US – EU BANANA DISPUTE: A CASE STUDY OF RETALIATORY TARIFFS ON PECORINO CHEESE

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INTRODUCTION

In the post war era, European banana imports were divided into two kinds. Some countries, such as the Great Britain, France and Spain mostly imported from their former colonies in Jamaica, Dominica, St. Lucia, Ivory Coast, and Cameroon. Germany, which is the largest banana consuming country in the Europe, offered a free market for bananas (Barlett and Steele, 2000).

In that time seventy African, Caribbean and Pacific (ACP) countries negotiated preferential agreements on trading rights with the European Economic Community. The European Community (EC) established a system, which gave its former colonies preferential trading terms for bananas, sugar and other tropical products. These agreements are popularly known as the Lomé Conventions.

The first Lomé Convention started in 1975, and re-negotiated at five-year intervals. The current, fourth Lomé Convention, which took effect in 1990 (Lomé IV) has a life of ten years. The trade provisions of the Lomé Convention exempt Caribbean and other ACP countries' imports from import duties. Successive banana protocols have guaranteed and maintained these advantages which the Caribbean and other ACP states have traditionally enjoyed in certain European markets, especially in the United Kingdom, France and Italy (The EU Trading Regime).

Bananas are the fifth most important product in the world trade. The European Union's banana production accounted for only 21% of its domestic market in 1990. It is mostly concentrated in Crete, the Canary Islands, Madeira, the Azores and the French Overseas Departments of Guadeloupe and Martinique.

'Dollar' bananas are principally produced in Latin America and marketed by Chiquita, Del Monte and Dole, US multinational corporations. Latin American bananas are much cheaper than in ACP countries (Grant, 1997, p. 135). ACP bananas are grown on small family farms with little or no mechanization or irrigation. Banana yields are below those in Honduras, Ecuador and Guatemala. The cost of banana production in the Caribbean is two times higher than in Latin American countries. Great Britain and France insisted that banana production in ACP countries is crucial for their economic growth and social welfare.

The economies of most ACP countries depend on banana production. In small island nations, by the late 1980s, about 30% of the work force was employed in banana plantations. In Windward Islands, bananas provide year-round income to farmers. (Barlett and Steele, 2000).

In 1993, the European Union established its current banana regime (Grant, 1997). Instead of an open market, which Chiquita hoped for, the EU continued its old regime, providing preferential trading rights to ACP countries. The new regulation took effect on July 1, 1993 (Barlett and Steele, 2000).

The pressure from the World Trade Organization forced the European Community to make a series of changes in its banana regime. On July 28, 1998 the Council of Ministers of the European Community modified its banana regime and adopted the new 1637/98 Council Regulation, which maintained the EC GATT bound tariff quota of 2.2 million tons at the in-quota tariff rate of 75 ECU and zero for ACP imports, and limited the quantity of traditional ACP banana imports eligible for zero tariff at 857,000 tons.

In accordance with WTO rules, quota allocations are given to all substantial banana suppliers to the European Union: Ecuador (26.17%), Costa Rica (25.61%), Colombia (23.03%) and Panama (15.76%). The goal of this decision is to have a more open market for banana imports. The share of the tariff-rate quota reserved for the 'newcomers' will be increased to 8% up from 3.5% under present import policy (Directorate General for Trade, 1998).

Some members of the European Union, such as France, Spain and Portugal, are still in favor of the banana regime, but others, such as Germany want a more efficient and open market for bananas (MacPherson, 1999). There was already a fragmentation in EU member countries over the banana issue: Germany, the major banana importer, as well as the Benelux countries, Austria, Denmark, Finland and Sweden, want higher quotas for the 'dollar' bananas. However, the countries that have their own interests in ACP countries continue to protect them (Grant, 1997).

On September 10, 1999 the European Commission agreed to a 'tariff-only' system as a possible solution to the dispute with the United States and Latin American countries over the EU's banana import regime (Journal of Commerce, September 10, 1999). On December 16, 1999, the president of the European Union, Romano Prodi, announced that the EU did not intend to make changes in its current tariffs on Central American banana policy.

