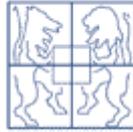


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# **WHAT ARE THE PROSPECTS FOR LIBERALIZATION IN AGRICULTURE?**

**OLIVIER CATTANEO**

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## INTRODUCTION

What are the prospects for liberalization in agriculture? This subject has several dimensions: liberalization can occur in the framework of multilateral negotiations, regional trade agreements, domestic reforms or unilateral concessions.

All dimensions are intertwined: there is no multilateral opening possible without domestic reforms (e.g. a reform of the CAP in Europe); regional integration calls for multilateralism and domestic reforms. For example, during at the occasion of the negotiations of the U.S.-Australia free-trade agreement: the U.S. pointed out the need for (1) a progress of multilateral talks so that costs of bilateral liberalization be compensated, and (2) a reform of Australian SPS standards (i.e. a domestic reform, which could hardly be decided outside the multilateral framework).

This paper concludes that, despite all these forms of liberalization, WTO members cannot make the economy of a multilateral agreement.

This multilateral agreement should not be seen as fatality – something farmers should be resigned to accept – but rather as a chance for agriculture. It is time to demystify the debate and stop stigmatizing agriculture.

The debate in France sent mixed signals to the rest of the world. On one hand, President Chirac launched a new initiative at the XXII meeting of the African and French Head of States in February of this year. He suggested (1) to adopt a moratorium on farm export subsidies, recognizing the distorting and negative effects of such subsidies on DCs, (2) to harmonize systems of preferences, and (3) to address the issue of the volatility of commodity prices. On the other hand, France is opposed to an adventurous reform of the CAP and rejected the Harbinson text on modalities.

There is a need for a multilateral agreement on agriculture, because:

- barriers to legitimate trade in agriculture are still important, despite a commitment of the international community to develop further an open, rule-based, predictable and non-discriminatory trading system;
- current agricultural policies are inefficient (i.e. don't meet the needs of the farmers despite their high cost) and have a serious negative impact on development;
- a failure of negotiations on agriculture would have a systemic impact on the world trading system and would cause a prejudice to an already fragile global economy;
- alternatives, such as regional agreements or preferences systems, are no substitutes but rather complements to a multilateral agreement.

## SECTION 1

### WHAT HAS BEEN ACHIEVED SO FAR? THE ILLUSION OF LIBERALIZATION

There is some debate about the impact of trade liberalization on global growth. Nonetheless, the international community has repeatedly committed to develop an open, rule-based, predictable and non-discriminatory trading system. Each single Declaration of the WTO members starts with a reference to this commitment. In other forums, such as the United Nations, the same objectives prevail: trade liberalization is one of the targets set by the UN Millennium Declaration. Agriculture is no exception, and references to liberalization in this particular sector are recurrent. Nonetheless, at the end of the implementation period of the first multilateral trade agreement on agriculture, farm protectionism does still occupy the front of the scene.

#### *1.1. “Develop further an open, rule-based, predictable, non-discriminatory trading and financial system”, UN Millennium Declaration, Goal 8, Target 12*

##### **- Liberalization: a universal goal?**

There is something about agriculture. Nonetheless, if agriculture is “special” to many, it is widely recognized that agricultural development is necessary to meet the UN MDGs (see Declaration of President Chirac at the XXIII Summit of African and French Heads of State). Divergence exists as to how to achieve this development.

Liberalization of agricultural markets is specifically referred to in the list of indicators to be monitored in the framework of the UN Millennium Project ([www.unmillenniumproject.org](http://www.unmillenniumproject.org)):

- indicator 37: proportion of exports (by value and excluding arms) admitted free of duties and quotas;
- indicator 38: average tariffs and quotas on agricultural products and textiles and clothing;
- indicator 39: domestic and export agricultural subsidies in OECD countries.

Analytical work related to the Millennium Project is carried out by ten task forces. One of them (Task Force 9 on Open and Rule-Based Trading System coordinated by Patrick Messerlin and Ernesto Zedillo) specifically looks at trade issues. In its background paper, Task Force 9 listed protection/liberalization in agriculture as the main area of interest and concern to DCs (Millennium Project, 2003).

##### **- Expected gains and cost of liberalization**

In general, trade liberalization tends to boost economic activity. In particular, it is expected that the removal of obstacles to trade in agriculture would be a major contribution to the enhancement of world welfare. For example, according to a USDA static model, a complete removal of agricultural

trade protection would result in a global gain of \$31 billion per year – of which 92% would go to developed countries. A study of the Australian Bureau of Agricultural and Resource Economics estimates that a 50% cut in global agricultural support would result in a \$53 billion yearly increase in world GDP (both studies in Beierle, 2002).

Calculation of expected gains from liberalization in agriculture is a difficult exercise. First, it is clear that not all agricultural trade protection will be removed at once; liberalization will take place over a long time period, and will remain partial only. Second, dynamic gains are hardly measured properly.

Special consideration should also be given to potential negative impacts of liberalization in agriculture. For example, DCs that are net food-importers fear that liberalization, if it proceeds too rapidly, may raise world farm prices enough to hurt their consumers but not enough to make their farmers competitive (Millennium Project, 2003). According to some studies (Anderson et al., 2001), food prices would rise by 5% in case of a full liberalization, generating more income to farmers in DCs, but affecting also their consumers. Raises in prices would also broadly vary product by product, depending on the initial level of protection. The immediate effect of liberalization in net food-importing countries would also be a deterioration of their balance of payments – unless rises in prices are sufficient to make those countries net-food exporters (due to an increase in value and volume of their exports).

