FAO TRADE POLICY BRIEFS
on issues related to the WTO negotiations on agriculture

# No. 3. BANANAS: Implications of EU tariff reform for producers

**SUMMARY**

- *It is unlikely that a single EU tariff exists that preserves the interests of the major players in banana production and trade.*
- *A high tariff gives a competitive edge to ACP suppliers, who benefit from duty-free access, while a low tariff favours dollar banana suppliers.*
- *An intermediate tariff level may result in expanded exports from Latin American countries and some ACP countries to the EU and a drop in EU domestic prices.*
- *Economic estimates of a tariff-equivalent diverge because of differences in policy objectives, assumptions, data sets and conceptual frameworks.*

This Trade Policy Brief [1] reviews key issues on the forthcoming change in the European Union (EU) banana import regime from a tariff rate quota (TRQ) to a tariff only regime. It discusses the extent of disagreement between different analyses on the likely impact of the policy changes and offers reasons why estimates of these impacts vary across the studies.

## 1 What is the policy question to be addressed?

The principal concern of current debates on world banana trade is the quantification of a tariff that would replace the current TRQ system of the EU (see Box 1). The term "tariff equivalent" has been extensively used. As defined in the legal texts of the Uruguay Round Agreement on Agriculture (AoA), it refers to duties to be computed in accordance with guidelines prescribed in the Attachment to Annex 5, related to paragraph 2 of Article 4 (Market Access): "tariff equivalents" are ordinary custom duties that replace existing border measures, and these are to be calculated according to specific guidelines. Nowhere in the text does it appear to be mentioned that tariff equivalents should be set to levels that would

### *Box 1 - The EU's system of tariff rate quotas (TRQ) for banana importation*

*There are four quotas: A (2 200 000 tonnes), B (453 000 tonnes), C (750 000 tonnes) and the AQ, Additional Quantity (460 000 tonnes in 2005). A complex system of import licences administers the quotas. Bananas from ACP countries can be imported duty-free under any of the above quotas. Bananas from other countries can only be imported under quotas A, B and the AQ and must pay a tariff of €75 per tonne. Although ACP bananas can enter the EU duty-free through any quota, they mostly do so under quota C because they usually cannot out-compete Latin American bananas in the other quotas.*

*Virtually all bananas imported under quotas A and B originate in Latin America. They are often referred to as "dollar bananas" because they are traded in US dollars. Dollar bananas also dominate the AQ quota, created following the May 2004 EU enlargement to allow banana imports into the new member states. Imports beyond quotas A, B and AQ have to pay an out-of-quota tariff of €680 per tonne, with a preferential tariff of €380 per tonne for ACP bananas over quota. There are virtually no imports of bananas outside the quotas due to the very high level of the out-of-quota tariff.*

[1] An informal consultation of experts involved in the analysis of banana trade, held on 28-29 October 2004 at FAO, Rome assisted in preparing this Policy Brief. A longer technical version of this brief provides a more detailed review of the existing studies, an explanation of the reasons for their divergent findings, and includes recommendations for further research and a full list of references. It is available at: www.fao.org/trade/policy_en.asp.

achieve specific policy outcomes. However, many analysts have taken the view that tariff equivalents should be designed to meet specific policy objectives. By giving various meanings to the term "equivalence", different analysts have obtained different tariff levels. Much of the controversy stems from this for example some argue that an equivalent tariff should be set at a level that maintains the quantities of bananas imported into the EU, or that maintains the level of access of a specific category of suppliers, or that it maintains the level of protection of certain producers.

Virtually all banana exports of the African, Caribbean and Pacific Group of States (ACP) are destined for the EU. In addition, 18 percent of all Ecuadorean banana exports, 33 percent of those from Costa Rica, and 46 percent of those from Colombia are exported to the EU. Latin American suppliers fear that an increased EU import tariff from the current €75 per tonne will erode their competitiveness vis-à-vis ACP suppliers, in particular African countries, and result in a loss of EU market share in the medium and long term. ACP countries, whose bananas enjoy duty-free access to the EU market under the Cotonou Agreement, are concerned that the price they receive following a regime change will not allow them to maintain the current levels of banana production.

EU producers, who have 20 percent of the market, fear that a lower EU domestic price would increase deficiency payments to levels unacceptable for both the WTO and the EU. This Trade Policy Brief explains that since it is unlikely that a single policy instrument will preserve the interests of all stakeholders, negotiation between them is inevitable. This negotiation should be underpinned by a better appreciation of what contemporary analytical studies tell us and what they do not.