EU import licenses were allocated in relation to the activities of primary importers, secondary importers and marketing polices. Banana import quotas for Chiquita, Del Monte and Dole, US multinational corporations, were allocated according to three categories. "It appears that part of the aim of this complex arrangement was to enable the ACP companies to cross-subsidise their more expensive ACP bananas from the profits of Dollar bananas" (Grant, 1997, p.135).

The Prime Minister of the Dominican Republic, James Edison, proposed a system that would allow the European Union to decrease tariffs on Central American bananas to 115 euro/ton from EU's proposed 275 euro/ton, and will allow the Caribbean and African countries a zero tariff on their bananas. This proposal will enable the US's biggest exporters, Dole and Chiquita, to capture 80% of European banana market leaving only 20% of the market to the ACP countries. The European Commission proposed "a two-step approach: a transitional tariff-rate quota (TRQ) system, which would maintain both the current GATT (General Agreements on Tariffs and Trade) bound quota of 2.2 million tons and the autonomous quota of 353,000 tons, both with a tariff of 75 euro/ton and open to all suppliers. The new third quota of 850,000 tons would be opened to all suppliers "at a level of tariff, which would ensure that the TRQ is filled. Within this quota, bananas from favored nations would have a maximum preference of 275 euro/ton" (Bourie, 1999). After a transition period through January 1, 2006, a tariff only system will be used. The level of the tariff will be negotiated under the Article XXVIII of General Agreements on Tariffs and Trade (GATT). ACP countries will be able to obtain preferential tariffs, which is possible on the basis of their current WTO waiver (European Commission, 1999).

The World Bank reported that the EU banana regime was costing $2.3 billion per year to the European consumers, while under the old regime it was $700 million per year. Most of this money went to the European companies as monopoly profits (Grant, 1997, pp. 134-136). US companies objected to the EU's restrictive banana import regime and the exclusion of the US firms from market growth.

Thus, the US participated in bringing a petition before the WTO alleging discrimination and losing market share by the EU banana policy.

OBJECTIVES

The objectives of this paper are (1) to describe the origin of the US-EU banana dispute and (2) to analyze the possible impact of the imposition of increased duties of 100% *ad valorem* on Pecorino cheese, a specialty cheese imported from Italy. Pecorino cheese was one of the commodities imported into the US selected for retaliation under Section 301 of the Trade Act of 1974.

As a case study example, we will show if the tariffs will have a prohibitive impact in the case of Pecorino cheese, and what the estimated losses in consumer and producer welfare will be.

EUROPEAN UNION BANANAS IN THE WTO

On April 6, 1999 WTO found that the EU's new banana import regime, which came into force on January 1, 1999, as part of the common organization of the market in bananas, does not comply with WTO rules in three respects:

a. The preferential import rights for bananas from the ACP countries constitute discrimination against other banana importing companies;
b. The distribution of the tariff-rate quota among supplier countries in South America is based on out-of-date and non-representative reference quantities; and
c. The distributions of import licenses are still based on the old, discriminatory system.

The WTO Dispute Settlement Body (DSB) has also authorized the United States to take retaliatory action in the form of 100% *ad valorem* duties on imports of targeted European products (Zervoudaki, 1999). On April 19, 1999, the US Trade Representative imposed prohibitive tariffs in the form of 100% *ad valorem* on nine EU products (Table 1). The US currently imposes duties of $191 million per year on selected EU products.

THE US BANANA INTERESTS

The United States has its own interests in the Latin America and Caribbean. US and Caribbean countries have common goals, such as security, orderly movement of citizens and control of migration, trade and investment expansion, and protection of the environment. Thus the US Government's goals over the banana issue are:

(1) promotion of economic growth in both regions;
(2) eliminate EU's discriminatory regulations against US and Latin American companies;
(3) force the EU compliance with WTO commitments;
(4) build acceptance of WTO consistent alternative regulations; and
(5) encourage economic diversification in Caribbean countries.

The Caribbean countries are not competitive because of special circumstances and EU protectionist regulations have smothered any incentive for the Caribbean islands to be competitive (The United States Trade Representative, 1996).

THE DEVELOPMENT OF THE DISPUTE

Twice Colombia, Costa Rica, Guatemala, Nicaragua and Venezuela petitioned the GATT, arguing that the European Union was discriminatory in its banana regime. Twice GATT panels found that EU banana regime was not GATT consistent, in 1993 and 1994. In both cases the European Union ignored those GATT panels' decisions and continued its banana regime (Ziegler and Klasky, January 14, 1999).