It is therefore necessary to minimize these effects by, e.g.:

- Adjusting the pace of liberalization, e.g. to the level of development and/or demand elasticity for farm imports;
- Linking liberalization to adjustment programs and aid.

This implies rethinking adjustment programs and aid, and focus on technical assistance and capacity building, in order to promote DCs' participation in the world trading system.

## ***1.2. The Uruguay Round Agreement Act: One step forward, two steps backward***

### **- One step forward: The introduction of agriculture in the multilateral trading system**

The URAA has been the first legally binding multilateral agreement on agriculture in the GATT's history. It was a significant first step towards liberalizing and reforming agricultural policies.

The URAA has three pillars:

- First, on market access, the URAA proceeded the same way as the GATT for industrial goods: countries agreed to convert all non-tariff agricultural import barriers into tariffs (tariffication and creation of tariff-rate quotas where necessary) and to reduce those tariffs over time (average cut and minimum cut per product);
- Second, on domestic support, countries agreed to categorize their measures in different boxes according to their degree of distortion to trade and to reduce total support;

- Third, on export subsidies, countries agreed to proceed to cuts in both the value of subsidies and subsidized quantities.

<b>Numerical targets for cutting subsidies and protection</b> As agreed in the Uruguay Round		
	<b>Developed countries</b> 6 years : 1995-2000	<b>Developing countries</b> 10 years: 1995-2004
<b>Tariffs</b>		
Average cut for all agricultural products	<b>-36%</b>	<b>-24%</b>
Minimum cut per product	-15%	-10%
<b>Domestic support</b>		
Cuts in total (“AMS”) support for the sector	<b>-20%</b>	<b>-13%</b>
<b>Exports</b>		
Value of subsidies (outlays)	<b>-36%</b>	<b>-24%</b>
Subsidized quantities	<b>-21%</b>	<b>-14%</b>
<b>Notes:</b> Least-developed countries do not have to reduce tariffs or subsidies. The base level for tariff cuts was the bound rate before 1 January 1995; or, for unbound tariffs, the actual rate charged in September 1986 when the Uruguay Round began. Only the figures for cutting export subsidies appear in the agreement. The other figures were targets used to calculate country’s legally binding “schedules” of commitments. Each country’s specific commitments vary according to the outcome of negotiations. As a result of those negotiations, several developing countries chose to set fixed bound tariff ceilings that do not decline over the years. <b>Source:</b> WTO, 2002		

The URAA also contained a build-in agenda for continuing the reform of agricultural policies. In accordance with Article 20 of the URAA, WTO Members engaged in new negotiations at the end of 1999.

#### - **Two steps backward: Flaws in implementation and the illusion of liberalization**

Eight years after Marrakech, the impact of the URAA is questioned. Agriculture is still a highly protected sector, with average tariffs over 60%, while average tariffs on industrial goods are close to 4%. Tariffs on some sensitive products such as beef, sugar and rice are even higher – up to 1000% in some cases (Short, 2003). Agricultural support during 1998-2000 represented \$20,803 per farmer per year in the U.S. and \$16,028 in the E.U. Farm receipts are respectively 30% and 60% higher in the U.S. and the E.U. than they would at world prices (Beierle, 2002, based on OECD).

At the end of the implementation period, total support to agriculture is almost unchanged. Reasons for this outcome are detailed in the table below. Amongst these reasons, countries vastly overestimated the level of farm protection, either by proceeding to a “dirty” tariffication in the last weeks of negotiation or by choosing a reference period (1986-1988) that witnessed the highest historical level of farm support.

Also, if the share of total support to agriculture in GDP has substantially decreased during the late 1990s, so did the share of farm gross value added in GDP during the same period. As a result, the

share of total support to agriculture in gross value added has only slightly declined in the whole OECD over the implementation period – from 75.9 to 61.9% (Messerlin, 2002).

Finally, the continued decline in the number of farmers in OECD countries resulted in a considerable increase in the average producer support per farmer. For instance, in the E.U., the average producer support per farmer has increased by 50% over the implementation period (Messerlin, 2002). In sum, fewer farmers are subsidized at an even higher level.

