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## The goals of sustainable development and the reform of the EU banana trade regime: a discussion of different trade instruments

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# **Discussion Paper No. 98-31**

## **The Goals of Sustainable Development and the Reform of the EU Banana Trade Regime**

**A Discussion of Different Trade Instruments  
by**

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## **Non-technical summary**

This study is meant to give a basis for evaluation for the reform of the EU-trade regime for bananas, currently discussed. Considering the goals of sustainable development, the reform of the EU banana regime not only strives to achieve short-term trade policy objectives, such as improved chances for market access for smaller market participants, but also to contribute to the realisation of long-term sustainable aims in the exporting countries.

A trade restriction measure is usually targeted towards protecting national producers against competition from foreign producers. However, the EU-trade regime for bananas has previously strived not only for the protection of EU banana producers, but also for those of the ACP farmers. When analysing different trade regimes in this paper, the problems emerging from inconsistencies between free-trade principles and the goals of a sustainable development are presented in a differentiated way. When assessing individual trade-political measures, the interests of small producers in developing countries were - in line with the aims of this study - the centre of focus.

From the point of view of GATT, levies are currently the preferred solution. However, from an economic perspective, the most important difference between a tariff- and a quota-regime is a problem of distribution rather than a problem of market efficiency. New trade instruments like the consideration of ecological and social standards in trade relationships and the actioning of import licences allow innovative paths to be followed in the trade policy.

To judge the performance of different trade instruments, evaluation criteria have been defined. From a point of view of sustainable development, a trade restriction measure has to fulfill at least the following requirements: it should support those producers who internalise the real environmental costs of production in their price structure and make sure that the specific trade measures do not contradict efforts on the improvement of social standards in exporting countries.

We showed in this paper that the allocation of the import licences in the import country can be a valuable contribution towards fair trade. For this, it must ensure that the import rent will be directed where it can most sensibly foster a sustainable development. Based on this assumption we presented an alternative suggestion for the allocation of import licences in the EU based on the auctioning of direct producers' offers. However, to enforce the position of sustainable banana production, the EU should also introduce - in addition to an auction of producers' offers - social and ecological labels in the banana market.

## **Abstract**

Ideally a new reform of the EU trade regime for bananas (COMB) should be equipped in a way that it makes a long-term contribution to the realisation of sustainable goals, or at least does not prevent them. From a point of view of sustainable development, a trade restriction measure has to fulfill at least the following requirements: it should support those producers/market operators by preferential market access who internalise the real costs of production in their price structure and make sure that the specific trade measures do not contradict efforts on sustainability in exporting countries. Against this background we introduce an innovative model – auctioning producers' offers in the EU. Issues concerning the auction design and its GATT/WTO compatibility are also discussed. In sum, the auctioning of direct producers' offers seems to be a practicable solution for fair trade with agricultural produce from developing countries. However, to enforce the position of sustainable banana production, the EU should also introduce - in addition to an auction of producers' offers - social and ecological labels in the banana market.

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# 1 Introduction

On 26th June 1998, after six months of intensive discussion, the EU Council of Agriculture reached a political agreement on the reform of the Common Organization of the Market in Bananas (COMB, Regulation 404/93). The reform of COMB was forced by the GATT/WTO<sup>1</sup> Panel WT/DS 27<sup>2</sup> from October 1997, which stated the inconsistency of the EU rules with GATT and GATS<sup>3</sup> (Chambron, 1998; Kuschel, 1998).

In May 1996 the USA, together with four of the so-called dollar-banana exporting countries in Latin America (Ecuador, Guatemala, Honduras, and Mexico), appealed to the Dispute Settlement Unit of GATT/WTO to assess the compatibility of the EU banana trade restrictions with GATT regulations. The complainant parties wanted GATT/WTO to force the EU to opt for a broader liberalisation of the banana market, i.e. for a tariff-only solution. The Panel, however, allowed the EU to choose one of several options, i.e. a tariff-only solution, a reform of the existing "constitutional restrictions", or negotiations with third parties while keeping the old regime until its end (Chambron, 1998). In its proposal from January 1998, the EU Commission rejected both the first and the last option and decided to proceed according to the "minimum change option". Thus, the new regulation keeps up the main "constitutional restrictions" of the old regime based on the assignment of quotas and import licences. It introduces, however, changes mainly concerning the GATT-incompatible allocation systems of country-specific quotas and import licences.

With its decision, the EU Council basically accepted the recommendation of the Commission from January 1998. However, it also considered the objections of the European Parliament<sup>4</sup> concerning the unequal chances for Fair Trade bananas in the European Market: "The Council and the Commission agree that the Commission should present a communication on Fair Trade accompanied by appropriate measures before 1st March, 1999. This communication and proposal will aim to achieve better social and environmental standards of production in developing countries and broaden support to Fair Trade organisations and to accredited Fair Trade products on any officially recognised certification procedures and the

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<sup>1</sup> GATT/WTO - General Agreement of Tariffs and Trade/World Trade Organization; they represent the binding framework of the international trade of goods.

<sup>2</sup> Panels are ad-hoc courts to decide about disputes between the WTO-member states.

<sup>3</sup> GATS (General Agreement on Trade in Services) is the parallel agreement to GATT, dealing with the international exchanges of services.

<sup>4</sup> See Thomas-Report, EU-Parliament 1998.

promotion of these products in Europe. In this context, the newcomer provision of the import licensing arrangements could help to facilitate Fair Trade Bananas to the extent that additional demand by consumers for these bananas is not met by traditional operators." (Press Statement of the EU Council of Agriculture, 26th June, 1998).

Furthermore, the Council requests the EU Commission by 31st December 2004 at the latest to present a report on the operation of the COMB and of possible alternatives, in particular as regards the import arrangements. Further claims - especially presented by NGOs from the North and the South - concerning the fair distribution of welfare gains from the international banana trade have not (yet) been taken into account, but the Council did not stop the discussion on those issues.

In fact, the Council's decision is based on the assumption that trade restrictions may be legitimate in certain circumstances. Concretely, it assumes that the interests of the banana producers in the EU and in the ACP countries must be protected against the competition from Latin-American producers, which are mainly controlled by USA multinational concerns. In this point the EU trade policy contradicts the GATT-rules of non-discrimination, but during the Uruguay Round, the EU position was accepted by GATT/WTO; that means from a legal and institutional point of view the restrictive EU policy is not, at its core, vulnerable. However, it contradicts the current mainstream position in economic theory, which argues that international trade is an appropriate tool to achieve a world-wide efficient allocation of resources, and trade restrictions should therefore theoretically be reduced to a minimum to allow economic efficiency and maximal growth of the world economy (welfare thesis). In the international trade policy we can observe a trend into the same direction, i.e. towards a broader trade liberalisation. However, world-wide acute distribution asymmetries and increasing environmental damage force politics to search for innovative solutions, setting limits to trade freedom when necessary.