***Box 2 - Negotiations towards a tariff-only system***

*The EC notified the WTO of its intention to modify the most favoured nation (MFN) tariff for bananas in July 2004 and in October 2004 it suggested a single tariff of €230 per tonne for banana imports from MFNs), indicating that it had calculated this tariff level by computing the gap between internal and external EC prices. Formal negotiations with its main MFN suppliers under the auspices of the WTO started in November 2004. As no agreement was found, the EC notified the WTO of its proposed new tariff in January 2005.*

*The text of the waiver granted at the WTO Ministerial Conference in Doha in 2001 states that third country suppliers (e.g. Latin American suppliers) can call for arbitration should they disagree with the tariff proposal. On 30 March 2005, Ecuador, Colombia, COSTA Rica, Panama, Honduras and Guatemala requested arbitration at the WTO on the level of tariff proposed. The complainants were later joined by Nicaragua, Venezuela and Brazil. In their award, issued on 1 August 2005, the WTO arbitrators determined that the EC's envisaged rebinding "would not result in at least maintaining total market access for MFN banana suppliers, taking into account all EC WTO market-access commitments relating to bananas". The European Commission then proposed a lower tariff of €187 per tonne and a duty-free quota of 775 000 tonnes for ACP bananas. This revised proposal was rejected by Latin American suppliers. On 26 September 2005, the EC requested a second WTO arbitration to determine whether its new proposal complied with the terms of the Doha Waiver. On 27 October, the WTO arbitrators rejected again the EC's proposal but did not indicate what tariff would be appropriate. Negotiations have resumed between the EC and its Latin American suppliers.*

## 2 How is the policy question being addressed?

Analysts have based their studies on the understanding that a tariff is "equivalent" if it meets a specific policy objective. There are different interpretations of the apparent objective of the tariff-only system, with stakeholders arguing for tariffs ranging from less than €75 per tonne to €300 per tonne. They base their claims on the conclusions of analytical studies of different issues, using different assumptions, data sets and methodologies. The methods can be classified into price-gap, accounting and simulation models.[2] While the WTO recommends price-gap analysis because of its transparency, some analysts have doubts about the reliability of the available price data and the type of prices that should be used and have preferred using accounting methods. Other analysts favour exploring the impact of various tariff scenarios on supply and demand, such as simulation models. Table 1 highlights the key similarities and differences between them.

[2] Price gap analyses measure the differences between internal and external prices, accounting methods compute tariff equivalents as the sum of the quota rent plus tariffs, and simulation models are mathematical representations of the market.

## Table 1 - Main characteristics of studies

### Studies that calculate a tariff equivalent

| | Policy objective of tariff "equivalent" | Tariff Equivalent (€/tonne) | Methodology | QR[1] of suppliers (€/tonne) |
|---|---|---|---|---|
| **Raboy (2004)** | Maintain LAM[2] access | 106-143 | Price-gap | 68 |
| **Guyomard et al. (2002)** | Maintain status quo | 182-239 | Accounting and partial equilibrium | 182 |
| **Guyomard et al. (2004)** | Maintain status quo | 227 | Partial equilibrium | n/a |
| **Borrell and Bauer (2004)** | Maintain LAM access | 64 | Partial equilibrium | 0 |
| **NERA (2004)** | Maintain competitiveness of Caribbean producers | 197-259 | Price-gap and accounting | 122-184 |
| **Pérez Sánchez (2004)** | Maintain status quo | 252 | Price-gap | n/a |

[1] Quota Rent. Assumptions on share of QR captured by suppliers can have an effect on model results;
[2] LAM: Traditional non-ACP banana exporting countries in Central and South America (Ecuador, Costa Rica, Colombia, Panama, etc.).

The full references to all these studies can be found in FAO Trade Policy Technical Note No 3 at www.fao.org/trade/policy_en.asp.

## 3 Why and to what extent do results differ?

Analysts have estimated different tariff equivalents mainly because they have assigned different meanings to the term "equivalence". In addition, it is difficult to assess how much models differ in their results because they generally offer point estimates without probability estimates. One lesson of the research is the need to undertake sensitivity analyses to capture the uncertainties that surround their key parameters. The technical paper that accompanies this Trade Policy Brief attempts to explain the reasons for their divergent findings by answering the following questions.