<b>The illusion of liberalization under the URAA</b>		
A synthetic view of flaws in the implementation of the URAA		
	<b>Surviving forms of protectionism</b>	<b>Flaws in the URAA</b>
<b>Market access</b>	<ul style="list-style-type: none"> <li>- Average tariffs over 60%</li> <li>- Quotas (including their administration) and high levels of tariffs outside the quotas</li> <li>- 43 countries have a combined total of 1,425 tariff quotas in their commitments</li> <li>- Tariff peaks up to 350% in the U.S. and 500% in the E.U.</li> <li>- Tariff escalation discouraging DCs from adding value to agricultural exports</li> <li>- Heavy use of the Special Agricultural Safeguard</li> </ul>	<ul style="list-style-type: none"> <li>- Very high baseline tariff rates (calculated after “dirty” tariffication process) on which to make reductions</li> <li>- Tariff reductions calculated as unweighted averages</li> <li>- Tariff reductions applied to bound rates instead of applied rates</li> </ul>
<b>Export support</b>	<ul style="list-style-type: none"> <li>- 25 countries can still subsidize exports</li> <li>- Use of aggregated and disaggregated product definitions</li> <li>- Export credit programs</li> <li>- Use of surpluses as food aid</li> </ul>	<ul style="list-style-type: none"> <li>- High baseline on which to make reductions</li> <li>- Possibility to exceed volume ceilings by carrying over unused export support from one year to the next one</li> </ul>
<b>Domestic support</b>	<ul style="list-style-type: none"> <li>- 34 countries have commitments to reduce their trade-distorting domestic support</li> <li>- Overall domestic support spending has increased due to a swelling green box</li> </ul>	<ul style="list-style-type: none"> <li>- High baseline on which to make reductions (1986-1988 base period)</li> <li>- Cuts were to be made in total spending, not on a product-by-product basis</li> <li>- Criteria for categorizing subsidies (mostly for green box)</li> <li>- De minimis exemption</li> <li>- Peace clause of article 13</li> </ul>
<b>Source:</b> based on Beierle, 2002, Messerlin, 2002, WTO, 2002		

Second step backward: illusion of liberalization and lack of transparency in the process reduced the awareness of public opinion that more efforts were needed. It is a common thought that lots has already been achieved, and support of consumers in favor of further liberalization is limited – in particular in a context of recurrent health crisis.

### **1.3. The Doha Mandate: Nuts and bulks of the negotiations**

#### **- The Doha Ministerial Declaration (articles 13 and 14)**

The Doha Declaration, adopted in November 2001, builds on work already undertaken in the negotiations that started in 2000 under article 20 of the URAA.

It reaffirms “the long-term objective to establish a fair and market-oriented trading system through a program of fundamental reform encompassing strengthened rules and specific commitments on support and protection in order to correct and prevent restrictions and distortions in world agricultural markets”.

The Declaration stipulates that the negotiations are aimed at: (1) substantial improvements in *market access*; (2) reductions of, with a view to phasing out, all forms of *export subsidies*; and (3) substantial reductions in trade-distorting *domestic support*.

An explicit reference is made to special and differential treatment for developing countries, which should be embodied in the negotiated rules and disciplines. Members have to take into account specific needs of developing countries, such as food security and rural development.

The Declaration takes note of non-trade concerns reflected in the negotiating proposals of the Members and confirms that these concerns would be taken into account in the negotiations.

Turning to the phasing of negotiations, the Declaration provides that modalities for further commitments shall be established no later than 31 March 2003, and Members shall provide their draft schedules based on these modalities by the Fifth Ministerial.

To conclude, the Declaration stipulates that agriculture is now part of a single undertaking, and negotiations are to end by 1 January 2005.

#### **- A difficult start for negotiations**

Negotiations on agriculture started in a difficult context. Due to a general mistrust for globalization and a recent multiplication of food safety related health crisis, farm reforms face a low public opinion support in the U.S. and the E.U.

First, the E.U. insisted on including in the text of the Doha Declaration formulas such as “without prejudging the outcome of the negotiations” or “with a view to”, which reflected and prejudged the cautiousness of the E.U. in agricultural negotiations.

Second, a few months only after Doha, the U.S. adopted a new Farm Bill, which announced an increase in U.S. farm support by \$73 billion over the next decade. Some commentators also contested the compatibility of these new measures with the URAA, and questioned the classification of some measures in the “green box” (see e.g. the reintroduction of counter-cyclical subsidies eliminated in 1996).

Third, negotiations on the revision of the CAP revealed a profound divergence of views within Europe on the prospects for agriculture. Delays in the revision of the CAP are detrimental to the WTO

negotiations, because the European Commissioner for Trade has its hands tight by the mandate of his Members.

Beside this context, it appears in practice that WTO members still diverge on the interpretation of the Doha mandate and on the ways to achieve reforms (see table below).

