Implications of the EU Banana Trade Regime for Selected Import Markets: Economic Analysis and Political Dimension

by
Patrick Verissimo

ISBN: 1-58112-124-5

DISSERTATION.COM

USA • 2001

Implications of the EU Banana Trade Regime for Selected Import Markets: Economic Analysis and Political Dimension

Dissertation.com
USA • 2001

ISBN: 1-58112-124-5

www.dissertation.com/books1121245a.htm

Implications of the EU Banana Trade Regime for Selected Import Markets: Economic Analysis and Political Dimension

Patrick Verissimo

Diese Promotion wurde von der Friedrich-Naumann-Stiftung mit Mitteln des Ministeriums für Bildung, Wissenschaft, Forschung und Technologie gefördert

The Boston tea party and interventionist US sugar policy

Over 200 years ago the British taxed sugar and a few other items entering North America. This upset the independently willed folk of North America no end, eventually leading to the Boston tea party and the War of Independence.

After the war the now US government slapped its own tax on imported sugar. When Louisiana was bought from the French the sugarcane farmers there were thrilled because now they effectively collected the sugar tax themselves because the import tax had raised the prices they received for their sugar.

As time went by, US politicians found some clever foreign policy applications for the sugar tax. To make friends in the Philippines they decided to allow Philippine sugar free entry to the United States – in effect allowing the Philippines to collect some of the tax. Word soon got around. More deals followed. Soon there were no taxed imports, much sugar and no tax revenue left for the government, and prices began to fall.

So just before an election all the concerned sugar producers got together in Washington and reminded the government how many states and friendly foreign regions they represented. After that the government didn't really care that producers were stealing its tax and when the producers said they'd like a system of production controls and import quotas, the government saw this as a way of keeping its old friends.

For a time sugar commanded a high premium on the US market. But the high price eventually attracted the attention of a few chemists who found that they could produce an almost perfect substitute for sugar, high fructose corn syrup. Soon there were too many sweeteners available again, prices were falling and sweetener producers, and even corn farmers, were hurting.

So just before another election sugar and corn farmers and corn syrup producers got together to remind the government just how many states they represented. This time the foreign suppliers were not invited. Not surprisingly, it was decided to reduce the import quotas to hold up the price of sugar so US sugar and corn farmers and corn syrup producers were guaranteed the right to collect the tax. As corn syrup went from strength to strength, more and more foreign sugar suppliers went broke. Now corn syrup is sending sugar farmers broke also. Who'll be effectively collecting the tax in a hundred years time?

The moral of this story is that once created, a policy instrument (such as a quota) will have a life of its own and become increasingly complex. Certain groups will seize it in an attempt to manipulate it to their advantage, regardless of its cost to others or the economy as a whole. And through time, the policy may evolve in unpredictable ways and in ways unrelated to the initial purpose.

Source: BORRELL, B. and CUTHBERTSON, S. (1991): EC Banana Policy 1992: Picking the Best Option. Centre for International Economics, Canberra.

Contents

Figures

Tables

Abbreviations

ACP	Africa, Caribbean, Pacific
ADF	Augmented Dickey-Fuller
AIC	Akaike's Information Criteria
CET	Common External Tariff
c.i.f.	cost insurance freight
COMB	Common Organization for the Market of Bananas
DF	Dickey-Fuller
DG	Direction Generale
DM	Deutsche Mark
DOM-TOM	Departement d'Outre Mer – Territoire d'Outre Mer
EC	European Communities
ECU	European Currency Unit
FAO	Food and Agriculture Organization of the United Nations
f.o.b.	free on board
f.o.r.	free on rail
GATT	General Agreement on Tariffs and Trade
LOOP	Law of one Price
ODT	Overseas Department and Territories
OLS	Ordinary Least Square method
SBC	Schwarz's Baysan Criterion
TRQ	Tariff Rate Quota
UK	United Kingdom
US	United States of America
USD	United States Dollar
USDA	United States Department of Agriculture
USTR	United States Trade Representative
VER	Voluntary Export Restraints
WTO	World Trade Organization
ZMP	Zentrale Markt- und Preisberichtsstelle GmbH