This study<sup>5</sup> is meant to give a basis for evaluation for the COMB reform, currently discussed. Considering the goals of sustainable development, the reform of the EU banana regime not only strives to achieve short-term trade policy objectives, such as improved chances for market access for smaller market participants, but also to contribute to the realisation of long-term sustainable aims in the exporting countries. Individual measures should therefore be regarded as steps of a long-term strategy.

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<sup>5</sup> The full German version of this study is available as ZEW-Dokumentation Nr. 98-07 „Die Reform der EU-Marktordnung für Bananen – Lösungsansätze eines fairen Handels unter Berücksichtigung der Interessen von Kleinproduzenten“ by Suhita Osório-Peters.

## **2 Why Trade Restrictions in the Banana Market?**

The legitimacy of trade restrictions can be discussed from different points of view. Currently it is mostly discussed from an institutional perspective, since there is a world-wide legal framework for trade (WTO) which aims at a broader liberalisation of international exchange. Trade restrictions are regularly seen by WTO as time-limited and/or object-limited exemptions.

However, among economists and even inside the WTO an intensive discussion is running about essential issues like the grounds for trade restrictions, the conflict between national sovereignty and international binding rules, and the interface between development goals and distribution of welfare gains from trade. As the discussion on these issues has only practical consequences when focused on a concrete problem, the discussion about the conflicts around the COMB may contribute to clearing some controversial aspects. Moreover, the banana market in the EU has many characteristics that make it appropriate for an exemplary case study for trade with agricultural products between developing and industrialised countries.

### **2.1 Different Goals of Trade Restrictions**

Every trade restriction measure has an impact on the economy of exporting and importing countries. Since this impact is highly dependent of the type of measure used, it is important to first assess the goals of politics before discussing the instruments to achieve these goals. The aims of the NGO engaged in the Banana Market are different from the aims of the EU Commission. The NGO aim to achieve:

- the protection of small-holder banana-producers in developing countries (actually some NGO wish a higher protection of ACP countries, and some of them even restrict their claims to just the protection of the Caribbean Windward Islands. Actually, in the Windward Islands bananas are still produced by small farmers with traditional techniques, whereas in Latin America multinational enterprises control largely the production and export of bananas regardless of social and ecological damage (cf. Osório-Peters 1997: 56-67; Kox, 1998: Godfrey 1998);
- Any new regime should restore competition within the market in order to strengthen the position of independent, small and medium scale operators against the strong oligopoly of the four TNC (Chiquita, Dole, Del Monte, Fyffes) controlling about 85% of the EU market.
- the positive discrimination of fair-trade bananas in the EU-Market to give them a chance in Europe in spite of their higher prices (it is supposed that there is a

market in Europe for these bananas, an assumption that was verified by a 'Eurobarometer' survey on consumers' willingness to purchase fair-trade bananas in early 1997).

- Any new regime should include a mechanism to reinvest the income from tariffs and licence fees in sustainable banana production and diversification.

By contrast, the aims of the EU on reforming the banana market regime are:

- the protection of the European banana producers;
- the achievement of the commitments stipulated on the Lome IV Convention;
- and, last but not least, to make its own trade policy GATT-compatible.

The contradiction between the EU and GATT actually concerns not only the measures, but also the aims of the EU banana regime. In fact, the protection of EU producers is in principle inconsistent with GATT. Thus, from the perspective of the EU Commission, trade restrictions in the banana market have to be seen as a provisional solution for the next years. In the long run, the EU will be obliged to change its own regime towards liberalisation. At the moment, an EU agreement with the explicit NGOs' aims concerns probably the incorporation of the commitments of Lome IV into Lome V as well as the establishment of a respective WTO waiver for a further ten years.

Some goals that have to be considered within a COMB-reform are not explicitly expressed because there is a broad consensus about their importance. This applies e.g. to the need of a stable framework. As all participants in the banana chain agree that - no matter which regime will be introduced in Europe - producers, exporting and importing operators as well as dealers have to cooperate very closely, as they all claim for a regime which allows the realisation of long-term contracts. Furthermore, all participants agree that the new regime must be transparent, politically controllable and reduce the bureaucratic costs ensuing from it as far as possible.

## **2.2 Trade Restrictions and Sustainability**

Another discussion point that is usually not explicitly discussed concerns the potential interest conflict between consumers in Europe and banana producers. The consumer protection argument pushes the EU Commission towards a liberalisation of the market, since it stresses the fact that the price of EU and ACP bananas is higher than the price of the so-called dollar-bananas, and that the current positive discrimination of EU and ACP bananas is inconsistent with European consumers' interests. During the discussion of the COMB-reform this argument was used by



several EU member states, for example Germany, which opposed to the EU banana regime. Several studies<sup>6</sup> on the welfare effects of the international banana trade came to the conclusion that the majority of European consumers would be the losers of a discriminatory trade policy. However, while all those studies regarded the trade effects exclusively from the point of view of the importing country, a respective assessment of the impacts of different trade regimes on the situation of the export countries is still missing.

The most important criticism against those studies, however, concerns their pure economic character, focusing exclusively on allocation aspects without taking into account neither the external ecological effects of production and trade of bananas nor the distribution asymmetry of welfare effects. NGOs engaged in the establishment of a fair framework for the banana trade look at this question from the point of view of a sustainable development in exporting countries and therefore claim that the EU should give political priority to the producers' interests in exporting countries. In fact, although European consumers' interests must be taken into consideration, bananas can be seen as a luxury good in Europe. By contrast, revenues from banana exports are essential for the survival of many producers in exporting countries. In this sense, a reform of the EU banana regime should be shaped in order to achieve not only short-term, but also long-term goals and consider both banana production and trade as factors of a sustainable development strategy in the producing regions.

If the EU introduces a trade restriction (levy or quota), operators in the EU market will try to protect their own interests. If they are not able to pass on their additional costs to the consumer prices, they will try to force the producers to lower their prices. This means that the producers will be obliged to bring down their production costs (mainly wages) and to accept lower revenues. As in the banana market the bargaining position of small farmers is weak, a fair-trade regime is the only solution to avoid that a large share of the producer rent flows to the importing country. Against this background, one of the most important issues from the point of view of a fair-trade regime should be the call for protection of the producers' prices in developing countries.

Furthermore it is desirable to set long-term goals for sustainable development in banana exporting countries, i.e. to set appropriate ecological and social standards for production, trade and consumption. But sustainable development normally requires a wide diversification of the economic activities as well as a reduction of dependence on cash crops and an efficient use of resources. As it is assumed that the EU will have to modify its banana regime in a few years, it is important to lay

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<sup>6</sup> Herrmann, 1996; Borrell, 1996.

down a trade strategy complying with the long-term goals of sustainable development.