<b>The Doha negotiations on agriculture in a nutshell</b>	
<b>General themes</b>	<b>Principal issues</b>
<b>Market access</b>	<p><b>(1) Tariff reductions</b></p> <ul style="list-style-type: none"> <li>- how much and how?</li> <li>- based on bound or applied rates?</li> <li>- product-by-product or averaged across products?</li> <li>- targeting tariff peaks or tariff escalation? Swiss v. Uruguay round formula?</li> </ul> <p><b>(2) Special Agricultural Safeguard</b></p> <ul style="list-style-type: none"> <li>- eliminate or retain it?</li> <li>- limited to DCs?</li> </ul> <p><b>(3) Tariff quotas</b></p> <ul style="list-style-type: none"> <li>- elimination of quotas or increase in quota volumes?</li> <li>- reduction of in-quota tariffs?</li> </ul> <p><b>(4) Quota administration</b></p> <ul style="list-style-type: none"> <li>- which principles? practicality, predictability, transparency, etc. (auctioning v. indicative list of methods)</li> </ul> <p><b>(5) Importing state trading enterprises</b></p> <p><b>(6) Other issues:</b></p> <ul style="list-style-type: none"> <li>- Food safety</li> <li>- Labeling</li> <li>- Geographical indications</li> </ul>
<b>Export support</b>	<p><b>(1) Export subsidies</b></p> <ul style="list-style-type: none"> <li>- down-payment?</li> <li>- pace of elimination?</li> </ul> <p><b>(2) Export credit, guarantees and insurance</b></p> <ul style="list-style-type: none"> <li>- rules based or reduction commitments?</li> </ul> <p><b>(3) Food aid</b></p> <ul style="list-style-type: none"> <li>- phasing out?</li> </ul> <p><b>(4) Exporting state trading enterprises</b></p> <ul style="list-style-type: none"> <li>- strengthening disciplines?</li> </ul> <p><b>(5) Export restrictions and taxes</b></p> <ul style="list-style-type: none"> <li>- within the Doha mandate?</li> <li>- To be bound and reduced?</li> </ul>
<b>Domestic support</b>	<p><b>(1) Green box</b></p> <ul style="list-style-type: none"> <li>- tighten or expand to cover non-trade concerns?</li> <li>- cap on payments?</li> </ul> <p><b>(2) Amber box</b></p> <ul style="list-style-type: none"> <li>- eliminate or substantially reduce?</li> <li>- reduction across products or product-by-product?</li> <li>- DCs exemptions (article 6.2) and de minimis limits?</li> </ul> <p><b>(3) Blue box</b></p> <ul style="list-style-type: none"> <li>- phasing out?</li> </ul> <p><b>(4) Development box</b></p>
<b>Source:</b> based on Beierle, 2002, WTO, 2002	

## SECTION 2

### ACKNOWLEDGING THE INEFFICIENCY AND ADVERSE EFFECTS OF CURRENT AGRICULTURAL POLICIES

There is no point condemning all forms of interventionism or farm support. Agricultural policies are needed just as much as any other economic policies. However, policies should be revised when associated costs – not only in terms of budget, but mostly in terms of global welfare – foreshadow expected gains.

It is also worth reminding that WTO negotiations have a limited purpose: to correct and prevent trade distorting effects of agricultural policies. The problem is that current agricultural policies in most OECD countries are inefficient and trade-distorting. Farm trade liberalization is a way of reinforcing the efficiency of agricultural policies.

#### *2.1. Reinforcing the efficiency of agricultural policies*

##### **- A high cost for modest results**

It is a common feature that “poor agrarian economies tend to tax their agriculture relative to other tradable sectors, but as nations industrialize their policy regimes tend to gradually change from negatively to positively assisting farmers to other producers (and from subsidizing to taxing food consumers)” (Anderson, 2003). This translates into an awkward logic, where fewer farmers get more and more support. Non-trade concerns set aside, one could wonder why the fuss about agriculture, since farm trade represents only 1/12<sup>th</sup> of world trade and less than 5% of GDP and employment in most countries seeking a high level of protection (Anderson, 2003).

Each year, OECD countries spend around 300 billion dollars in farm support. This is five times more than global aid for development.

There are serious doubts, however, that this money is spent in the most efficient way. For example, some studies revealed that for each dollar spent on price support, only 25 cents was actually going to farm income. The rest goes to non-farm landowners, input suppliers and inefficient resource use (Tangermann, 2003). Despite important support, competitiveness of farmers in Europe has not drastically increased.

##### **- Important adverse effects**

Protectionist agricultural policies result in an inefficient allocation of resources (1) between agriculture and other sectors, and (2) amongst agricultural sectors.

- (1) Public resources are scarce. Spending in other sectors of the economy where a country is more competitive would probably lead to a larger increase in welfare. Absent the distorting effect of subsidies, farmers could also undertake new activities for which the country has a comparative advantage.
- (2) Farmers are encouraged to over-produce in some highly protected sectors, and surplus is poured over world markets, contributing to the depression of world commodity prices. In most OECD countries, however, consumers do not even benefit from these prices because of set domestic prices and high tariffs on imports. Victims of these policies are consequently consumers in protectionist countries and producers in the rest of the world, and in particular in DCs.

## ***2.2. Adapting agricultural policies to new needs: The paradoxes of multifunctionality***

### **- Promoting rural development, equity, food safety, diversity, quality, and environment**

If current agricultural policies cannot be justified on the basis of economic considerations, can they be justified otherwise? Agricultural policies include important “non-trade” concerns such as food security, environment, rural development, etc. Both the URAA and the Doha Declaration acknowledged these concerns, that should be taken into account in the negotiations. However, the so-called “friends of multifunctionality” – with some echo in the public opinion – linked these concerns to the maintenance of highly protective agricultural policies. Paradoxically, liberalization of agriculture and suppression of trade-distorting measures would probably better serve the purpose of multifunctionality than current farm policies. Not only current agricultural policies are inefficient, but they also do not meet the needs of farmers.

#### *(1) Rural development and equity*

Rural poverty is mostly a feature of DCs. In most OECD countries, the income of farm households is comparable if not superior to the income of other households. This, despite the fact that only ¼ of price support transfers to farm income. Therefore, domestic support in OECD countries is often unnecessary from an equity perspective (Tangermann, 2003).

Domestic support in Europe is also inequitable, because it is biased in favor of large farmers. Dividing farms into four groups, based on size, and representing each 1/4<sup>th</sup> of the total number of farms, it appears that (Messerlin, Tangermann, 2003):

- the first 25% (smallest farms) get 4% of total support;
- the next 25% get 8%;
- the next 25% get 18%;
- the last 25% (largest farms) get 70% of total support.

