COMMISSION OF THE EUROPEAN COMMUNITIES

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COMMUNICATION FROM THE COMMISSION TO THE COUNCIL

ON BANANAS

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1) INTRODUCTION

The Council invited the Commission to present it with proposals to resolve the bananas dispute by 31st May, having consulted with all the parties principally concerned. The purpose of this paper is to report on these consultations and to propose possible courses of action.

This consultation took place against the background that the panel suggested 4 possible ways of bringing the Community regime into conformity with the W.T.O.

(1) A flat tariff with a preference for the ACP granted on the basis of a waiver or in the framework of a Free Trade Agreement.

(2) A flat tariff with a tariff quota for the ACP, covered by " a suitable waiver".

(3) A tariff quota, as at present, with duty free treatment of ACP imports. (This option appears to be the same as the W.T.O. consistent counterfactual used by the arbitrators to calculate the level of nullification or impairment in the U.S. arbitration) .

(4) An MFN quota combined with a tariff quota to the ACP (i.e., the present system on the panel's interpretation of the 857,700 tonnes ACP tariff preference as a tariff quota). For this option, the panel say, an Article XIII waiver would be needed.

2) POSITIONS OF PARTIES PRINCIPALLY CONCERNED

Consultations have taken place with the US and the four "principal suppliers" (Costa Rica, Colombia, Ecuador and Panama) and the ACP. Various representatives of Community producers have also made their views known.

The key conclusions of these consultations are as follows:-

(a) **The US can conceive of three possible outcomes:**

(1) The regime remains unchanged and the US maintains its sanctions.

(2) The regime is changed in ways which meet the key concerns of the US companies. The key concerns of the companies are that, if the tariff quota is continued, it should be enlarged and that they should have what they view as their

"correct" share of the licences. The US has suggested that this could be achieved by distribution of import licences on the basis of a pre 1993 reference period. If all these concerns were met then even an Article XIII waiver might not be out of the question.

(3) The regime is changed in such a way as to be indisputably WTO consistent on the basis of the existing waiver. In that case the US will remove the sanctions, but they insist on the right to reach their own view on whether a solution which did not meet the concerns of the US companies is truly WTO compatible. If we did not agree with their views, we would have to start a panel against the sanctions in which we would have to demonstrate the WTO conformity of our new regime.

(b) **Ecuador** can agree to support continuation of our protection for the ACP, even if an Article XIII waiver is needed, provided we meet her key concerns, which are principally that there should be no distribution of the tariff quota between principal suppliers and that licences should be distributed to a revised definition of operator ("shipper importers" i.e. the old "primary importer") on the basis of a 1994 - 1996 reference period.

(c) **Costa Rica and Colombia** are attached to a distribution of the tariff quota between principal suppliers which they consider to be their right inscribed in the EC Schedule. They, therefore, regret that we did not appeal the panel conclusions that this can only be done in agreement with all four principal suppliers, which they believe to be legally wrong. They also remain attached to measures linked to distribution of the tariff quota, designed to enable them to obtain a reasonable share of the quota rent. If these concerns are not met then they will look for compensation for loss of the value of having the tariff quota shared out and/or oppose solutions which protect ACP interests but not theirs.

(d) It's clear that the four principal suppliers could not agree on the distribution of the tariff quota, because of the opposition to distribution by Ecuador. Panama has also not shown any readiness to agree a distribution of the tariff quota.

(e) **The ACP** are strongly attached to the protection afforded to them by the present and previous regime in fulfilment of the obligations of the Community, in particular under the Lomé Convention, Protocol n. 5. They warn of the grave damage which would be done their economies, especially the economies of those of them who are most heavily dependent on bananas as a source of employment and foreign exchange, if they could no longer sell to the Community. They insist that aid cannot replace trade and that a solution on the line of opinion 3 of the panel (counterfactual) would be in conformity with what is "required" by the Lomé Convention.