In 1996, the US, Guatemala, Honduras, Mexico and Ecuador again brought the case to the WTO. In May 22, 1997, the WTO panel found that the EU banana regime violated WTO rules. During 1997, the European Union tried to prove that its 'banana regime' is WTO consistent. The EU ignored WTO reports and the US's request for negotiation (Ziegler and Klasky, December 21, 1998).

On May 22, 1997, the WTO panel again found that the EU banana regime violated WTO rules and the Appellate Body sustained that decision on September 9, 1997 (Daly, Stilwell and Glass, May 26, 2000).

In January 8, 1998, WTO gave the EU until January 1, 1999 to comply with WTO decisions. In June 26, the European Agricultural Council made some changes in its banana regulations and declared them WTO consistent.

Throughout the 1990's, European Union ignored all suggestions made by the US and some Latin American countries as well as the WTO and declared its banana policy WTO and GATT consistent (Ziegler and Klasky, December 21, 1998).

As a result of the European Union's failure to comply with WTO's DSB rulings, the DSB authorized the U.S. on April 19, 1999 to impose 100% *ad valorem* duties in the amount of $191.4 million per year on nine selected products imported from European Union (Daly, Stilwell, and Todd, May 26, 2000, p.4).

US POLICIES AND WTO REGULATIONS ON EU BANANA DISPUTE: SECTION 301 OF THE TRADE ACT AND SECTION 407 OF THE TRADE AND DEVELOPMENT ACT

Section 301 of the Trade Act of 1974 authorizes the United States Trade Representative's Office (USTR) to take responsive actions when another WTO member country fails to implement WTO Dispute Settlement Body's (DSB) rulings in dispute settlement proceedings. In the banana case, the USTR used its authority to impose prohibitive tariffs in the forms of 100% *ad valorem* duties on goods imported from the EU.

Section 407 of the Trade and Development Act of 2000, entered into force on May 18, 2000, amended Section 301 by requiring the USTR to review the actions taken under Section 301 and make changes, if any. Section 407 provides standards for making changes that would result in implementation of the WTO DSB recommendations and achieve a satisfactory resolution of the dispute.

On May 26, 2000, the US Trade Representative's Office announced that they are intending to modify the list of European products subject to increased tariffs as a result of EU's failure to comply with WTO DSB rulings on banana and beef cases. The USTR is also trying to decide if currently imposed tariffs should remain the same or if they need to be higher. They also seek comments on whether currently imposed duties are high enough to be called *prohibitive*. The product list that is subject to prohibitive tariffs and is under consideration for imposition over EU's banana regime failure to comply with the WTO DSB are shown in the Tables 1 and 2 respectively.

The modifications to the list of products imported into the US from the EU are made by Section 407 of the Trade and Development Act of 2000, which entered into force on May 18, 2000. This section applies to the EU - US dispute over banana and beef imports by the European Union. The Section 407 intends to maintain the levels of retaliation within the levels authorized by the WTO DSB (Daly, Stilwell and Glass, May 26, 2000).

THE IMPACT OF PROHIBITIVE TARIFFS ON SELECTED EU IMPORTS ON UNITED STATES CONSUMER

Imports of Pecorino cheese from Italy account for about 20-40% of the total US imports of this type of cheese. Any change in these imports will have its impact on US Pecorino cheese market as well as on the domestic consumer of this specialty cheese. This study is an exercise in estimating what will happen if the prohibitive tariff is imposed on this commodity.

Pecorino cheese is mainly made in southern Italy, especially on the island of Sardinia. The best-known variety is Pecorino Romano. It is made from specialty sheep's milk. This type of cheese is primarily used on pasta dishes but also it is enjoyable with red wine. Pecorino is straw colored, with 36% fat, semi-hard, granular with a smooth rind coated in oil. Pecorino cheese is used in many of the same menu applications as Parmesan, especially when stronger cheese flavor is desired (Reluctant Gourmet, 2000).

The annual imported quantities and values of this specialty cheese are shown on the Charts 1 and 2. Italian imports account for about 20-40 % of the US total imports, thus providing clear understanding of its importance in the US market.

