this system (Commission of the European Communities, 1998b).</p>

The EU–US Compensation Dispute

The WTO dispute then moved on to an Arbitration Panel which found that the Mark IV regime continued to be non-compliant with the WTO rules. The plaintiffs were therefore entitled to compensation via the nullification or impairment of trade benefits. On 3 March 1999, the United States announced punitive sanctions, in the form of 100 percent tariffs worth \$US 520 million, on a targeted range of EU exports, including Scottish cashmere products. The decision of the Arbitration Panel was published on 9 April 1999 and stated that the United States had the right to impose sanctions to the value of \$US 191.4 million (WTO, 1999c, 8.1). The United States then requested authorisation from the WTO for the suspension of trade concessions to the EU to this value. The Arbitration Panel also permitted sanctions by Ecuador against the EU to the value of \$US 201.6 million (WTO, 2000, 170), rather less than the \$US 450 million originally requested but still substantially greater than the annual value of its imports from the EU.

The pre-emptive announcement by the United States concerning its punitive sanctions against the EU resulted in a WTO complaint by the EU concerning the legality of the U.S. action. The Panel found that the United States had, in pre-empting the decision of the Arbitration Panel, violated the GATT rules and the provisions of the DSP.

The Mark V EU Banana Trade Regime: Phases 1 & 2

The findings of the WTO Decision and Arbitration Panels against the EU banana regime, and the consequent imposition of punitive trade sanctions, led the EU to agree to make a number of changes to its banana import regime. Its immediate response was to consider several alternative means to resolve the trade dispute and consult with the interested parties, the main problem being to amend the tariff quota and licence systems at the heart of the dispute. The details of the proposed Mark V banana regime were published in October 2000 and became effective on 1 July 2001 (Commission of the European Communities, 2001). Its implementation signalled the end of the U.S. WTO complaint. The Mark V banana regime comprises two separate and distinct phases, detailed in table 4.

Table 4 The Mark V EU Banana Trade Regime

Phase 1	<p>A transitional system based upon three separate tariff quotas open to imports from all origins, to remain in place until 31 December 2005.</p> <p><i>A Quota:</i> a 2.2 million tonnes tariff quota at a rate of 75 Euros bound in the WTO.</p> <p><i>B Quota:</i> a 353,000 tonnes tariff quota at a rate of 75 Euros.</p> <p><i>C Quota:</i> an autonomous tariff quota of 850,000 tonnes at a rate of 300 Euros.</p> <p>Imports from the ACP to be zero-rated. Imports from third countries over and above the combined <i>A</i> and <i>B</i> tariff quotas, without adjustment of the <i>B</i> quota by the EU for market subject to exceptional circumstances, to incur a penalty levy of 300 Euros per tonne (subject to revision). The tariff quotas to be allocated on a first-come first-served basis but in accordance with traditional trade flows and managed on a fortnightly or weekly basis to ensure a smooth flow of banana imports.</p>
Phase 2	<p>A tariff-only system with a flat-rate tariff from 1 January 2006. The rate to be determined so as to provide <i>a level of protection and trade as close as possible to the system of tariff quotas</i> in order to maintain market balance and avoid losses for suppliers (emphasis added).</p>

The Mark V EU banana trade regime represents a significant change in the policy position of the European Commission concerning the WTO-compatibility of its

preferred regime. Phase 1 is a temporary continuation of the problematic tariff quota system. The introduction of a simple tariff-based system in Phase 2 in 2006 however, represents a fundamental shift in Commission thinking and recognises that its banana regime should, in future, be compliant with WTO rules for the conduct of trade. It is important to note however, that most of the interested parties in the dispute, and the exporting countries in particular, nevertheless actually prefer a managed tariff quota system to a flat-rate tariff regime (Commission of the European Communities, 1999) in spite of the former not being WTO-compatible. The explanation for this apparently paradoxical preference is that, although the flat-rate tariff in Phase 2 will greatly simplify the import regime, it will result in the loss of the quota rents. Further, it is also likely to lead to increased intensity of competition in the EU market, with an uncertain outcome for many participants.