(f) **Community producers** are not directly affected by the panel rulings, because these rulings do not criticise the internal regime. They are, however, very conscious of the effect a change in the external regime could have on their position in the market.

3) BUDGETARY CONSIDERATIONS

The Community regime provides support for the Community's producers by way of a payment calculated on the basis of the difference between prices on the Community market and a reference price (i.e. by a form of deficiency payment). The external regime, which is based on a tariff quota plus a volume limited preference for the traditional ACP bananas (which, as the arbitrators noted is not, in fact, restrictive because available supplies are less than this limit) serves effectively to regulate prices on the Community market and hence limits expenditure on the deficiency payment regime. The implications of solutions which reduced the effective level of market protection and hence led to a reduction in Community market prices are set out in Annex I.

It should be noted that the new inter institutional agreement following the decisions of the Berlin summit set very tight limits on FEOGA spending and made no provision for any increase in expenditure in the year 2000 on this or any other CAP regime beyond the latest forecast of expenditure. Indeed the limit for the year 2000 was somewhat below total forecast expenditure. So any proposal which would lead to additional expenditure, would have to be accompanied by proposals to finance the additional expenditure by cuts elsewhere or by a proposal to cut the level of the reference price by an equivalent amount to the anticipated fall in prices.

4) OPTIONS

a) Tariff only, variant N. 1

Remove the tariff quota and leave the ACP only with a tariff preference of 75 Euro. This solution is not one which is sought by any of the complainants but, so long as the existing waiver continues, is certainly WTO compatible and should, therefore, lead the US to remove their sanctions. The cost in terms of the Community's own deficiency payment scheme is estimated in Annex I. As regards the ACP, they would lose both in terms of export volumes and selling prices for their bananas.

b) Tariff only, variant N. 2

Remove the tariff quota and, through an Article XXVIII negotiation, fix the tariff to a level which approximates the price effects of the tariff quota. For details see Annex II. The cost in terms of the Community's own deficiency payment scheme is estimated in Annex I.

Assuming that the ACP were given duty free access and the correct level of tariff is determined, such a solution could protect their interests, although they (like Community producers) could suffer as an indirect consequence of the loss of the quota rent currently being enjoyed by operators who deal in Latin American as well as ACP bananas. Moreover, such a solution would have a negative impact on the US companies who pressed the US to take the WTO action but it would be difficult for the US to contest the WTO compatibility of the regime. The US is opposed to this option because they insist on a level of tariff which would involve increase imports from the dollar suppliers and hence lower market prices. But they have indicated a willingness to consider a tariff higher than 75 € provided this condition was met. It should be noted that, formally

speaking, the US does not have negotiating rights in relation to the level of the tariff as they are not suppliers.

c) Tariff only, variant N.3

Move to a flat tariff with a low or zero tariff quota for the ACP. This solution is amongst the alternatives suggested by the Ecuador panel but appears to achieve none of the Community's objectives.

d) Tariff quota with a tariff preference and unlimited access for ACP

Retain a tariff quota and give the ACP a tariff preference or a zero tariff for an unlimited volume , on the basis of Article 168 of the Lomé Convention. This option is the "WTO compatible counterfactual" used by the panellists in their capacity as arbitrators in order to assess the level of retaliation which the US should be authorised to impose. The US make it clear that they consider this option would require an Article XIII waiver even if this is not the view of the panel.Similary, their opinion, shared in this case by the Panel, is that the option of keeping the ACP volume limited tariff preference requires an Article XIII waiver. Moreover, the US clearly expressed the opinion that this solution would not be acceptable for them, since they would perceive it as paradoxical to have a solution which would be more favourable to the ACP than the one that was condemned by the panel.