To conciliate the aims of sustainability with the rules of the current world-wide trade frame the short term goals of concrete trade measures to regulate the banana market should be the following:

- Any new regime should support those producers/market operators by preferential market access who internalise the real costs of production in their pricing structure. This means, it must give fair-trade organisations and other operators dealing with “sustainably“ produced bananas, free access to the European Market under fair and competitive conditions and ensure that stimuli are created in order to internalise the real environmental and social costs of banana production and to pass them on to the consumer.
- Any new regime has to make sure that the specific trade measures do not contradict sustainability efforts in exporting countries. That means, it should provide real market access for new operators, including fair-trade operators, and small and medium sized farmers. For this it should provide real market access for those new operators. Furthermore, revenues resulting from EU trade restrictions must remain with the producers or alternatively be used to finance development projects in the exporting countries (return transfer of the producer rent); in this case, these means should be used specifically for the support of sustainable cultivation methods in banana production and of projects aimed at the diversification of economic activities.
- Any new regime has to comply with the special obligations of the EU in favour of the ACP countries (Lomé IV, add. prot. 5).
- Any new regime has to comply with the special obligations in favour of the European banana producers (Community preference).
- Any new regime has to be legal in terms of the WTO.

### **3 Trade Instruments**

#### **3.1 Tariffs**

Levies are the trade instrument least affecting the operations of markets. As they act through the normal price mechanisms, in well functioning markets they lead to efficient allocations and need not be supported by other measures. However, this implies the assumption that there is a competitive market and no monopoly structures. Many arguments based on this assumption support the thesis that a tariff-

only solution is better for consumers in importing countries and producers in exporting countries than any kind of quantitative import restrictions.

Indeed, since governments of importing countries should be interested in keeping the whole consumer rent in the public treasury, they should normally prefer a tariff solution. However, it is rather difficult to assess exactly at what level a levy will guarantee the degree of protection that is politically desirable. Actually, the degree of protection in the importing country depends not only on the domestic prices, but also on the development of productivity in exporting countries and on the fluctuations of the world market prices caused by financial market instabilities.

If trade is economically successful, levies can lead to an improvement of productivity in exporting countries, as producers are encouraged to reduce their production costs. In this case, however, the levies of the importing country will gradually lose their trade barrier function. To keep the original degree of protection, importing countries would have to raise their levies to the same degree that the productivity in exporting countries increases. At present this solution is illegal, since governments can not easily raise their levies. Specific tariffs (like a levy for banana imports in the EU) must be accepted by GATT/WTO, and according to GATT, levies must not be raised, but are supposed to be gradually reduced.

As mentioned above, exporting countries may benefit more if importing countries set a tariff (instead of a quota), because this measure can be an incentive for exporters to enhance their productivity, thus neutralising the price effect of the levy in the importing country. On the other hand, a tariff-only solution exposes exporting countries to world-wide competition. If these countries cannot improve their productivity in the short term, it will be difficult for them to survive. Non-competitive producers (small farmers) will disappear from the market.

Competitiveness on the banana market is related to prices and quality. A small group of consumers in Europe will certainly buy sustainable produced bananas, even if they are more expensive than other bananas. But empirical studies show that the demand of "normal" consumers reacts very sensitively to price differences. Under a tariff-only solution, it may be possible to keep a small niche market for sustainable and fair-trade bananas in some EU countries, but expansion of those niches will be very difficult.

One possible solution would be a positive discrimination for fair-trade/sustainable bananas, i.e. they could be exempt from taxes. But a tariff differentiation based on qualitative criteria related to production is still incompatible with GATT. In the long run a tariff-only system is probably going to replace the EU banana regime. Arguments in favour of a tariff-only solution are for example that

- a) in well-functioning markets (full competitiveness, no monopoly), levies (price mechanisms) are pure market instruments leading to an efficient allocation;
- b) with levies, a share of the consumer (and foreign producer) rent resulting from a trade restriction measure will flow into the public treasury of the importing countries;
- c) a tariff (instead of quotas) can bring advantages to the exporting country too, as this measure can be an incentive for the exporting sector to promote its productivity.

However, at present most arguments are against a tariff-only solution in the EU banana market, because

- a) regardless of the theoretical reasons and the GATT-compatibility arguments that plead for a tariff-only solution, it is very difficult to quantify the exact tariff level in view of the desired protection;
- b) usually tariffs do not offer a basis for long term planning, neither in importing countries, nor in exporting countries;
- c) without a GATT-reform, there is the danger that sustainably produced bananas will not have a real chance on the market. A tariff-only solution will only be possible if GATT is reformed in two essential points: Production-related standards (for agriculture) must be integrated into Art. XX of GATT and into the technical agreements of GATT (TBT and SPS). However, it will still be necessary to develop international binding specific sustainability standards and respective labels for banana production and trade;
- d) as the EU-Commission has obviously opted for the "minimum change option" for pragmatic reasons, the tariff-only solution has very little chance to be accepted.

### **3.2 Quotas**

Quota solutions have two important short-term advantages:

- a) They make sure that the degree of protection that is politically suitable in the importing country will be achieved and
- b) they provide a steady planning basis to the exporting countries.

For a limited period of time a quota system will therefore probably assure the achievement of development aims in ACP countries better than a tariff-only

solution. Therefore there is no reason for the EU to abolish the quota for ACP countries and other countries with substantial interests.

Although the EU will certainly maintain its quota-regime (the GATT/WTO-Panel has only criticised the distribution of the country-specific quotas, not the quotas itself), the following arguments against a quota solution should be kept in mind:

- a) Quota systems use up a lot of public resources and require a considerable administrative involvement;
- b) The short-term advantages of quotas (the provision of a stable basis for importing and exporting countries) can turn out to be negative in the long run, because they may hinder development. This is especially the case when non-sustainable structures in the importing and exporting countries are artificially kept, causing high inefficiency costs over a long period of time.

One alternative to combine the advantages of both tariffs and quotas and at the same time to reduce the disadvantages of each, is to set up a tariff-quota solution. In the transition phase from a quota-system to a GATT-compatible tariff-only solution, many countries have opted for this option. The EU banana regime is a tariff-quota solution, too. Furthermore, the distribution issues mentioned above demand special attention. Problems of quota-allocation can be partially solved by auctioning import licences (see below chapt. 4).

### **3.3 Environmental and Social Standards - GATT Compatible?**

Free trade supporters argue that international trade is an appropriate tool to achieve a world-wide efficient allocation of resources. Thus, politics should neither restrict trade to protect a state's domestic producers nor use trade measures to resolve social or environmental problems.

However, the evaluation of the relationship between trade and welfare depends in fact on how the "efficient allocation of resources" is defined. Recently more and more experts have joined the argument that trade itself can be a source of social and environmental damage. If these damages are a potential source of inefficiency, measures for environmental protection and the world-wide assertion of social standards may have a higher priority than free trade principles. From this point of view, trade restrictions can be used to support social and ecological standards.

However, fair-trade organisations must take into account that their claims (the introduction of environmental and social clauses) from the point of view of economic theory - which also represents the main stream in GATT/WTO - concern two different types of problems. Ecological damages can be seen as external effects

which can be treated as an economic issue, i.e. as a source of inefficiency. In this case, political measures to neutralise market failure are allowed. Accordingly, arguments concerning global and international environmental problems will be increasingly taken into account during international negotiations (Brockmann / Osório-Peters / Bergmann, 1998). GATT/WTO may perhaps even incorporate a general environmental clause in the near future, although they are restricted to binding international law agreements.