Conclusions: Trade Liberalisation & Welfare in the EU Banana Market

This discussion of the WTO banana dispute focuses solely on trade policy analysis and the legality of the EU banana regime in the context of the WTO rules for the conduct of international trade. The EU–U.S. banana trade dispute is extremely complex but it is important to note that it also has a significant competitive dimension discussed in depth elsewhere (see Holmes and Read, 2001; Read, 2002). The primary concern of the WTO is enforcing the agreed rules on international trade according to its Articles and ruling on the legality of Member States' trade regimes. Specific allowance is made for granting preferential market access to developing countries under the GSP, subject to Article XIII on Non-Discrimination. The EU has been permitted to discriminate between particular developing countries under the Lomé Waiver, an Article XIII derogation. A critical issue in the WTO banana dispute however, has been the extent to which discrimination can be permitted under such a derogation. The WTO Panel ruled that the Lomé Waiver could only be applied to discrimination in accordance with the GATT rules such that tariff quotas, whether generally or specifically discriminatory, were WTO-incompatible. The problem for the EU has been that its historical obligations to the ACP, enshrined in the Lomé Convention, resulted in its discriminatory treatment of the Dollar Area developing countries, the principal supply source of the major U.S. banana firms.

Although the banana dispute was fought out in the WTO arena, its underlying cause can be seen to be the battle for quota rents in the EU market between preferred

ACP exporters and the MNEs. The successive EU banana trade regimes, excluding Phase 2 of Mark V, can therefore be seen as attempts to utilise trade policy to achieve domestic competition objectives by hindering market penetration by the MNEs. This strategy has been criticised for the priority given to special interests over an efficient and transparent trade policy (Read, 1994; Wolf, 1999), and, having been ruled WTO-incompatible, it will now have to be pursued via orthodox competition policy after 2006.

The advent of Phase 2 of the Mark V regime in 2006 will greatly improve the efficiency and transparency of the EU banana regime, with benefits for all consumers and some producers. In this respect, both the ACP producers and the MNEs can be seen to have lost out, since Phase 2 will eliminate quota rents through the introduction of a flat-rate tariff. It is particularly ironic that the elimination of quota rents in the EU banana market is a direct result of the U.S. complaint to the WTO at the instigation of the major banana firms. The U.S. complaint was unusual in that it was based upon alleged discriminatory treatment of U.S. firms in the EU market although no U.S. jobs were at risk, exposing the United States International Trade Commission to criticism that it was in hock to corporate interests. The outcome is likely to be a reduction in the long-term profitability of Chiquita and Dole in the EU market as a result of the forthcoming introduction of a flat-rate tariff system, most probably contrary to their original objective of enhanced market power in a still heavily protected market. The ability of the banana MNEs to transform the former quota rents into oligopoly rents through the exercise of their market power will depend upon the willingness of the EU competition authorities to regulate the market effectively. Problems relating to restructuring in some ACP banana exporting states can now be dealt with more directly via aid transfers.

The banana dispute also highlights the improved workings and efficiency of the WTO's DSP compared with that of the GATT. Neither the EU nor the United States emerged from this lengthy dispute particularly well (see Wolf, 1999). The EU dragged its feet and made use of the WTO disputes and appeals procedures to draw out the final decision and delay WTO-compliant reform of its banana regimes. The U.S. action, initiated at the behest of a corporate lobby and involving no material domestic loss, was questionable although the Panel decision is likely to be a pyrrhic victory for the U.S. banana firms. Further, the pre-emptive (and illegal) inflated initial U.S. claim for trade sanctions worth \$US 520 million indicated a degree of contempt for the WTO and its DSM that does not augur well for the future. Nevertheless, the conclusion of the dispute in July 2001 should be regarded as a success for the WTO,

even though it demonstrates yet again that trade policy alone cannot achieve distributional objectives and that free and fair trade requires a competition dimension (Holmes and Read, 2001).

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Endnotes

¹ A longer and more detailed version of this paper, including a discussion of competition-related issues, is to be published as “The EU-US WTO Banana Dispute & the Evolution of the EU Banana Trade Regime” in *Trade Liberalization, Competition & the WTO*, edited by C.R. Milner & R. Read (Cheltenham: Edward Elgar, 2002).

² A tariff quota is a volume quota which is also subject to a specific tariff. In the case of Type M_{III} bananas in the Mark II regime, this was 100 Ecus (Euros) per tonne, i.e., not *ad valorem*. The *ad valorem* equivalent is calculated as a percentage of the specific tariff with respect to the value per tonne of the import over a specified period. The *ad valorem* magnitude of a specific penalty levy can be calculated in a similar way.

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