1 Introduction

When the EU countries implemented the Single Common Market in 1992, they had to remove all internal borders to facilitate the free movement of goods across the EU. It also implied the introduction of a set of external trade and internal marketing regulations common to all member countries for all commodities, particularly those subject to some form of protection. In the agricultural sector, most products had been covered by the EU's Common Agricultural Policy and the associated market organizations, long before the implementation of the Single Market. However, bananas had been exempted from the common organization for the market in fruits and vegetables established in the early sixties, due to diverging positions on banana trade issues already existing at that time among the six founding members of the European Communities. However, for the completion of its Single Market the EU had to replace the then existing disparate national banana regimes, with a unique set of market regulations common to all member countries.

In July 1993, the EU implemented the common organization of the market in bananas (COMB), which among other aspects, regulates the importation of bananas from non-EU countries. The COMB import regulations are designed to give preferential access to bananas produced domestically in the Overseas Departments and Territories, as well as in selected ACP states (Africa, Caribbean, Pacific). The latter are former colonies of the EU member countries that had traditionally been supplying bananas to those EU markets with a protectionistic banana trade regime. Without sufficient protection, most ACP and domestic bananas would not be able to compete with the cheaper bananas from Central and South America whose plantation production and shipping has traditionally been controlled by US transnational companies. The COMB is based on license-managed tariff-rate quotas for banana imports from non-EU countries, particularly affecting trade with Central and South American bananas.

Within the EU, the COMB had stirred considerable controversy targeted mainly towards its import regime, long before implementation. Concomitantly, the EU had faced complaints for its COMB from the United States and the banana exporting countries from Central and South America, which have culminated in the condemnation of several COMB aspects, by the GATT and later the WTO. Today the issue has become a political matter in the EU and on the global market, in which judicial aspects have long overtaken economic issues, leaving the future for the EU banana market uncertain [114]. Nevertheless, the multifaceted implications of the EU banana regime and the protectionistic nature of its policy have been fertile grounds for numerous economic analyses across the world.

Several of these economic studies have followed the approach of modeling global banana trade in a pre-COMB reference period with a multi-region, single commodity, partial equilibrium model, then simulating the EU banana trade regime to determine its effects on price and trade flow, and to quantify the welfare implications on the various key players in the global banana economy [11] [49] [62] [82] [87]. In these studies, several alternative policy scenarios are subsequently run, highlighting the superior economic efficiency of banana trade regimes based on other policy instruments than the ones applied under the COMB. The empirical results of those studies vary widely, and are at times even opposed, depending upon which pre-COMB reference period has been selected (this determines whether the tariff-rate quota level for Central and South American bananas is lower, equal or higher than the corresponding EU imports in the pre-COMB situation). Most analysts agree however, that in terms of economic impact on consumers, Germany has been the principal loser of the change from national banana policy to common banana regime, while France has been one of the main beneficiaries.

The analysis presented here takes a different approach than those based on partial equilibrium models, in that it focuses on market integration and pricing efficiency as indicators of economic efficiency under the uniform policy framework, relative to the pre-COMB period. The objective of this work is twofold: to assess the changes that have occurred in the organization and the performance of the EU banana market with the introduction of the COMB; and to identify the strategies adopted by banana operators in the EU to adapt to these changes. In that context, the analysis focuses on the two largest banana markets in the EU, Germany and France, which had operated largely opposed national banana regimes in the pre-COMB period. The analysis is extended to the US market for its importance in the global banana economy as the largest single importer, with an unlimited tariff-free access for bananas from all sources. All empirical work covers the period from 1980 to 1996. The analysis further emphasizes the political economy context at both the European and the international level, in which the COMB has evolved from a delicate policy compromise by the EU into an international lengthy dispute, which, on more than one occasion, has set a precedent with the WTO.