In the U.S., the share of the largest farms in total support is even higher – close to 90% (Tangermann, 2003).

Looking at the income of farm households, it also appears that large/very large farms' income is well above the average income in the whole economy, while small farms' income is well below this average (Messerlin, 2002). In other terms, in OECD countries, farm support does not reduce rural poverty, but rather increases inequity and income gaps amongst farmers.

Decoupling support from production levels or prices could contribute to limit the perversity of the system. First, equity would prevail, and income gaps between large and small farmers would decrease. Second, efficiency of support and effective transfers to farmers' income would increase. Third, farmers could develop new activities – either in the agricultural sector or in other sectors. Rural development does not only depend on agriculture – services (post office, pub, hotel), for example, are just as important. Decoupling could help developing activities such as eco-tourism.

### *(2) Environment and food safety*

Looking first at environment protection. Domestic support measures directly linked to production or animal numbers create an incentive to produce more, independently of the consumers' needs and sometimes with disregard to environment. For example, the existence of surplus in farm production in OECD countries, due to massive support, seems to be quite counterintuitive in an environment-friendly perspective. Similarly, while large farmers receive the largest share of domestic support, they are the ones contributing the least to the preservation of our rural landscape. The extinction of numerous fish species is also a major source of concern.

By decoupling support from production levels or prices, and by better targeting their support, governments could probably more easily pursue worthy objectives such as environment protection (Tangermann, 2003). Incentives to produce more would be less prominent, and small farmers - who contribute to the preservation of landscapes - would be better off. Liberalization in agriculture would also lead to a reallocation of resources and diversification of production, which would be benefic to biodiversity.

Looking then at food safety, it appears that it has little to do with the nationality of the farmers (Messerlin, 2002). There is no positive link between food safety and domestic support or protectionism. On the contrary, there could be a negative link between support measures directly linked to production and food safety, if farmers are incited to produce more and faster (e.g. poultry). Indeed, the most protectionist countries have had their fair share of food safety problems. The “mad cow” disease is a good illustration of this statement. Here again, there was a confusion about who was responsible for what. This crisis was purely domestic, but some pressure groups invented a link with globalization and trade liberalization.

### *(3) Diversity and quality*

Domestic support related to production levels or prices plays against diversification of production and quality improvement. Here again, decoupling support could contribute to remedy this situation.

From a DCs' point of view, liberalization in agriculture – and in particular the suppression of tariff peaks and tariff escalation in OECD countries – could help diversifying and improving the quality of their production, as they could benefit more broadly from their comparative advantages and climb the value-added scale.

Future of agriculture is in diversification and products' differentiation. The experience of the European common agricultural policy has revealed that massive subsidies would never compensate for the fact that a Canadian or Australian farm is the size of a whole French region. Accordingly, production costs are often not comparable. A sound strategy is sometimes to produce less at a better quality. For example, a report of the French Parliament linked losses of share markets in the wine sector to a massive increase in production and decrease in quality of certain types of French wine. In order to compete with new world wines, the report suggested, amongst others, to produce less of better quality products. Therefore, the definition of rules on labels, standards and other geographical indications have become a major challenge for future negotiations. For example, geographical indications are essential to a business strategy based on differentiation and exploitation of niche markets. Abusive use of geographical and other technical indications should also be avoided, as a profusion of information could mislead consumers, and such rights could become themselves obstacles to legitimate trade if they prevented other producers to enter niche markets. Although this issue is obviously essential to agriculture and its future, it remains questionable whether countries would not be better off addressing it in other instances of negotiations, such as the groups on TRIPS, TBT or SPS.

#### *(4) Animal welfare*

Animal welfare is a non-trade concern and has been the subject of a few proposals. Here again, current support measures do not guaranty animal welfare, and support related to animal numbers or production levels would rather have a negative impact on animal welfare. Decoupling support and eventually compensating farmers for the extra cost they bear when applying higher standards would probably contribute to improve the situation.

#### **- The emergence of a new generation of obstacles**

It is a common feature of protectionist measures to evolve over time as the multilateral system develops and better regulates traditional barriers to trade. Typically, the elimination of quotas and the reduction of tariffs have been the main focus of the first GATT rounds of negotiation, while the regulation of non-tariff barriers to trade has been an increasing concern since the Kennedy and Tokyo rounds. Agriculture is a late comer in the negotiations, as it was previously excluded from most multilateral disciplines. Traditional obstacles (tariffs, subventions) to trade in agriculture remain important, nonetheless the URAA has already had an impact on the shape of farm protectionism.

For example, the creation of different “boxes” created an incentive to “green” agricultural policies – while some countries, like the U.S., already primarily used decoupled payments, some

others, like the E.U., still have to adjust their policies – and it is now questioned whether “green box” measures are really non-distorting, and whether the swelling size of this box is an encouraging sign or not.