In contrast to this, social issues like working conditions are seen by the main stream economy as a problem of distribution policy. Low social standards are still considered to be an essential comparative cost advantage of developing countries, and there are no signs that a social clause could be successful in GATT/WTO.

Nevertheless, GATT/WTO has tolerated ecological, social and fair-trade labels so far, on the condition that they do not discriminate imported goods. Independently of the banana market regime to be implemented in the EU, a voluntary fair-trade label can therefore always be additionally introduced.

## **4 Quota Sharing Issues: Allocation of Export and Import Licences**

As the GATT/WTO Panel noted, distribution problems under the „old“ COMB arose on one hand from the allocation of export quotas under exporting countries; on the other hand, the allocation of import licences under the market operators in Europe was also a source of injustice. Therefore, different approaches concerning the design of export and import licensing systems are currently discussed. These approaches deal with the question whether a specific design of quota allocation systems would make it possible to create an efficient and fair alternative to tariffs.

### **4.1 Sharing the Export Quota**

The best provisional solution to allocate the export quotas would probably be to set up a EU global import quota for bananas, which would be shared out in fair negotiations among the exporting countries. In that way, import restrictions would be formally transformed into voluntary export restrictions by each exporting country. For political reasons this solution has probably no chance of success in the near future.

In fact, if the EU decides on a global import quota, it could be at least theoretically imagined that the exporting countries could, in their mutual negotiations, re-declare specific country quotas as deliberate export restrictions, whereby in this case the power over licence allocation would also be transferred to them. Actually, the

current COMB country quotas are - even if they are agreed in bilateral negotiations - in principle a “deliberate“ export restriction. For economic and political reasons, this solution is welcomed by some authors (e.g. Feenstra, 1991: 106). In this context it should be mentioned that “an import quota applied as a safeguard measure in conformity with the relevant provisions of GATT (...) may, by mutual agreement, be administered by the exporting Member” (cited in Glismann 1996: 11).

Into this direction also goes the allocation of export licences of the four so-called “Frame countries“ Costa Rica, Columbia, Venezuela and Nicaragua. In Costa Rica, for example, the producers, or the exporting firms, can buy licences for an export volume based on the average value of their production output of the last two years. Thus the Costa-Rican State retains a part of the rents which would otherwise go to local producers or the exporting firms and EU importers.

Under the existing conditions, it is however unlikely that the exporting countries can change the EU quotas into export restrictions. This possibility would require as preconditions that

- a) the number of exporters is fairly small,
- b) they cooperate rather than compete with each other, and
- c) that the respective good is scarce on the world market.

These conditions are certainly not met within the current international banana market, and thus the EU will be obliged to find a solution for sharing the export quota among the exporting countries.

## **4.2 The Allocation of Import Licences**

Having resolved the problem of sharing the export quota, the EU must still find a solution for the distribution of import licences. These could be allocated to the market participants

- a) according to traditional market shares (grandfathering model),
- b) according to the "first come, first served" principle,
- c) by lots,
- d) by auctioning

provided a sovereign decision<sup>7</sup> (free of charge or in exchange for administrative licence fees<sup>8</sup>).

If licences are distributed free of charge, the entire quota rent will be taken by importers (Osório-Peters, 1998: 23-25). In this context, two salient questions are raised: Why should the State, if it opposes trading restrictions which require a high administrative effort, dispense with the income from tariffs? And if it dispenses, in favour of whom should it do it?

Hence, the allocation criteria are the key words in the assessment of a quota system. The "first come, first served" procedure and „lots“ are generally rejected, as both models are connected with substantial insecurity for the market participants<sup>9</sup>. On the other hand, a grandfathering model would mean the maintenance of the status quo and appears therefore very stable. However, it would discriminate against new market participants (newcomers) and therefore potentially distort competition. In fact, under the current EU banana trade regime based on a grand-fathering principle, in which the quotas are allocated in accordance with the historical market shares of dealers, the access of new operators is quite difficult.

As an alternative to a 'free of charge' licence allocation, the state has the option of auctioning licences. As auctions normally assure equal market access opportunities to all participants and newcomers, some fair-trade organisations have suggested that the COMB regulations be replaced by a regime based on the auctioning of import licences. Though auction systems are currently not very popular in the European trade policy, they may offer a valuable alternative for the solution of quota allocation under exporting countries as well as under market operators in importing countries. In our opinion this proposal merits a detailed analysis, since it may open new perspectives for the establishment of a fair-trade regime not only in the banana market, but also in other fields of international trade. The following chapters deal with the function, design and risks of different auction models in order to evaluate their applicability to the banana market.

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<sup>7</sup> The allotment of licences by public authorities according to arbitrary criteria is unlikely in European democracies.

<sup>8</sup> The licence fees currently paid by importers serve to cover the administrative costs and represent only a small fraction of the quota rent. In the following I will differentiate between a *licence fee* referring to administrative costs and a *licence price* which reflects the actual (market) value of the licences.

<sup>9</sup> In the banana business reliable planning is very important for all participants (Osório-Peters, 1998: 8).



## **5 Auctioning of Producers' Offers - an Alternative Suggestion**

As mentioned above, from an environmental and development-political point of view, the results of negotiations at State level to share the export quota are not necessarily the best solutions, as the governments of developing countries often represent the interests of resource-intensive, export-oriented economic sectors, while neglecting the interests of small farm enterprises. Nor is an administrative decision in import countries, it seems, able to ensure a fair allocation of the import licences. In conformity with the goals of this study, it should be demanded that, by reforming the COMB, small, traditional production enterprises also get a fair opportunity for marketing their produce in Europe. Searching for a solution, we set up the hypothesis that this would be possible if foreign producers directly participated in the market. The „auctioning“ model seems in our opinion to hold some interesting development potential to restore market transparency and competitiveness, and to improve the chances of market access of weaker participants. Before our proposal „Auctioning of Producers' Offers“ can be explained in detail, it is important to have a look at some general aspects of auction systems.

### **5.1.1 Forms of Auctioning - General Introduction**

From a theoretical economic point of view, the special advantage of auctions lies in their ability to "uncover" in an efficient way, the prices of goods with unknown market value (Feldman / Mehra, 1993: 487). Auctions are therefore especially popular with art and antique markets. They are also widely used in financial markets. The area of application of auctions has meanwhile also spread to other, relatively unknown or very complex markets. In the USA for example in 1993 frequencies for mobile phones, portable fax machines and wireless computer networks. In Holland there are currently discussions about a possible auctioning of licences for the exploitation of radio frequencies for mobile phones (cf. van Damme, 1997).