The first chapter is an introductory chapter describing the situation in the EU banana market before the COMB took effect, how such a COMB came about, and the main regulations of the COMB. It gives an overview of how the global banana economy is structured, emphasizing on the distinct trade flows that have characterized the EU banana economy in the pre-COMB period, and the significance of the involvement of US transnational companies in international banana trade. Furthermore, it describes the policies existing in Germany and France for the trade in bananas before the implementation of the Single Market. Finally, after the description of the regulatory framework of the COMB, the first chapter concludes with a review of the interrelationship between the COMB and the GATT and WTO, and the changes that ensued to the EU import regime for bananas in the first few year of its implementation.

In the second chapter, the performance of the selected import markets is assessed with respect to horizontal market integration. In other words, the extent and the speed of the adjustment of the landed price in the import countries to changes in the banana price on international markets is determined, both before and after the COMB implementation. Furthermore, taking the German and French banana market as case studies, this chapter looks into the empirical evidence supporting the completion of market integration in the single EU banana market, in which prices at the same marketing level would eventually converge and supposedly be aligned and uniform. In the context of the law of one price, the empirical approach followed in this chapter covers dynamic price transmission models and the co-integration analysis of time series of prices.

The third chapter addresses market performance in the banana distribution chain of the selected import markets, whereby stressing changes between the pre-COMB and COMB period in the two EU countries chosen. The analysis of vertical market integration focuses on the domestic price relationships between the import, wholesale and retail levels. At first, price formation in the selected banana markets is analyzed, with a special attention to the characteristics and development of marketing margins in the banana distribution chain. Then, the extent and speed of the price response to a price change at a lower marketing level is assessed with dynamic mark-up pricing models, at all three exchange points in the banana distribution chain, for all three import markets. Finally, the presence of asymmetry in price transmission, by which a price increase is passed on to the next marketing level to a fuller extent and more rapidly than a price decrease, is investigated, based on the WOLFFRAM-HOUCK approach.

Finally, in the fourth chapter, the impact of the COMB tariff-rate quota for third-country bananas on the organization of and the performance in the EU is analyzed. In that context, the strategies of different types of EU-based banana operators to maintain their competitiveness in the new policy environment are identified. Then, based on the analysis of the evolution of marketing margins in the EU after the implementation of the COMB, a quantification of the quota rents is undertaken. Furthermore, based on banana and import license trade flows, a quantitative assessment of the distribution of quota rents among operators on the one hand, and between Germany and France on the other hand, is attempted. Finally, a brief analysis of the economic impact on operators traditionally trading with bananas from Central and Latin America of a COMB reform towards a tariff-only system, is carried out, to determine whether such a reform proposal by the EU, which would eliminate windfall profits from quota rents, would still be contested by the countries these firms are affiliated to (i.e. US, Central and South America).

Finally, an outlook on the latest developments in the banana issue concludes this work. It briefly reviews the banana regime currently applied and the most recent proposals put forward by the EU in an additional attempt to adopt a substantially reformed, internationally uncontested, new import regime for bananas.

2 The Emergence of Banana Trade Regulations in the EU: From National Policies to a Single Common Market

2.1 The world banana economy: a geographically segmented market

2.1.1 The supply side

Bananas are the most important fruit in trade with tropical products. Along with coffee, sugar, tea, cocoa and rubber, bananas are among the major internationally traded agricultural commodities which are produced in low-income and exported to and consumed in high-income countries. For most of the major exporting countries, they are one of the primary sources of domestic employment and export earnings [53]. In 1997, world net imports of bananas amounted to 11.5 million metric tons and are expected to reach 13.7 million tons by 2005 [33]. These imports represent almost 20 per cent of the global CAVENDISH production, the botanical group of bananas traded internationally. Prior to the change in trade policy introduced in the EU on July 1st, 1993, world banana trade showed a very distinctive, almost rigid structure established a century ago when banana production first experienced large-scale international commercialization. Today, this market is still characterized by geographically and historically determined trade flows as well as by the predominant involvement of transnational companies. It has, however, evolved from a typically demand-driven market to a market increasingly influenced by political and economic lobbying surrounding a commodity often accurately referred to as the ‘green gold’ [99].