In this analysis, the monthly quantity of Pecorino cheese imports from Italy is specified as a function of monthly prices of imports to the US, Italian Lira exchange rate with respect to the US dollar, per capita Gross Domestic Product for US, lagged imports, monthly prices of substitute Parmesan cheese, a trend variable, and a dummy variable which stands for consumer expectations that prohibitive tariffs will be imposed. A semi-logarithmic function was used to estimate the impact of prices and other factors on the imported quantities of Pecorino cheese:

$$LN(Q_t)=\beta_0+\ \beta_1 P_{PEC}+\ \beta_2 EX+\ \beta_3 I_{PC}+ \beta_4 Q_{PC(t-1)}+ \beta_5 P_{PARM}+ \beta_5 T+\beta_6 D +U_t$$

where

$LN(Q_t)$ - Log of monthly imported quantities of Pecorino cheese from Italy. (USDA, FAS, 2000).

$P_{PE\ C}$ - Per unit (pound) price of Pecorino cheese in cents per pound, calculated using monthly data of imported quantity and value, adjusted for inflation using US Consumer Price Index (USDA, FAS, 2000)/(BLS, 2000).

EX - Exchange rate:Italian Lira per US Dollar (FXHistory™, 2000), adjusted for inflation using US CPI (BLS, 2000) and Italian CPI (BLS, 2000).

I_{PC} - Per capita GDP for US, adjusted for inflation using US CPI (US Census Bureau, 2000, US Department of Commerce, 2000, and BLS, 2000).

$Q_{PC(t-1)}$ - Monthly Imported Quantities of Pecorino Cheese lagged one month (USDA, FAS, 2000).

P_{PARM} . Price of domesti-cally made Parmesan Cheese (Agricultural Marketing Service, 1997-2000), adjusted for inflation using US CPI (BLS, 2000); and

D - Dummy variable, which explains consumer expectations over tariff imposition (1 for January-July 1999, 0 otherwise).

Statistical Analysis Software (SAS) was employed to estimate the equation parameters shown in Table 3. Price of Pecorino cheese, exchange rate and lagged quantity were significant at 5, 10 and 1% levels respectively. The trend variable was significant at 15% level.

In case of imposition, 100% *ad valorem* tariffs will impact US consumer welfare. Estimated parameters from the model were used to estimate the possible loss in consumer surplus due to the policy.

The consumer surplus was calculated for the last 12 months before United States trade representative announced the list of products under consideration of tariff imposition. Then assuming tariffs were imposed (i.e. price increase by 100%) the loss in consumer surplus was calculated. Area A and B on Figure 1 represents the loss in consumer surplus.

For Pecorino cheese we estimated a loss in consumer surplus (Area A and B) in the amount of $636,090 per year due to the US retaliatory policy over the banana dispute with the European Union, $251,810 of which is the tariff revenue (Area A) collected by the US Government and $384,280 is the dead weight loss (Area B). Italian producers will lose $1,040,170 due to a decline in imports (area E).

IMPLICATIONS OF A BANANA WAR

The European Union's banana regime, which began after World War II and resulted in the US-EU banana trade dispute, will not end in the near future. Two powerful sides of the dispute have their own interests in the world banana trade. Unfortunately their interests do not move in the same direction. The European Union tries to protect its former colonies giving them preferential trading rights in bananas.

Spreen et al. (2000) found that making the EU banana policy GATT consistent would improve the global welfare in terms of producer and consumer surplus. "While the model estimates that countries which now benefit from preferential access to the EU would suffer, exports of bananas continue to be economically viable, albeit in much smaller volumes. Replacing the current policy with a common external tariff could generate between $363 million and $1.08 billion in revenue, which could be used to develop assistance programs for those producers who are already affected by the change in policy" (Spreen et al., 2000).

The United States tries to make sure that the banana trade for its multinational companies, such as Dole and Chiquita, is fair, is based on perfect competition and complies with WTO and GATT regulations. On this matter, the United States retaliates against EU member countries by imposing prohibitive tariffs on imports of selected European products. The US's intention is to entirely eliminate the imports of targeted products, thus urging the EU to revise its banana trade policy and make it WTO and GATT consistent.