The auction theory (as part of the game theory, cf. Feess, 1997: 709 ff.) not only deals with the question of the profit of the seller (in our case the State as seller of import licences), but also and in particular with the efficiency of different auction formats (designs). In order to check the congruence of auction theory and practice, Feldmann and Reinhart (1996) have carried out a detailed examination of the auctioning of part of the gold reserves of the International Monetary Fund, which took place between 1976 and 1980 in 45 individual auctions. Afterwards, they gave their article the telling title "Auction Format Matters: Evidence on Bidding Behaviour and Seller Revenue".

In fact, the quality of an auction depends decisively on its formal characteristics. The aim of an auction from the auctioneer's point of view (in the case of import licences, the State) is to obtain the highest possible revenue for the good auctioned. From a theoretical economic point of view, an auction should however make sure that that bidder is accepted who benefits most from the licence. An auction procedure which ensures both can be called efficient. (Feess, 1997: 710). Theoretically it is assumed that in that case, the auction price comes very near to the price that would emerge under perfect market conditions. The design of an auction procedure is basically nothing else than the design of an artificial market place.

The subject of an auction can be for individual goods (as e.g. at an auction of works of art) or several objects of the same kind (e.g. at auctions on financial markets). The former case is referred to as a "single unit auction", the latter case is called a "multiple unit auction". In the frame of this work, only "single unit auctions" will be examined.

There are four large auction formats, differentiating between open and close procedures. Open procedures - during which the bidders come together in a room or are connected by computer networks - are for example

- the widely spread *English Auction Model*, at which the price rises constantly during the bidding process until no higher bids are made. At those auctions, the auction participants know the behaviour of the other participants and can adjust their own behaviour accordingly;

and

- the *Dutch Model*, during which the price is constantly lowered by the seller until a bidder stops the auctioning process. Here, the influence of the participants on the behaviour of the others is reduced to a minimum.

In close auctions, bids are given in writing (tender) to the seller (e.g. the State). In principle, the participants do not know the tenders of the other participants. The decision on the price at which the auctioned good is transferred, can in the case of written tenders be made

- according to the "*first price method*", during which the highest bidder receives the bid award for the price quoted by him,

or

- according to the "*second price method*", during which the highest bidder gets the award, too, but not for the price quoted by him but at a price which is fixed after

the auction. This price can be the average of all tenders or the second highest quoted price (Vickrey Auctions)<sup>10</sup>.

In complex procedures, the auction can be made up of several auction rounds. The repetition of auctions is especially useful if a new market is to be established and the good to be auctioned does not yet have a price, which means that the ideas of the bidders are extremely different from each other. The aim of these auctions is usually not the uncovering of private preferences, but to find out the so-called "common value" of the good. By repeated auctions, the level of information of the different participants on the good and the value concept of the other participants can be gradually improved.

There is no clear "best" method. All auction procedures can, under specific conditions, lead to efficient solutions. Feess (1997: 716) shows, that under certain conditions and with a perfect level of information of all participants, both kinds of procedure - i.e. open and close - have theoretically the same results. Thus, the results of an English auction are logically equivalent to the results of a *second price* auction according to Vickrey. Analogous to that, a Dutch auction is in theory comparable to the *first price model*.

However, empirical analyses have shown that despite of the logical equivalence, in practice the results will be different from each other. Although it is assumed that both the open Dutch auctions and the closed *first price procedure* show the true preferences of the bidders, it is at the same observed that the bids at Dutch auctions are in their tendency lower than at a *first price auction* (Feess, 1997: 724). At *second price* auctions sometimes bids are made higher than the bidders actually want to pay. It can be assumed that each bidder does not expect to pay the price quoted by him, but a lower one. At English auctions, the bidders tend systematically to underbid, so that the price fixed at the end of the auction is lower than the true readiness to pay of the highest bidder (Feess, 1997: 715). However, particularly at English auctions there may appear the frequently observed phenomenon that in the heat of the moment overbidding is stimulated and the winner pays more in the end than he actually wanted to (Winner's Curse). For these reasons there are sometimes concerns regarding the efficiency of an English auction.

As coordinated actions between bidders question the efficiency of every kind of auction, it is important to design auctions in a way that they offer as little room for

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<sup>10</sup> Thus the fixing of the price is separated from the decision about the winner. In theory, the Vickrey auction was regarded as efficient, provided that the participants are completely informed and there is real competition between them. In the case of a strategic behaviour and coordinated actions among the bidders, the model is not practical.

coordinated actions as possible. However, in the practice it is noticed that auction procedures are often determined by the formation of coalitions (Feess, 1997: 725). The stimulus to form coalitions seems to be greater at *second price auctions* than at *first price auction*; analogous to that, the danger of coalition formation is greater at English auctions than at Dutch ones (Feldman / Mehra, 1993: 500-501). The lower the number of the bidders, the greater is usually the risk of coalition formation. Therefore it is usually sensible at open auctions with few participants to carry out an auction according to the Dutch model.

Conclusion: The efficiency of an auction depends mainly on the price achieved, which again depends on the possibility of coordinated actions among the bidders. Against this background, the Dutch model has - among the open methods - two advantages in comparison to the English model: Firstly, usually it reveals the true payment willingness of the bidders, and secondly, it offers less room for coordinated actions. In the case of a close auction, the *second price method* according to Vickrey should be preferred in order to counteract the danger of overbidding by insufficiently informed bidders. This method is, however, only efficient under the strict assumptions of theory, and only if coalition formation is not possible. If the danger of coalition formation exists, it is presumably much more sensible to choose a *first price* method, even if it contains the stimulus of underbidding. If this procedure is applied, financially powerful participants could systematically overbid smaller bidders. The same applies for participants which, for strategic reasons, bid over their true preferences in order to eliminate competitors. The edge of these problems could be taken away by calculating the average price of all bids (except extremely deviating bids) as *second price*, whereby bidders whose offers lie outside a certain range above the average price (e.g. more than 20% higher), are not considered in the awarding process.

### **5.1.2 Case of Application: Import Licences**

Although there are numerous publications available on the topic of "auctions" - especially on financial markets auctions - only few practical cases of import licence auctions have been recorded so far. In 1979 there was established an authority for auctioning import quotas in the USA, however it has not become active until now. Only Australia and New Zealand have introduced import quota auctions as an important instrument of trade policy. As far as it is known (but has unfortunately not been documented in literature), in single cases, Switzerland and Spain also carry out import quota auctions.

Auction models have, in comparison to bureaucratic allocation models, the advantage that the price of licences is the result of negotiations among market participants. Thus they minimise already a priori the high costs of lobby activities

and avoid a posteriori conflicts between authorities and reject applicants, which sometimes have to be settled in a court action.

As I have shown in the previous paragraph, the negotiations on the licence value proceed according to specific game rules, from which different allocation mechanisms can be derived. In the case of import quotas, each bidder will reveal his payment willingness for a licence, which is the result of the information available to him. His calculation will be founded especially on the expectations on the development of the national price compared to the development of the international market price. The difference between both prices represents his maximum payment willingness. Seen as a consequence of the exposition in section 3.1., in theory this difference represents the entire import rent. The value ensuing from the auctioning of import licences indirectly reveals to the State the real degree of protectionism of its past trade policy. Here lies the actual attraction of import licence auctions, particularly if - as targeted by GATT - quantity restrictions are to be transformed into tariffs. In New Zealand, exactly for this reason - i.e. to find out the tariff equivalents of existing quotas - auctions of import licences were carried through. (Takacs, 1988: 42).