Bananas are grown throughout the tropical zone. An annual crop (botanically, a giant grass), they are usually harvested well within the year of planting. Depending upon the production structure, the capital investment required to establish a banana orchard can be quite considerable. Due to the relatively short growing cycle, the response of banana supply may be faster and stronger to rising prices, and slower and/or weaker to declining prices (due to the significant investment in the ground) [33].

The bulk of world banana exports are supplied by the Latin American region, which in 1997 accounted for 84 per cent of total world exports [34]. Ecuador, Costa Rica and Colombia account for almost two thirds of the global banana exports. Ecuador alone, the world's largest single exporting country of bananas, provides a third of the world's banana supply. Although not major exporters in terms of volume traded, countries from the Caribbean and Africa region have been at the center of the debate surrounding the EU banana trade policy. In 1997, Africa's share of world banana export was less than 3.5 per cent, while the Caribbean countries (without the French overseas departments) exported less than 1.5 per cent of global exports [34]. In other regions, the Philippines is the only significant country on the supply side. Its share of world exports had been continuously declining and reached just less than 10 per cent in 1997. Finally, the world's largest producers India and Brazil do not participate in the international trade with bananas, producing mainly for their domestic markets.

Regardless of their geographic origin the commercially traded bananas can be considered to be a homogeneous commodity, despite considerable disparities existing between production systems and costs of production across exporting countries. At the export level, the cost of production are the crucial element of trade performance, as it directly determines the international competitiveness of bananas from particular sources, and thus has a major impact on international banana trade flows. Banana production in Central and South America is characterized by large-scale plantation units. These require substantial initial investments but provide the opportunity to reap economies of scale. Traditionally, with the exception of Ecuador and to a lesser extent Columbia where smaller production units prevail, banana production on plantations has heavily depended upon the involvement of transnational corporations [52]. Following the control of production and export of Latin American bananas by US transnational corporations since the early days of the 20th century, the region is being commonly referred to as the ‘dollar zone’. Bananas from the dollar zone (so called ‘dollar bananas’) are exported worldwide, with the majority being traded to the US and the EU.

In sharp contrast to the banana production in Latin America, Caribbean bananas are produced on family smallholdings. The island topography does not permit plantation production and leads to lower yields, hence resulting in higher unit costs. However, unlike in the Caribbean islands, other ACP countries such as Surinam, Belize, and particularly the African countries of Côte d’Ivoire and Cameroon have enjoyed a comparative advantage in banana production due to low wages, more favorable topographic conditions and less exposure to hurricanes. These factors, combined with adaptation strategies of firms to the change in the EU banana trade regime (see Section 5.4.1 p.177), have increasingly attracted investments from transnational corporations and encouraged a shift towards plantation production, resulting in production costs which are lower than in the Caribbean islands, though not as low as in the dollar zone [30] [32]. Bananas from ACP countries have traditionally been shipped almost exclusively to the EU.