The panel notes that this option would not produce any different economic effects from those produced by the existing situation, given that traditional ACP supplies have been running at levels below the theoretical maximum. The longer term effect, however, could be to allow for an increase in the ACP (traditional and non traditional combined as the two could no longer be distinguished) which would plainly be to the disadvantage of other suppliers, including the complainants, although production capacity in ACP exporting countries is limited.

e) Maintenance of the existing tariff regime on the basis of an Article XIII waiver

This is the last option of those offered by the panel. Such a solution would (subject to the resolution of other problems in the regime discussed below) assure WTO conformity and the maintenance of the regime's objectives.

f) Establishment of two tariff rate quotas

An option not suggested by the panel but which might ensure WTO compatibility without the need for an additional waiver would be to establish a new tariff quota, outside the current tariff quota, for a volume higher than current ACP exports. Within this new autonomous quota, the EC would establish a rate intermediate between the bound out of quota rate of 737 Euro/tonne and the rate of 75 Euro/tonne which applies within the WTO bound quota.

Within this tariff quota, the ACP would benefit from a zero tariff. A key problem in applying this solution is, however, that of determining the level of tariff which would apply to other suppliers. Too high and it could be judged to be prohibitive and hence, in the light of the earlier jurisprudence of this case, a volume limitation. In this case, the tariff quota would be seen simply as new (and larger) version of the 857 700 tonnes ACP quota which the last panel has said conflicts with Article XIII. Too low and all but the

most competitive ACP would be displaced by Latin American supplies. The US didn't reject this possibility but under condition of a low tariff (they could start negotiations 150 €/t) and an adequate volume of tonnes.

g) All the options so far considered have in common that they would amount to attempts **to achieve WTO compatibility** without the assent of the complainants.

The US has made clear that it reserves the right to make its own judgement on the WTO compatibility of the EC new regime. Their view is not necessarily the same as that of the panel. It follows, therefore, that the certainty of lifting of the US retaliatory measures relies either on an unambiguous WTO compatible solution or in an agreement with the US. In any other circumstance, we would need to take a panel against the US sanctions, to prove that we were now in conformity (or, at least, that the US was no longer suffering any loss due to any failings in our new regime). After three lost panels, this possibility would certainly lead to serious problems in terms of compatibility and public perception.

h) The US have offered one more option, **a flat tariff of 75 Euro completed by an aid to importers of bananas from the most vulnerable ACP** (i.e. the Caribbean) to provide sufficient incentive for them to continue to import at prices at which these countries can afford to produce. Such an option does not seem to be clearly WTO compatible, given the discrimination in the import conditions would, according to first draft estimations, involve expenditure of around € 160 m on the Community regimes as well as the cost of the subsidy to importers of Caribbean bananas; and it leaves open the question of how the Community's commitment the other traditional ACP suppliers would be met. It would also do nothing to resolve the problems of non traditional ACP producers and it would leave the ACP dependent on EC financial support, which is not an ppropriate long-term solution.

5) QUOTA DISTRIBUTION

If any of the above options which require the maintenance of a tariff quota were chosen, then the problem of the GATS incompatibility found by the panel in the way the licences were distributed would need to be resolved, as would the incompatibility found in the way the tariff quota is distributed between main suppliers. Taking the latter point first, the reason why the tariff quota is at present distributed between major suppliers at present is that the Community wished to honour its WTO obligation to the framework agreement countries to make such a distribution. If the DSU determines that under WTO rules this obligation can only be fulfilled by agreement with all four main suppliers and if one or two of the four refuse, then one WTO obligation overrides the other. This does not mean, however, that we could simply walk away from this obligation. Pacta sunt servanda. But nor can we implement it if we are prevented by other from doing so. The only immediately possible means of reconciling this dilemma is to remain ready to make a quota distribution when and if the four can agree and, in the meantime, to suspend the distribution and allow free competition within the tariff quota. Compensation could also offer a way out. The positions of Ecuador and Panama on quota distribution, firm though they may be at present, are not necessarily immutable as they will obviously need to re-examine where their best interests lay when they saw the form of WTO compatible regime which the Community decides to adopt..