The State has an interest in selling licences for the highest price possible, if it wants to obtain the entire rent itself. This is however only possible if the conditions of competition on the international market are ensured. Takacs (1988: 43-45) shows how easily in case of a monopolistic structure the quota rent can be redirected along the marketing chain. Also an effective auction design in the importing country would not rule out this danger. However, Takacs reduces the importance of his own contributions by regarding the existence of monopolies as exceptions and notes that the danger is especially small “if import quotas are global, rather than divided up with sub-quotas for each exporting country“ (Takacs, 1988: 44). According to his assessment, it has to be clarified first whether the EU decides on global or country-specific quotas.

Since the international banana market structure is undoubtedly oligopolistic, the answer to this question may be of central importance for this study. However, it is not possible in this frame to evaluate the welfare effects of different quota systems for the each exporting country. Thus, we have to neglect in the next chapter the role of import quota distribution systems assuming that – independently of the distribution system of the import quota under the exporting countries – just the allocation of the import licences in the import country can be a valuable step towards fair trade. For this, it must ensure that a part of the import rent stemming from the welfare loss of the consumers in the importing countries and the producers in the exporting countries will be directed where it can most sensibly foster a sustainable development. Based on this assumption we will present in the next chapters an alternative suggestion for the allocation of import licences in the EU.

## **5.2 Alternative Suggestion for the EU-Bananamarket: Direct producer bids instead of a global quota and fixed amounts**

The following suggestion represents an innovative alternative to traditional institutional arrangements:

1. The EU asks foreign producers to submit their export tenders<sup>11</sup>.
2. Each producer submits to the EU an offer stating quantities, quality and the minimum price<sup>12</sup>.
3. If the offers entered lie quantitatively above the quota fixed by the EU, the EU Commission would have to work out reduction criteria. One possibility, which would conform to both GATT and EU policy would be to grant those exporters who have already in the past exported to the EU a respective fixed amount. A quota has to be reserved for potential newcomers.
4. For participating in individual auctions, those market participants are admitted first which have already in the past marketed bananas of the respective supplier. A specific percentage (e.g. 7 %) of the individually offered amount is reserved for newcomers.
5. The prices of the offers are not subject to discussion. In the face of the oversupply on the international banana market it can be assumed that producers will demand the lowest price possible for their bananas<sup>13</sup>.
6. The EU Commission takes the offers by means of an auction into the European market. The price quoted by the producer represents the lowest limit of the auction.
7. Producers can take part in the auction of licences for their own bananas. Thus they are given the opportunity to market their own products if no other interested person can be found.

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<sup>11</sup> Because of the necessity to grant all participants sufficient planning scope, the invitation to tender by the EU Commission should grant sensible deadlines for entering the tenders. The tenders have to refer to a specific period of time (e.g. until October of a year, the tenders for the exports of the following year have to be entered).

<sup>12</sup> In practice, primary exporters will presumably calculate their tenders on the basis of FOB prices.

<sup>13</sup> However, banana exporters can sell their produce at a higher price in Europe than in other markets.

With this system, an internalisation of external effects (social and ecological costs) in the proper sense would be achieved, as the higher price of the sustainable banana production would thus be integrated into the market price. Importers supplying a respective niche market in Europe will, in principle, be prepared to pay a higher price for these bananas. However, it is not excluded that other participants (newcomers) also become interested in the trade with “sustainably“ grown bananas and bid higher prices for the respective licences than the small participants and fair-trade organisations, which have so far supplied the niche market, can pay. Rule Nr. 4 described above can reduce this risk, but not fully exclude it.

### **5.2.1 Questions of Realisation**

In order to conclude the discussion about the most suitable kind of auction, I will assume here that the introduction of an import quota for bananas is a prerequisite. The entire quota can either consist of several fixed amounts, either according to the principle of origin (then there would be a fixed amount for ACP countries, a fixed amount for third countries, etc.) or according to quality characteristics (a fixed amount for bananas from large plantations, one for biologically grown bananas, another one for fair-trade bananas, etc.).

If the producers are able to offer directly, as suggested above, the entire import quota will be split up in individual auctioning amounts (e.g. 20 tons of traditionally grown bananas from the enterprise X in Ecuador, ten tons of biologically grown bananas from the enterprise Y in Costa Rica, etc.). Each single offer of the producers will be auctioned in a "single unit auction".

### **5.2.2 Auction design**

As the resolution of the EU Council followed the Commission's recommendation, it will be assumed in the following that there will be country-specific quotas. However, this does not prevent the EU collecting direct offers from individual producers, which - for an efficient allocation of import quotas - are then auctioned among the importers.

Depending on how the auction is designed, it may be wise for the participants to be honest about their maximum payment willingness. This is also in the interest of the State. As coordinated action between banana importers cannot be ruled out, models that are prone to coalition-forming, such as the English auction model, do not seem very suitable for allocation of import licences. Moreover, the English model might foster the "insensibility" of participants (Winner's Curse).

Also the second-price auctions according to Vickrey, which were applied in Australia, have not proven worthwhile in practice, as they stimulate extremely high

bids (van Dammen, 1997: 26). For this reason, these two auction models are not discussed any further. Therefore an auction according to the Dutch model or to a closed auction seems to be the only appropriate solution. However, as these two procedures cannot fully rule out sources of inefficiency, it is important to take into account the following situations for the design of an auction:

- *If for reason of insufficient information of the bidders, an "unrealistic" price wins over:*

The better the participants are informed, the more likely their preferences will reflect the real market value. If all participants are well informed about the situation in the banana market, they will have a relatively accurate idea of which price will be obtainable for their bananas (differentiated by specific market niches), and how the world market price will develop. It is therefore appropriate to admit preferably auction-experienced market participants. This could for example be achieved by reserving only a small share of licences for newcomers - which could represent a restriction conflicting with GATT. Another possibility would be the exclusion of participants whose bids lie outside a certain range around the average price. By this restriction, participants may be induced to make "realistic" bids.

- *If auctions are used for political manipulations:*

A reason for restrictive admission to participation is that financially powerful bidders from other industries could for some reason have an interest in purchasing licences which they do not want to use directly for the purpose of importing and selling. Interestingly it can be observed that this case can on the one hand only occur theoretically, on the other it is sometimes discussed in literature as a desirable phenomenon. Thus the admission of environmentalist/conservationist groups in auctions of pollution certificates (e.g. certificates for sulphur dioxide emissions), this is regarded as an efficiency condition for the auction. For, it is argued, if a group of environmentalists purchases a percentage of the certificates e.g. from donated money, this expresses a high readiness of society to pay (in this case for clean air), which should be considered in the price fixing process. Because of the thus created shortage of pollution licences, emission avoidance is stimulated. Analogous to this, in the case of import licences for bananas, it cannot be completely ruled out that specific groups may have an interest in purchasing a part of the licences (e.g. biologically grown bananas), which will not be successfully marketed. If, for example, licences for biologically grown bananas are auctioned, but these bananas are not offered on the market, this does not only lead to welfare losses for the consumers in the importing country, but also for the producers and exporters of biologically grown



bananas in the exporting country. The decision on restrictions can for these reasons only be discussed at a political level. For example, to prevent misuse of import licences, their use could be made a compulsory requirement.