Currently the United States collects duties in the form of 100% *ad valorem* from nine products imported from the European Union. "Critics say that by targeting a fixed list of European goods, the trade representative makes it easy for the EU to hold out by providing aid for the affected companies. If the target list is reviewed and changed every six months, pressure on the EU will intensify..."(Rogers, 2000).

This is the reason that the USTR is currently analyzing the efficiency of imposed retaliatory duties on selected EU products and is intending to make modifications in the list of products (Daly, Stilwell and Glass, May 26, 2000). USTR may revise the list of products in order to increase the pressure on the European Union. It is said that the new list would change the mix of products, and might even double the rate of prohibitive tariffs on some products (Winestock, 2000, p.A15).

Only small businesses in the import business were affected by the US government's decision to levy tariffs on some EU products. "Scores of European products, from clothing to stoves to glass Christmas ornaments, were originally targeted for the retaliatory tariffs. But aggressive lobbying by big corporations, trade groups and members of Congress got most of the threatened import products off the list" (Barlett and Steele, 2000).

In the case of Pecorino cheese, the estimated loss in consumer surplus accounted for $636,090 and loss in exporter surplus accounted for $1,040,170 per year due to tariff imposition. These values represent just one commodity. The impact will be greater if we take into account all the other commodities affected by prohibitive tariffs and those that are under consideration for retaliation.

The final resolution of the dispute should consider the interests of both sides, the US multinational corporations, farmers in ACP countries, and consumers of banana and other goods related to banana dispute, in the United States and EU. Only an even-handed solution will result in an effective resolution to this importing trade dispute.

Table 1. List of Products Currently Subject to Increased Duties

HTS[a] Number	Product Description
33073050	Bath preparations, other than bath salts
42022215	Handbags, with or without shoulder straps or without handle, with outer surface sheeting plastics
42023210	Articles of a kind normally carried in the pocket or handbag, with outer surface of reinforced or laminated plastics
48055000	Uncoated felt paper and paperboard in rolls or sheets
48192000	Folding cartons, boxes and cases of non-corrugated paper or paperboard
49119120	Lithographs on paper or paperboard, not over 0.51 mm in thickness, printed not over 20 years at time of importation
63022190	Bed linen, not knit or crochet, printed, of cotton, not containing any embroidery, lace, braid, edging, trimming, piping or appliqué work, not napped
85072080	Lead-acid storage batteries other than of a kind used for starting piston engines or as the primary source of power for certain electric vehicle principally designed for the transport of up to nine persons
85167100	Electrothermic coffee or tea makers, for domestic purposes [b]

[a] Harmonized Tariff Schedule of the United States
[b] Except Produced in Italy
Source: Daly, Stilwell, and Glass (2000)

Table 2. List of Products Under Consideration for the Imposition of Increased Duties

HTS[a] Number	Product Description
02101900	Meat of swine, other than hams, shoulders, bellies (streaky) and cuts thereof, salted, in brine, dried or smoked
04069057	Pecorino cheese, from sheep's milk, in original loaves, not suitable for grating
19053000	Sweet biscuits; waffles and wafers
33073050	Bath preparations, other than bath salts
34060000	Candles, tapers and the like
39202000	Non-adhesive plates, sheets, film, foil and strip, non-cellular, not reinforced or combined with other materials, of polymers of propylene
42022215	Handbags, with or without shoulder straps or without handle, with outer surface of reinforced or laminated plastics
48055000	Uncoated felt paper and paperboard in rolls or sheets
48192000	Folding cartons, boxes and cases of non-corrugated paper or paperboard
49090040	Printer cards (except postcards) bearing personal greetings, messages or announcements, with or without envelopes or trimmings
49119120	Lithographs on paper or paperboard, not over 0.51 mm in thickness, printed not over 20 years at time of importation
61101010	Sweaters, pullovers, sweatshirts, waistcoats (vests) and similar articles, knitted or crocheted, wholly of cashmere
63022190	Bed linen, not knit or crochet, printed, of cotton, not containing any embroidery, lace, braid, edging, trimming, piping or appliqué work, not napped
85072080	Lead-acid storage batteries other than of a kind used for starting piston engines or as the primary source of power for certain electric vehicle principally designed for the transport of up to nine persons
85167100	Electrothermic coffee or tea makers, for domestic purposes [b]
94051080	Chandeliers and other electric ceiling or wall lighting fittings (other than used for public spaces), not of base metal