Finally, it should be mentioned that the EU also produces bananas, though only for the domestic market. They are produced in the overseas departments and territories of the EU (ODT) and have traditionally been shipped exclusively to the EU mainland, mainly France and Spain (see Section 2.3.1 p.38). Although these bananas (referred herein as ‘eurobananas’) are not commercially traded on the world market, they have been traditionally used along with ACP bananas as the political justification for the erection of trade barriers under the national policies of several EU countries before 1993, as well as for the design of protectionist regulations under the common banana regime. Eurobananas have never played a significant role in international banana trade because of their low competitiveness relative to dollar and even ACP bananas. On the one hand, the banana sectors in the ODT in the Caribbean region suffer from their exposure to devastating hurricanes. On the other hand, eurobananas from the sub-tropical and Mediterranean zones are grown on smallholdings in unfavorable climatic conditions, where cooler seasons result in longer vegetation periods and require large investments in greenhouses-like facilities. Thus, the production costs of eurobananas are even higher than for the ACP fruit [30]. In addition, the islands of Guadeloupe and Martinique, two French overseas departments, are at a further cost disadvantage, as they are bound to the French minimum wage legislation. Before the implementation of the EU banana policy, transnational corporations had been involved neither in the production nor in the marketing of eurobananas.

2.1.2 International marketing and distribution of bananas

Ever since the early years of international banana trade, at the turn of the last century, US transnational corporations have been omnipresent in the production, shipping, distribution and ripening of bananas. The ‘big three’ of global banana business are CHIQUITA BRANDS INTERNATIONAL INC., DOLE FOOD COMPANY INC. and DEL MONTE FRESH PRODUCE and are all part of larger finance corporations in which banana operations only play a minor role. With enormous capital investments, the banana transnational corporations have succeeded in establishing a very efficient, large scale, multi-faceted network allowing them to operate on a highly productive base characterized by a high degree of vertical integration. Owning land (although with declining trend) in many exporting countries and running their own fleets of refrigerated vessels has given them the flexibility to obtain bananas from different sources without interrupting the supply to the import markets (e.g. when a producing region is struck by natural disasters). Additionally, in many import markets the banana transnational corporations have also been involved further downstream in the marketing chain, from control over ripening activities to advertising at retail level. This efficient vertical system has allowed them to quickly adapt to technological changes regularly occurring in production, transport and ripening, such as the relatively recent cost-reducing palletization of bananas throughout the various stages of the marketing chain. Traditionally, the US transnational corporations have controlled the production and export of bananas from Central and South America by providing massive direct investments and securing political ties in most dollar zone countries [52] [67].

Considerable barriers to entry exist for newcomers in global banana trade. These result in the need to gain access to banana supplies, to source from a number of countries in order to avoid supply interruptions due to exogenous factors, to control port facilities and shipping, to control ripening and distribution facilities, and to secure exclusive contracts with retailers [53]. Hence, newcomers require substantial financial strength to perform investments in the banana sector to overcome the minimum efficient firm size needed to reap economies of scale. Nevertheless, in recent years, the three transnational corporations have seen several foreign firms, operating under the same principles, successfully establish themselves with own brand names on the global banana market, notably FYFFES LTD (Ireland) and GEEST PLC (UK).[1] It is estimated that on aggregate, transnational corporations control more than two thirds of global banana exports and have a market share in the EU of 57 per cent [79]. Additionally, private firms in the exporting countries NOBOA (Ecuador), UNIBAN and BANACOL (Columbia), DAHITRI (Philippines) have emerged on the banana trade scene and gained increasing importance. As an example, in recent years the ‘big three’ have lost 25 per cent of the US import market to South American banana firms [31]. Despite the overall decline of the dominance of the three transnational corporations in world banana trade, the market remains fragmented geographically with still only a few number of exporting firms participating in the various market fragments.

In a traditionally demand-driven global market for a homogenous product where competition is mostly restrained to criteria associated with brand names, one of the main goals followed by the large banana companies has been to supply traders and consumers in high income countries with a high quality product, at the lowest production and marketing costs possible. Beyond visual aspects, this quality is determined by the continuous supply of a standardized product along with technical support. The marketing of bananas requires a high level of coordination of production, shipping, ripening and wholesale distribution if the perishable commodity is to be moved swiftly and smoothly through the distribution chain, and the high unit costs of less than full capacity use of

---

1 In 1996, FYFFES purchased all banana operations controlled by GEEST.