– *If small bidders are disadvantaged due to business cost calculations:*

For bidders for import licences, above all business economic cost-revenue calculations play a decisive role. Their profit in the banana business does not primarily depend on the quota rent, but from the relationship between price at which they can sell their bananas and their marginal costs (i.e. which costs are created for the sale of an additional unit of the good - e.g. one kilo bananas). They will only be interested in the sale as long as their marginal costs stay below the market price. However, the licence costs (and thus their quotation at the auction) are only one of several items of their entire cost calculation. Thus, participants' readiness to pay can be very different from each other, even if it is assumed that all of them are equally informed on market prices. It can generally be expected that efficient enterprises with a very cost-effective marketing chain can bid higher than small suppliers, which have to partially resort to external services. Although this result is efficient from an economic point of view, such auctions would endanger the market admission of small, less cost efficient enterprises. If the State aims at counteracting a concentration of the market, it could reserve a portion of licences at auctions for small and medium-sized companies (this practice is already used e.g. at invitations for tender for innovative projects). Of course there would be the danger that big companies form fictitious subsidiaries to act as small bidders. At an open auction following the Dutch model, these small enterprises could (as agreed with their parent company) bid higher prices than its competitors in order to collect all licences. Even if this danger cannot be completely counteracted, a closed auction according to the *second price* method might lead to a better fixing of prices and thus create better chances for independent, small importers.

– *If strategic behaviour of one or several bidders leads to overbidding:*

In the case of strategic behaviour it cannot be excluded that a participant bids a price which actually lies above its (short-term rational) readiness to pay. This can very easily happen in oligopolistic market structures. Large companies can have an interest in ousting certain (also small) competitors from the market. To reach this aim, they would accept short-term losses if they expect additional medium-term gains. In my opinion, especially in the case of the banana market this danger must not be underestimated and should in any case be taken into account when designing an auction model. The choice of a form of auction which separates the decision of the winner(s) and

the decision on the price of the licences would prevent (or at least not foster) strategic behaviour. The choice of an average price of all bids (except those deviating too much from the average, see above) could bring the auction result nearer to the real market price.

- *If the goals of an auction are a posteriori undermined by means of the rights of disposal granted to the winner of an auction:*

There is a difference in whether a participant wants to resell, hoard or destroy its licences, or whether by purchasing the licences one obtains certain rights of disposal, but no property rights in a narrower sense of meaning. The admission to licence trading has in the realisation of the COMB in several respects led to obvious undesirable developments. Licences were sometimes bought from entitled persons from class B and C only to resell them to class A importers. If licences can be resold, it can be expected that participants will buy them at a price that lies below the expected “real” price, i.e. the State abandons part of the rent. It seems to be wise for a number of reasons to stop licence trading. However, a situation might arise in which a financially powerful bidder buys a major portion of the licences, but does not use them to import goods. This would result in an undesired scarcity at the cost of consumers and exporters. By the introduction of a compulsory use of the licences (with the threat of punishment or a guarantee deposit), hoarding or destruction of licences could partially be stopped (see above text for a discussion of the possibility of political manipulation). In exceptional cases in which e.g. a licence holder can, for understandable reasons, not make use of his licences to the full extent, there may be the possibility to return it to the State, which can then distribute it among the other participants or resell it.

- *If the administrative effort is inappropriately high:*

This argument is frequently brought forward by banana importers. Indeed experiences with import licences made so far do not give reason for optimism. For example<sup>14</sup>, before 1993 in a Portuguese port there were bi-weekly auctions of import licences for bananas from third countries. From the experiences made there, the following conclusions can be drawn:

- Although the auction took place in a single port, the bureaucratic effort was very high. If import quotas had to be distributed among the entirety of EU ports of importation, the carrying through of an auction system could not be realised for merely practical reasons.

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<sup>14</sup> This exposition is based on a friendly information of Mr Hellebuyk (Bananic International).

- The licences were auctioned too late. Usually the bananas to be imported were already on their way and the importers were under the pressure to get the delicate freight on land as soon as possible. Large companies were therefore prepared to bid relatively high prices for the licences, while the totally unpredictable context resulted in the inability of smaller importers to operate.

This is certainly a question of management, which cannot be fully clarified here. The effort could certainly be managed if the EU would set up a central authority for the allocation of licences to which all bids would have to be made and which would also be responsible for carrying through close auctions. However, a discussion of the concrete administrative design of such a procedure would exceed the scope of this study.

### **5.2.3 GATT Conformity**

In the opinion of renowned WTO lawyers (among them Prof. Frieder Roessler, cited by Douglas, 1998:13), an auction would in principle not be against GATT provisions. If the non-discrimination regulation and other basic principles of GATT would remain untouched by the auction design (above all, the auction admission criteria for exporters and importers have to be adapted accordingly), GATT will not prevent an auction. However, the legal assessment of the GATT conformity of import licences is to be seen in close relationship with two possible interpretations of Article II of GATT:

1. If import licences are understood as a duty to be paid at the customs border, they contradict GATT, as only the fixed duties approved by GATT are permitted. As in an auction procedure the amount of the licence price is ex ante unknown, GATT cannot approve of the price a priori. However, the problem is a different one if the auction procedure is seen as a marketing mechanism. In this case, auctions are as a rule not GATT- relevant.
2. The second questions raised deals with the fact that at an auction the state usually incurs profits. Permitted according to GATT is the levying of licence fees with which the state can cover its own administrative costs; there is however reason for concern if the auction has fiscal aims, i.e. if its aim is to redirect the import rent into the public purse (infringement of Art. II 1 b) of GATT). For the auction solution suggested by Solidaridad, this is the case.

On the other hand, an auction which aims at an automatic transfer of the import rent to the producers and exporters abroad - as suggested above - would, in our opinion, be in accordance with Article II of GATT. The model allows at the same time to

take into account environmental and development-political goals without interfering with the other GATT principles.

These questions are also controversially discussed in the EU Commission. Final certainty on this topic could bring only a GATT arbitration procedure<sup>15</sup>. It would probably be wise to allocate the import licences in the EU banana market by means of an independent auction procedure in order to obtain legal clarity on these questions.

## **6 Conclusions**

A trade restriction measure is usually targeted towards protecting national producers against competition from foreign producers. However, the COMB has previously strived not only for the protection of EU banana producers, but also for those of the ACP farmers. On this basis, development policy goals have obviously got priority in the EU trade policy against free-trade principles. From a point of view of sustainable development, several arguments supporting the EU position have been presented in this paper. Moreover, problems resulting from fundamental inconsistencies between EU aims and measures and the GATT/WTO rules have been described.