- *Which prices should researchers use?* The prices used have a key influence on the results for both simulation models and price-gap analysis and yet researchers struggle to decide which ones to use.
- *Who are the market players?* Banana trade is concentrated in a small number of multinational companies but models assume the market players are countries rather than companies. Some analysts tend to separate countries while others tend to aggregate them into clusters.
- *How do market players respond to the changing import regime?* The answer to this question depends on how the impact of tariff-only is simulated and different analysts choose different architectures and parameters for their models.
- *How is the quota rent distributed between market players?* In trying to predict the future workings of this market, analysts need to know how the various players will react to their loss of quota rent. Analysts disagree not only on the total value of the quota rent but also on how it is shared between market players along the supply chain.
- *What is the nature of banana demand in the EU?* All EU member countries are subject to the same import regime and yet the aggregation of demand into a single equation, as assumed in most models, is questionable. As FAO Trade Policy Technical Note No. 3 explains, there are also severe methodological problems in modelling demand at a less aggregated level.

## 4 What will be the impact of a tariff-only policy?

### It is unlikely that a single tariff exists that would preserve the status quo

If no single tariff that would preserve the *status quo* exists, then the substitution of the current TRQ into a tariff-only system will result in changes in the world banana market. No tariff equivalent to the current system may exist because the conditions to guarantee the equivalence between a tariff and the existing quota system do not hold in practice. In particular licences are not sold to importers at

public auctions, bananas are not allowed to enter duty-free within the quota, and the market is characterized by imperfect competition. These market characteristics are contrary to what would be required to guarantee the existence of equivalence between a tariff only and a quota based system. Nevertheless, some analysts claim that the theoretical conditions for the existence of equivalence are met in practice and therefore tariffs that maintain the *status quo* do exist.

**Too high a tariff would give a competitive edge to ACP suppliers, while too low a tariff would give a competitive edge to Latin American suppliers**

Since bananas imported from ACP countries enter the EU duty-free, a high tariff would apply only to their competitors from non-ACP third countries (mainly Latin America). ACP exports have increased steadily in recent years and in 2004 exceeded quota C by some 20 000 tonnes. Some analysts have taken this as evidence that the current tariff preference already grants ACP suppliers some competitiveness vis-à-vis Latin American suppliers and argue that a higher tariff would exceed the current protection. Conversely, a low tariff may favour low cost Latin American suppliers, lead to a surge in imports and curtail prices in the EC. Although these effects may be true for some countries, neither country group is homogeneous and considerable differences exist between countries in production structures, productivity, competitiveness and capacity to respond to changes in demand.

**An intermediate tariff level may result in expanded exports from Latin American countries and some ACP countries to the EU and a drop in EU domestic prices**

Most studies suggest domestic EU prices would fall if the tariff was set below a certain threshold, but the threshold varies according to the study. One model predicts an intermediate tariff level may exist that would leave the import shares of ACP and Latin American suppliers unchanged in 2006 but this tariff would be below the threshold and result in an expansion of imports and a fall in EU domestic prices.

**A quantification of a tariff equivalent based solely on prices would not be entirely reliable because of the nature of publicly available data**

Each method that calculates tariff equivalents has its strengths and weaknesses but none can provide reliable assessments without better quality data. There are no complete data sets on export and import prices and their respective volumes, and experience show that unit values of exports and imports are not good proxies for such analyses. The information to analyze the impact of a tariff-only banana import system is commercially confidential and few researchers have access to it.

## 5 Conclusion

The diversity of results from economic analyses of tariff levels reflects different methodological approaches to calculating tariff equivalents. They use different assumptions, different data and different model architectures. In addition, little is known about imperfect competition and how supply and demand respond to various tariff levels. Greater insights for policy makers are possible by building into the models more of the uncertainty implicit in banana production and trade.

Nevertheless, two key indications cast doubts that there may be one tariff that simultaneously maintains the interests of the major stakeholders: the first is that the conditions that would guarantee its existence are not met in reality, and the second is that different studies demonstrate that different "tariff equivalents" would be needed to maintain different policy objectives.

The current banana trade policy regime comprises different policy instruments to address multiple policy objectives. The analysis shows that these cannot be met with the single policy instrument of a simple tariff. The imperfectly competitive market structure adds a further complication. It appears that additional policy instruments must be brought to bear if a solution acceptable to all stakeholders is to be found.