6) DISTRIBUTION OF IMPORT LICENCES

As regards the distribution of import licences, if any of the above options which require the maintenance of a tariff quota were chosen, a system based on the current traditional importers/newcomers would necessarily be confronted to two conflicting views: the US, on the one hand, requires a distant reference period (before 1993). This would pose problems under Community law and, to judge from what is said in the Ecuador panel, is probably no more WTO consistent than the present reference period. On the other hand, this solution would run directly counter to the key demand of Ecuador, which is that the reference period 1994 - 96 be maintained.

If this option is rejected, then one of the alternative means of licence distribution suggested by the panel would need to be used.

These were **"first come first served"** or **auctioning.**

a) First come, first served : If "first come first served" is to be interpreted in the sense of the ***ship race***, with the licences going to the bananas or the ships first in harbour at the beginning of each licence period, then it would appear to pose insuperable technical difficulties in view of the large number of ports potentially involved. It would also be discriminatory in the sense that companies with large alternative European markets would be better able to cope with the uncertainties involved. An alternative form of "first come first served", sometimes called ***simultaneous examination*** is used in several EC tariff quotas. Experience has, however, shown that when this system is used when a large quota rent is involved, over-subscription tends to rise exponentially. One solution that could be used to overcome the problem raised by simultaneous examination, would be a more strict definition of the operators as ***shipper/importers***, i.e. as those who are responsible for shipping and for clearing customs.

This last alternative would meet in principle Ecuador's demand. It would have the effect of increasing the licences available to US companies and other importers, albeit at the expense of former secondary importers and ripeners. Using shipper/importers as a base for licence distribution would however give rise to problems in policing the reality and binding nature of shipping contracts presented in pursuit of licence claim. In order to prevent speculative application, the period of validity of the licence could be shortened and stiff penalties introduced for those not using the licences.

b)Auctioning : Some regard auctioning import licences as involving a breach of tariff bindings because the price paid in the auction is seen as an additional import charge (see annex III). This is not the panel's view. Moreover, there are means of designing auction systems which make it clear that it is used only as a means of distributing licences and not as means of imposing a charge. This system would have as a clear advantage of being transparent and WTO compatible. The Commission, in its contacts, noted a certain resistance to this option from the operators which seems shared by the USTR.

7) CONCLUSION

It is clear that there is no solution which is guaranteed to solve the dispute which does not involve major difficulties in relation to the Community's own interests, budget resources and obligations. It is also clear that the Community will have to put forward its solution if it wants to avoid an indefinite continuation of the US sanctions, possibly followed by more retaliation by Ecuador. The Commission would find a continuation of the sanctions inappropriate in view of the damage they do to European industry but also because of the wider implications this would have on our WTO obligations. Article 22 (8) of the WTO Dispute Settlement Understanding requires these measures to be temporary.

At the moment, the first solution which would guarantee immediate lifting of the sanctions and an end to the WTO disputes would be a tariff only system as described under paragraph 4 a; this option however would involve major costs to the budget and ACP trade would become largely uncompetitive as a result. The second solution which would have the same desirable effect of ending the disputes and lifting the sanctions would be a system agreed with all the major players. However, it has so far not been possible to pursue this avenue successfully given the lack of flexibility on the US side concerning the distribution of licences.

The options which would seem capable of resolving the dispute and respecting the Communities' key budget concerns and internal commitments to its own producers would be:

1. **Moving to a high flat tariff (Option b)**

The disadvantages of that option are its uncertain budgetary effects, and the uncertainty of its effects on trade from the weaker ACP suppliers; it would require Article XXVIII GATT negotiations (deconsolidation of bound tariffs; see annex II) and if compensation were payable to Latin American suppliers, it is not clear how this would be found. Depending on the level of duty which in the light of foregoing would be very difficult to establish, this option is also likely to involve a cost for consumers. In principle, the US would have difficulty rejecting this option, although whether or not they would remove their sanctions without a panel, would depend on their assessment of the tariff level. This option would not require a licensing system or a new waiver.