Non-tariff barriers exist in agriculture. Underlying objectives are often legitimate, but abuses can occur:

- SPS measures have become a major source of concern – for example, in the framework of the US-Australia FTA talks, U.S. farm groups have raised repeated complaints about the Australian SPS standards which is seen as too cautious (Inside US Trade, May 9, 2003); implementation issues for DCs in agriculture are also likely to be most severe in the area of SPS standards (Millennium Project, 2003);
- closely related is the question of GMOs and, more broadly, rules on labeling – behind the dispute between the U.S. and the E.U., regional trade agreements are a privileged channel for each of the trade super-powers to extend their own rules;
- geographical indications were introduced in the debate on agriculture, just as intellectual property rights were introduced in the broader GATT negotiations in Punta del Este – absence of protection could cause prejudice to both consumers (deceitful practices) and producers (efforts to preserve the quality and distinctiveness of a product), but abusive protection could have important negative effects too (anti-competitive practices, creation of market niches, decreasing demand for substitutes).

The Doha round has revealed the importance of rules on labeling, standards, geographical indications, as they are at the heart of many discussions. A multilateral framework for dealing with related conflicts is essential, because these rules have non-trade concerns attached to them, and they threaten to become new obstacles to legitimate trade if they are abused. The E.U. has also linked the outcome of the negotiations to an adequate treatment of non-trade concerns.

## SECTION 3

### PRESERVING THE MULTILATERAL TRADING SYSTEM

A failure of negotiations in agriculture could have a systemic impact far exceeding the scope of this particular sector. Since the origin of the GATT, multilateral trade negotiations have been based on the principle of reciprocity. In each agreement there must be a balance of concessions amongst participating countries. As a result of the successive GATT rounds, developed countries have much less concessions to make, and sectors which are still protected – such as agriculture – are often highly politically sensitive. Nonetheless, it appears that concessions in the agricultural sector are necessary to ensure that DCs' will continue to participate in the WTO negotiations.

An absence of progress on agriculture would result in a dead-lock in negotiations. Systemic impacts could include the weakening of both the multilateral trading system and the global economy.

#### *3.1. Preserving the willingness of developing countries to participate in the WTO*

##### **- An accumulation of negative signals sent to developing countries**

The Doha round was dedicated to development, and the Doha Declaration was sprinkled with references to DCs, LDCs and their special needs. However, at the end of 2002, WTO members missed two key negotiations deadlines – on access to medicines and special and differential treatment – both of particular interest to DCs. In March 2003, WTO members also missed the deadline on modalities for the agriculture negotiations – another key subject for DCs. In May 2003, WTO Members did not come to an agreement on the revision of the dispute settlement system. As a result, expectations for the next Ministerial Conference in Cancun are increased.

This situation could be dangerous for the Doha round, which started with negative signals sent to DCs. Further disappointment in Cancun could destroy DCs' trust in the WTO and their willingness to negotiate or make any concessions.

In particular, an agreement on agriculture seems to be a prerequisite for many DCs to continue negotiations.

##### **- The poor are the first victims of agricultural policies and would be the first beneficiaries of liberalization**

In most DCs, poverty is mostly a rural phenomenon. Three-quarters of the world's poor live in rural areas. Increasing agricultural income is therefore essential to the alleviation of poverty.

Farm and food policies contribute to 40% of the cost to DCs of global goods trade distortions (Anderson et al., 2001). Gains to all DCs of agriculture liberalization in developed countries could reach between \$30 billion and \$100 billion in 2015 (Short, 2003).

Benefits from liberalization would be two-fold: (1) DCs could export more and benefit from their comparative advantage in sectors such as cotton, groundnuts or sugar, and (2) DCs exports would be inflated by the rise in food prices. Price increases induced by liberalization would range from 10-20% for cotton, 20% for groundnuts, 20-40% for sugar and dairy, to 90% for medium/short grain rice (Beghin and Aksoy, 2003). In other terms, DCs would export more at a higher price. It is significant that Burkina Faso increased its regional cattle exports by 70% when the E.U. reduced its beef export subsidies to sub-Saharan Africa by 25% to 40% between 1993 and 1995 (Short, 2003).

Here again, potential negative impacts in the short term should be stressed. Rises in prices could cause a prejudice to the poor, and food security is a valid concern. At the international level, as well as at the domestic level, trade liberalization creates winners and losers. It is however too simplistic to say that the U.S. and the Cairns group would be the only winners if trade in agriculture was liberalized. DCs have comparative advantages in some agricultural sectors. For the rest, adjustments will be needed in agriculture just as in other sectors. Therefore, technical assistance and capacity building have a major role to play.

Compared with OECD countries, agriculture plays a more important role in DCs, as illustrated by its the share in GDP (about 27%), employment and exports (about 50%). As a result, dynamic gains of growth in the agricultural sector are larger. For example, in West Africa, it is estimated that every additional dollar in income in the rural sector generates an additional 3\$ for the whole economy through increased demand for goods and services (Watkins, 2003).

Tariff escalation – where tariffs rise as goods are processed – deprives DCs of the opportunity to process their agricultural products and get the increased jobs and income this would lead to. Remedy to this situation could “enable DCs to take up the first steps up the technology ladder, to diversify and to trade their way out of poverty” (Short, 2003). Since 1997, tariff escalation for agricultural and food products has been reduced, however it remains in a vast array of products such as sugar, tobacco, tea, chocolate and cereals (Gallezot, 2003).

- **What it should not be about: self-sufficiency, compensation and higher tariffs**

In order to remedy the negative impact on DCs of farm support in developed countries, several ideas have been put forward, which aim at preserving a certain level of protectionism. However, these solutions do not seem to be realistic.