When analysing different trade regimes in this paper, the complexity of problems was presented in a differentiated way. Ideally the reform of the COMB should be equipped in a way that it makes a long-term contribution to the realisation of sustainable goals, or at least does not prevent them. The limitations of merging long-term sustainability aims and existing trade-political frame conditions were shown as well.

When assessing individual trade-political measures, the interests of small producers in developing countries - in line with the aims of this study - were the centre of focus. The following trade measures (proposals for a COMB-reform) have been discussed:

- a) a tariff-only-solution
- b) the current EU-tariff-quota-system - Regulation 404/93

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<sup>15</sup> For the valuable information on the current discussion in the EU Commission concerning auctions of import licences I thank above all Mme Zélie Peppiette (GD VI) and Mrs Alison Mable (Ministry of Agriculture, London).

c) the auctioning of import licences based on direct producer offers <sup>16</sup>.

d) the introduction of ecological and social standards in the international trade (fair-trade labels)

The question whether the banana regime should be based on a tariff-only, a quota-restriction and/or an auction regime with or without the introduction of standards (labels), requires the definition of evaluation criteria according to the aims envisaged by the trade restriction.

From the point of view of GATT, levies are currently the preferred solution. However, from an economic point of view, one can say that the most important difference between a tariff- and a quota-regime is a problem of distribution rather than a problem of market efficiency. In fact, both measures theoretically generate similar changes of demand caused by an intended modification in the price relations. Although the welfare effect of both measures in the importing country is quite similar, winners and losers are not the same. In the case of a levy, the welfare loss caused by higher consumer prices (reduction of the consumer rent) will be partly compensated by an increase of the respective state's revenues. If there is a quota assigned to certain operators (like in the present EU banana regime), the price of the imported bananas will increase as well, because this measure creates an artificial scarcity of bananas on the market. The consumer rent will be reduced, too; however, in this case the consumer rent will not be compensated by the state's revenues, but instead private operators will benefit from the trade restriction.

New trade instruments like the consideration of ecological and social standards in trade relationships and the auctioning of import licences allow innovative paths to be taken in the development of trade policy. The discussion of these instruments in this paper has taken up a large space to set a basis for the evaluation of their performance in the frame of a COMB-reform.

Against this background, the goals that legitimate a particular trade measure on the banana-market (see above chap. 2.2) are taken in the following evaluation procedure as quality requirements to a new COMB (criteria marked by \* have priority from the point of view of sustainable development):

1. \* Any new regime should support those producers/market operators by preferential market access who internalise the real costs of production in their

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<sup>16</sup> See above chap. 5.2. This proposal is different from the proposal that Solidaridad presented in the Conference in Brussels (cf. Proceedings of the International Banana Conference in Brussels 4th - 6th May)

price structure. This means, it must give fair-trade organisations and other operators dealing with “sustainably” produced bananas free access to the European Market under fair and competitive conditions and ensure that stimuli are created in order to internalise the real environmental and social costs of banana production and to pass them on to the consumer.

2. \* Any new regime has to make sure that the specific trade measures do not contradict efforts on sustainability in exporting countries. That means, it should provide real market access for new operators, including fair-trade operators, small and medium scale farmers. Furthermore, revenues resulting from EU trade restrictions must remain with the producers or are used to finance development projects in the exporting countries (return transfer of the producer rent); in this case, these means should be used particularly for the support of sustainable cultivation methods in banana production and of projects aimed at the diversification of economic activities.
3. Any new regime has to comply with the special obligations of the EU in favour of the ACP countries (Lomé IV, add. prot. 5).
4. Any new regime has to comply with the special obligations in favour of the European banana producers (Community preference).
5. Any new regime has to be legal in terms of the WTO.
6. Any new regime must ensure that all market participants have appropriate planning security and are able to conclude long-term contracts with their partners.
7. Any new regime must be transparent and politically controllable and reduce the bureaucratic costs ensuing from it as far as possible;

The evaluation of concrete reform suggestions is based on an estimate of the degree of congruence of the individual evaluation criteria and the single reform suggestions; it will be made by giving them qualitative marks:

### **Tabular Summary of the Evaluation**

<b>Reform suggestions</b>				
<b>Criteria</b>	<b>a) tariff only</b>	<b>b) tariff-quota</b>	<b>c) auction</b>	<b>d) labels</b>
<b>1 *</b>	-	-	+/-	+
<b>2 *</b>	+/-	+/-	+	+/-
<b>3</b>	-	+	+	+
<b>4</b>	-	+	+	+

5	+	+/-	+/-	-
6	-	+	-	+/-
7	+	-	+/-	-

+ means: "Suggestion complies with the criterion"; +/- means: "Suggestion complies with the criterion only under certain conditions, i.e. the suggestion has to be amended or specified more closely at some point"; - means: "Suggestion does not comply with the criterion".

From the tabular summary of the evaluation it can be seen that the "auction" and "fair-trade labels" models meet best with the sustainability criteria. The auction model, however, offers less planning security to the market participants than the other models. On the other hand, the label model does not contain any automatism ensuring a return transfer of the producer rent into the exporting countries. The minimum price guarantee on which the fair-trade philosophy is based depends in practice on the faithfulness to principles of both institutions transferring the label and of the fair-trade organisations themselves.

In sum, the auctioning of direct producers' offers seems to be a practicable solution for a fair trade with agricultural produce from developing countries. However, to enforce the position of sustainable produced bananas in European market, the EU should also introduce - in addition to auctioning producers' offers - social and ecological labels in the banana market.

The GATT compatibility of both models (auction and labels) is not currently completely ensured, although the auction model is more likely to fulfill this requirement, as it is dependent on the interpretation of Article II of GATT and could be positively decided in an arbitration procedure. The label model on the other hand is legally contestable because of the existing GATT regulations regarding production standards, but GATT/WTO has so far tolerated voluntary labels when a mis-use of them for dumping aims can be excluded (see above chap. 3.3).

On 26 June 1998, the EU Council of Ministers agreed in principle to the recommendation of the Commission. The recommendations of the EU Parliament for a stronger consideration of fair-trade organisations have also met with approval. For the realisation of this regulation, the EU Commission shall prepare a draft by Spring 1999. This decision represents in our opinion a first step into the right direction, as it leaves options for other solutions open for the period after 2004. The auction model with minimum price guarantee for producers needs - not least because of its innovative character - a broad discussion forum before it can gain political ground. As the model explicitly takes into account the interests of small producers and could in the short term (as compared to the label model) be most likely realised, it should be introduced into the current discussion. Concerning the

introduction of labels it seems clear that there is a broader acceptance in the EU. In our opinion a trade regime combining the auctioning of direct producers' offers and the labelling of sustainable produced goods represents a practicable solution for fair trade with agricultural products from developing countries, which can be applied to other products and markets as well.

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