2. **Removing the limit on the ACP preferences and maintaining the (other) two existing tariff rate quotas (Option d)**

This option should have no immediate budgetary impact and would clearly safeguard ACP trade. The Ecuador panel considers it WTO consistent but the US claim that it would require an Article XIII waiver and that they would not accept it. Hence a panel would probably be necessary to remove the US sanctions.

This option would of course require a system of licence distribution and the panel has said that auctioning is WTO consistent.

If under this option, the ACP trade expanded significantly, market prices could fall in the Community and budgetary consequences would ensue; at that point an Article XIII waiver could be requested in order to reimpose a limit on ACP imports.

3. **Introduction of a new tariff rate quota (Option f)**

Depending on the level of the duty in this new autonomous tariff rate quota for a volume higher than the current ACP entitlements, there could be no budgetary consequences and ACP trade should be ensured. The US do not contest this possibility as being WTO consistent in theory, but would do so if they considered the level of the in quota tariff so high as to be prohibitive for Latin American bananas. In that case, a panel might be necessary to remove the US sanctions.

Under this option too, auctioning could be used to distribute the licences but separate auctions would be required for the different tariff rate quotas given the different in-quota tariff rates.

It is the Commission's view that a choice must be made among the 3 options set out above. The Commission therefore invites the Council to urgently give its views on these options.

In the meantime, the Commission continues to explore all avenues to reach with the complainants an agreed and WTO compatible solution, as quick as possible.

IMPLICATIONS OF A TARIFF ONLY SYSTEM

(I.E. WITHOUT QUANTITATIVE RESTRICTIONS)

Four scenarios have been examined on the basis of a range of assumptions. Each assuming ACP access at 0 duty would be maintained and existing support for Community producers would be maintained:

(i)	a single tariff of	75
(ii)	"	175
(iii)	"	275
(iiii)	"	375

The following comments are in relation to the status quo.

Scenario I (75 Euro/t)

Market prices would fall and consumption would increase. However, ACP supplies from the Caribbean would be uncompetitive, although some supplies from Africa would continue.

The cost of the domestic support regime would increase by 100-150 MEURO.

Scenario II (175 Euro/t)

Market prices would fall and consumption would increase. However, ACP supplies would still be less competitive and fewer bananas would arrive from such origins.

The cost of domestic support regime would increase by 50-100 MEURO.

Scenario III (275 Euro/t)

Whilst the competitive position of individual ACP suppliers might vary, the overall price formation on the EU market would be similar to the present one.

The cost of the domestic support regime would broadly be similar to the present, with a year to year risk of increased expenditure due to greater price volatility.

Scenario IV (375 Euro/t)

Market prices would increase and consumption would fall. However, all ACP suppliers would be competitive but the Latin-American share would fall.

The cost of domestic support regime would decrease slightly.

ANNEX II

UNBINDING OF THE CURRENT TARIFFS FOR BANANAS

Under tariff heading "08 03 00 12 Fresh bananas other than plantains" the bound rate of duty at the conclusion of the Uruguay Round negotiations was Euros 850/t., to be reduced by the year 2000 to Euros 680/t. A tariff rate quota of 2.2 mio./t. at Euros 75/t. was also bound; and subsequently the Community opened a further quota at Euros 75/t. of 353.000t. Almost all MFN trade takes place within the reduced tariff quotas.

Should the Community wish to move to a "tariff only" system at a rate higher than Euros 75/t., GATT Article XXVIII provides that such modification shall be notified to all the GATT Contracting Parties, and consultations shall take place on request with Parties who are principal suppliers or have an initial negotiating right (INR) as well as those having a substantial interest in the product concerned. Following negotiations and agreement with any Party with which such concession was originally negotiated and any other Contracting party having a "substantial interest" - usually considered as supplying 10% or more of the market - the tariff rate shall be rebound [1] at the new rate. The negotiations "which may include provision for compensatory adjustment with respect to other products" are aimed at maintaining a similar general level of reciprocal and mutually advantageous concessions to that existing before the negotiations.