[a] Harmonized Tariff Schedule of the United States [b] Except Produced in Italy
Source: Daly, Stilwell, and Glass (2000)

Table 3. Parameter Estimates for the Model*

Variables	Parameter Estimate	t-value	Probability
PPEC	-1.232186	-2.031	0.0484
EX	9874.8373	1.649	0.1065
IPC	-0.000818	-0.989	0.3283
LAGQPC	1012.2169	2.703	0.0098
PPARM	0.13499	0.172	0.8645
TREND	0.044040	1.214	0.2313
DUMMY	-0.332264	-1.482	0.1456
N	52		
DF	45		
R-square	0.3833		
F Value	3.818		
P-Value	0.0026		

* SAS program was employed to estimate the parameters

Chart 1. US Pecorino Cheese Imports (Quantity)

Source: USDA, Foreign Agricultural Service, 2000

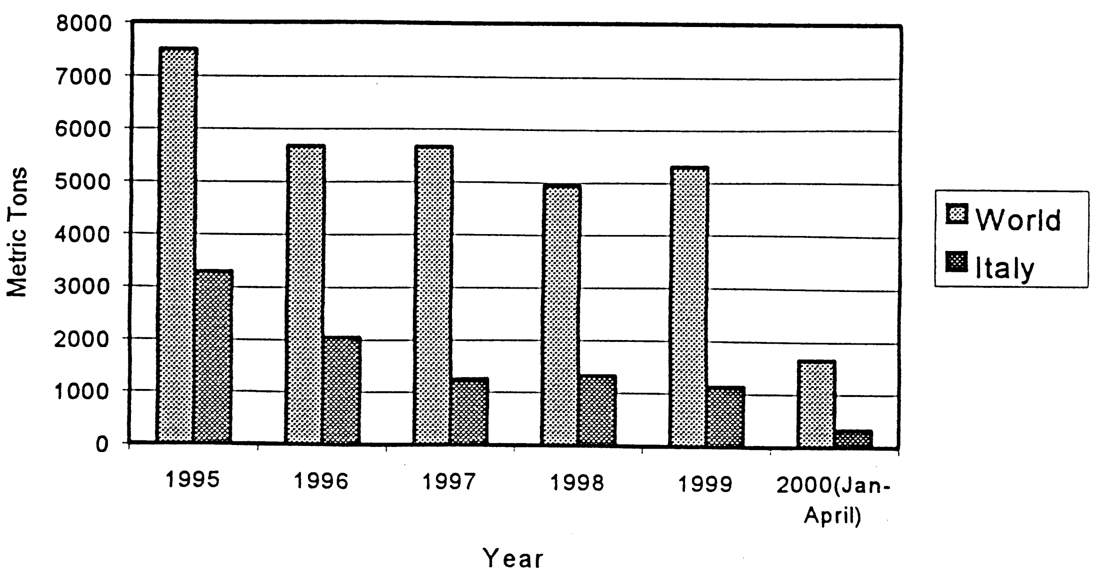
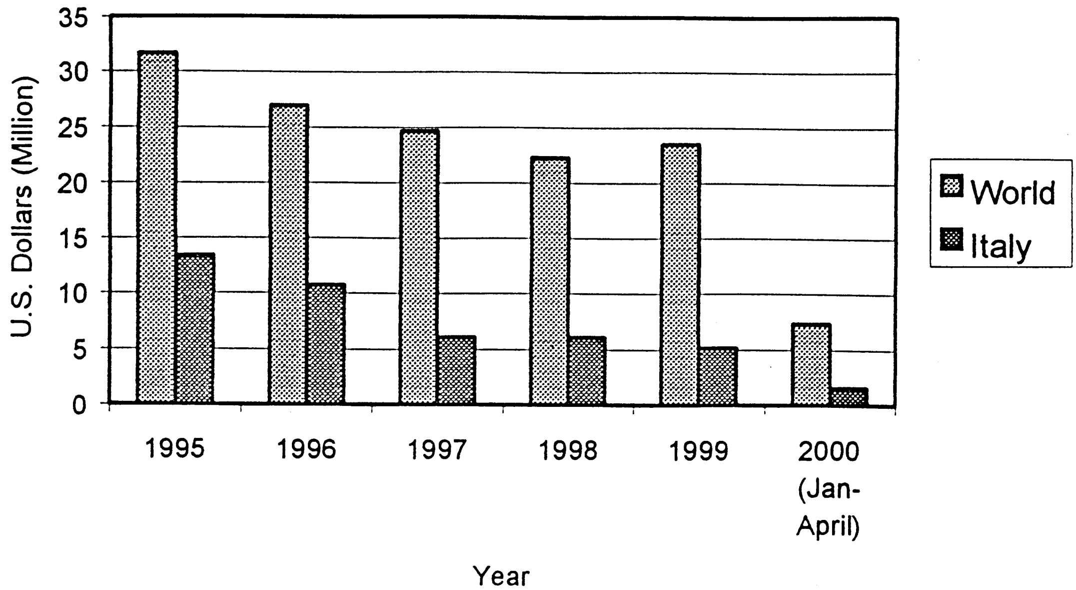
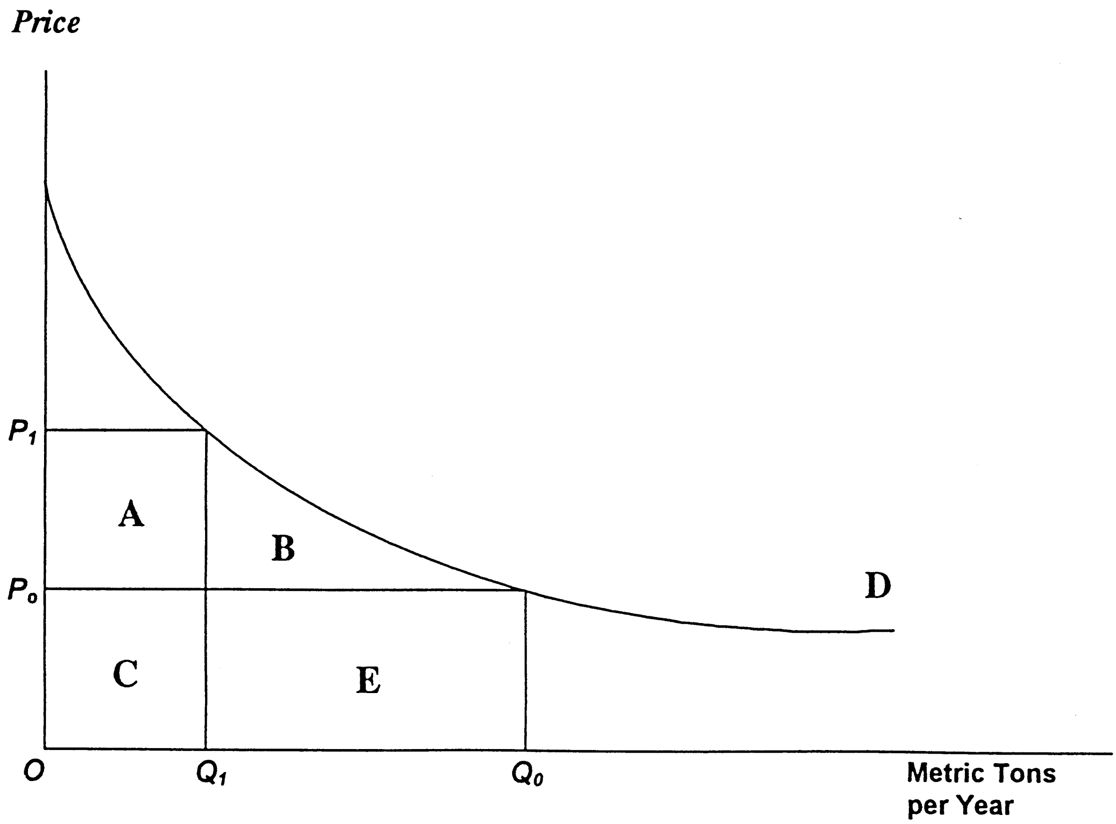


Chart 2. US Pecorino Cheese Imports (Values)



Source: USDA, Foreign Agricultural Service, 2000

Figure 1. Loss in Consumer And Exporter Surplus Due to Increased Price



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