First, the Doha Declaration makes a specific reference to food security. This concept has been a source of confusion. In French, for instance, food security and food safety are translated by the same expression (‘sécurité alimentaire’), although they refer to different non-trade concerns. Food security is only concerned with access to food covering essential needs of DCs populations. This has often been assimilated to self-sufficiency (see Chirac, 2003). However, the concept of self-sufficiency is an economic non-sense: each country shall specialize in productions where it has a comparative advantage. There is no point developing the agricultural sector in an arid country where resources

would be better allocated in other sectors. The concept of self-sufficiency is often used by governments of rich protectionist countries who would like to share with DCs the blame of a situation created by their farm interventionism. Food security should rather be about assisting net food-importing DCs in their efforts of adjustment and insertion in global trade, and re-thinking food aid.

Second, some actors reluctant to liberalization have also suggested to compensate DCs for the prejudice caused by their agricultural policies. Spending \$300 billion dollars a year in OECD countries for agricultural support is already a non-sense – spending \$600 billion would be absurd. The only positive impact would be an increased pressure of taxpayers in favor of a reform of agricultural policies.

Finally, some have suggested to eventually to create a form of CAP in Africa. This sounds a little bit like Marie-Antoinette, Queen of France, who said in 1789 to the poor complaining that they had no bread that they should eat brioche instead. DCs can already hardly pay their civil servants, so it is difficult to imagine that they could subsidize their farmers.

### **3.2. *A global agenda aiming at a single undertaking***

#### **- Dangerous linkages (Singapore issues, access to medicines, etc.)**

According to the Doha Declaration, agriculture is part of a single undertaking, and negotiations are to end by 1 January 2005. The E.U. insisted on having a very broad agenda for negotiations, partially because the broader the agenda the easier it is to make concessions in sectors of least importance. DCs were reluctant to adopt such a broad agenda, as they considered they already had enough problems implementing commitments made at the end of the Uruguay round. As a result, the E.U. had to pay a high price for a broad agenda, and the Doha round became the Doha Development Agenda. This focus on development now paradoxically makes it more difficult to avoid reforms on subjects like agriculture, which is of particular importance to DCs. The strategy of the E.U. was flawed.

Trade negotiations are about balance of concessions. However, in the current context of tension between DCs and others, some linkages appear dangerous for the outcome of the Doha round. For instance, if the E.U. did not get full satisfaction on the Singapore issues, it could not use this argument to avoid concessions on agriculture. Similarly, DCs consider a solution to the problem of access to medicines in countries with insufficient production capacities as exogenous to the package deal. In other terms, concessions on agriculture and access to medicines are a starting point for negotiations rather than bargaining chips for the negotiations themselves.

#### **- Lack of ambition should not prevail**

A related danger is a possible lack of ambition in the negotiations due to a defensive interest on agriculture. Concretely, some countries might want to moderate their requests, for instance on

services, in order to put less weight in the balance of concessions, and offer less in the agricultural sector. Fear is that if one obtains too much in one sector, it will have to give up more in sensitive sectors.

This lack of ambition should not prevail. In particular, agriculture does represent only a small part of GDP and employment in most OECD countries. Although politically costly, concessions on agriculture have a high return on “investment”. For example, market access gained in services is profitable to a larger share of the economy.

### **3.3. *Potential consequences of a failure of the legislator***

#### **- Tensions on the dispute settlement system**

Absent any multilateral agreement on agriculture, and in particular on non-trade concerns, the risk is that WTO members flip on dispute settlement panels and the Appellate Body the burden of deciding controversial issues, such as the level of precaution authorized in the assessment of sanitary and phyto-sanitary measures. However, it is not the role of the dispute settlement system to add to or diminish the rights and obligations of the members (articles 3.2 and 19.2 of DSU). It is the responsibility of the members, acting as a legislator, to discuss issues such as the precautionary principle.

The question of GMOs is also a good illustration of what could become a “wrong case”. It is doubtful that the E.U. would renounce to its precautionary policy, even if a panel or the Appellate Body concluded it was contrary to WTO law. The political cost of renouncing to precaution would be higher than the economic cost of trade sanctions.

Agriculture policies have been at the origin of the most contentious trade disputes (e.g. banana cases, beef-hormones). Hudec attributed the crisis and the collapse of the GATT dispute settlement system to recurring disputes on agriculture and a misunderstanding of related commitments. Absent any rules clearly defined at the multilateral level, the WTO dispute settlement system could meet the same problems.

Finally, if DCs do not obtain satisfaction with the negotiations on agriculture, the WTO will be weakened, and their expectations towards the dispute settlement system will be increased. For example, the conjunction of a failure of the negotiations on agriculture and a victory of the U.S. in the cotton case would probably destroy DCs trust in the WTO and lead to a credibility crisis.

#### **- The balkanization of disciplines and the segmentation of markets**

Multilateral negotiations coexist with regional and bilateral trade talks. Liberalization can intervene on several fronts. However, it should be noticed that agriculture is often excluded from regional trade agreements. In the case of the E.U., regional integration has not led to a diminution of

protectionism in each country. Also, the multiplication of regional or free-trade areas has both positive and negative effects.