The implications of such negotiations in the banana case would depend on the level at which the Community wished to rebind the tariff. If the objective were to remove the reduced duty quotas and replace the bound duty of over Euros. 700/t with a tariff of, say, Euros 500/t., the principal suppliers (Equador, Panama, Costa Rica and Colombia) would be likely to seek compensation equal to the difference in tariff perception between Euros 500/t and Euros 75/t. for their average annual sendings. The problem with this is, of course, that since all those principal suppliers benefit from GSP preferences, there are no major products on which they pay duty at all; so the scope for reduction scarcely exists.

If on the other hand the Community sought to establish a new binding of, say, 275 Euros/t., it could be argued that the replacement of a prohibitive tariff of some Euros. 700/t. with a tariff which permits trade to flow freely would in itself compensate for the elimination of the reduced tariff quotas.

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[1] Since the URA, all agricultural products have to be bound

In all cases, should agreement not be reached with the principal suppliers, the Community retains its right to unbind and rebind the product; in that case, Contracting Parties having WTO rights shall be free to withdraw equivalent concessions.

ANNEX III

OUTLINE OF THE OPTIONS ON THE AUCTIONING OF BANANA IMPORT LICENCES

1. Auctioning of import licences is a system to allocate licences. It is not an extra charge to imports. Auctioning is arguably the single best system to allocate licences when there is a significant quota rent. The other available systems to distribute licences, such as first come/first served or simultaneous examination, have a fundamental shortcoming which is that the licences which are granted are only a fraction of what operators request, and therefore do not facilitate normal trade flows.

   Historically based licences distribution systems have another fundamental shortcoming, which is that they freeze the market, they reduce competition between operators and they create vested interests. In the case of bananas, the criticisms of the panel make it difficult if not impossible to devise a system of historical based licence distribution which could be considered WTO compatible.

   In addition, the fact that an allocation mechanism can be considered to be discriminatory merely on the basis of its actual impact will make it difficult to devise systems of administrative quota allocation that meet the requirements of the GATS. For instance, according to the rulings of the Appellate Body, a Member's allocation based on the past trade performance of the importers could be considered to be discriminatory if *de facto* most importers with past trade performance are owned or controlled by nationals of that Member (which seems likely in most cases).

   The only practicable quota allocation mechanism which ensures that importers of all origins are given an equal opportunity to supply their services is auctioning. (The only alternative mechanism that would also ensure equal treatment would be a lottery).

2. There are two different auctioning systems, which could be operated. Both have in common the fact that they will allow a full utilisation of the tariff rate quotas.

   The first option could work according to the following lines:

   - The import licences on the tariff rate quota would be auctioned by lot of a given number of tonnes. The size of the lots could be either the same, or one could have different lots with different sizes.

   - Operators requesting import licences would bid a certain amount per lot. The bids would then be ranked starting with the highest. The lots for which the bids were made would be added up to reach the tariff rate quota volume. All the operators that were ranked as having made the highest bids until the volume of the quota is fulfilled would get the licences, and would pay the full amount of their bids.

The second option (called striking price) would operate exactly in the same way with one single difference, which would be that all the operators would only pay the minimum bid in the rank of all those who were successful. A feature of the second system is that, in the event that the bids were for less than the total volume of licences on offer, the minimum price would, by definition, be zero. This makes it totally transparent that the system is only a means of distributing licences, not an additional import charge because the licences would all be free so long as the total quantity was not oversubscribed.

3. With respect to access to auctioning, it could be open to all interested operators. However, it could also be conceived that access to auctioning be restricted to a well-defined category of operator, on the basis of objective non-discriminatory criteria – although there would have to be very good reasons to justify such limitations and there would always be the risk that they could be considered to be discriminatory.

4. With respect to the frequency of auctioning any reasonable period is conceivable, from a yearly to a monthly auction.

5. Separate auctioning seems appropriate for separate in-quota rates. If the banana import regime has two (or more) in-quota rates, operators should be allowed to lodge separate bids for the different in-quota rates. To do otherwise would discriminate in favour of those who bid for the lower in quota rates.