Absent any multilateral agreement on agriculture, each of the trade powers will try to impose its own rules through its spheres of influence. For example, the E.U. will include provisions on the protection of geographical indications in free-trade agreements it negotiates. Similarly, the U.S. might want to secure the support of its trading partners on its approach towards GMOs.

This behavior is normal. The multiplication of free-trade or regional agreements also contributes to further trade liberalization and harmonization of rules inside the regions. However, power is less balanced in bilateral or regional negotiations, and some countries might abandon moderate policies in favor of more radical ones imposed at the regional level. The question is whether regional rules can be later conciliated in a global agreement.

The multiplication of regional trade agreements also means the multiplication of rules, such as rules of origin, which make transactions more complex and generate additional administrative costs.

Multilateralism should be preferred, because it avoids the risk of segmentation of markets.

#### **- Considerations for Europe and the balance of power**

A failure of the WTO negotiations on agriculture could have a systemic impact far exceeding the borders of the world trading system.

Recent experience in the UN, i.e. the decision of the U.S. to go on war with Iraq and the division of Europe on the same issue, raised questions as to whether the U.S. was applying a “divide and rule” policy (The Economist, April 26, 2003). Negotiations in agriculture could be a channel to introduce this policy in the WTO.

The U.S. has a major incentive to divide and weaken E.U. Members in the WTO. Unlike in other fields of foreign policy, where E.U. Members are divided, trade has been the exclusive prerogative of the European Community (qualified majority vote applies and the Commission alone negotiates). Thus, the E.U. has widely used trade policy as a tool to expand its presence and influence on the international scene, sometimes introducing considerations that go beyond trade in bilateral, regional or multilateral trade agreements (Cattaneo, 2002a/b). International trade is the only field of foreign policy where the E.U. is on an equal footing with the U.S. (Cattaneo, 2003). As the revision of the CAP has revealed, European countries are divided on the prospects for agriculture. If this division is exported to the WTO and the E.U. provokes a failure of the negotiations on agriculture, then (1) the WTO would be weakened (which, according to some commentators in the U.S., does not necessarily serve the interests of the U.S. anymore), and (2) the E.U. would be deprived of a major source of influence on the international scene.

The U.S. Trade Representative recently made clear that trade was just part of the U.S. foreign policy. For example, according to Bob Zoellick, FTA candidates should support the U.S. on its foreign

policy and national security goals (Inside US Trade, May 16, 2003). Access to tariff preferences is also often conditioned by a participation to the U.S. effort to fight against terrorism or drug traffic.

If the Doha round is a failure, the balance of power could tip in favor of the U.S. – not only in the world trading system, but on the international scene more broadly. Indeed, the U.S. is the only country able to offer agreements combining trade and security aspects.

## SECTION 4

### THE PERVERSITY OF PREFERENCES

Systems of preferences should not be considered as a cheap way out of the multilateral trade negotiations – something developed countries would give to DCs so that they put less pressure on the reform of their agricultural policies. Similarly, fear of loss of preferences should not refrain DCs from supporting a further liberalization of agriculture at the multilateral level.

Indeed, trade preferences have some perverse effects, and it appears that they are not a panacea for DCs. De facto, it appears that systems of preferences are under-utilized by DCs, and the associated gains are limited. As a result, systems of preferences do not constitute a substitute for a multilateral agreement on agriculture, although the link between these systems and a multilateral cut in tariffs should be carefully analyzed.

Systems of preferences refer to GSP (Generalized Systems of Preferences) schemes, as well as to other systems of narrower scope, such as the Everything But Arms or Africa Growth and Opportunity Act, the Caribbean Basin Initiative, the Andean Community preference, the ACP Cotonou Agreement, etc...

#### **4.1. *Limits on the gains accruing through preferences***

##### **- From the viewpoint of the importing country**

In the E.U., 77% of imports come from countries eligible for trade preferences (Gallezot, 2003). This, however, does not mean that these countries are more competitive than the others: their comparative advantage is sometimes based on tariff differentials only. By lowering its MFN tariffs, a country could import a broader range of cheaper and better quality products. For example, every dollar of benefit the E.U. banana policy brought to ACP countries harmed the E.U. consumers by 13 dollars (Borrell, 1999). The banana dispute and associated tests also revealed that European consumers preferred the taste of non-ACP bananas.

##### **- From the viewpoint of the exporting country**

If DCs want to maximize their benefit from trade liberalization, they need also to open their own markets. Most of the gains resulting from liberalization accrue to the liberalizing country. According to a study using a GTAP model (Anderson et al., 2001):

- as for DCs liberalizing their own farm and food policies,  $\frac{3}{4}$  of the benefits therefrom would stay the DCs themselves;
- 60% of the contribution to DCs from trade liberalization would come from reforms by DCs themselves.

Preferences confine DCs to the production of agricultural goods that are not politically sensitive in developed countries. This historical selectivity of preferences has prevented DCs from diversifying their production and adjusting to changes in world demand.

- **From the viewpoint of third parties and the global economy**

Preferences may create some diversion effects and contribute to the segmentation of markets.

As pointed out by the UN Millennium Task Force 9 in its background paper, the focus on protectionism in industrialized countries should not obscure the fact that DCs' farm markets are also highly protected. Average bound and applied agricultural tariffs in developing countries are 19.9 and 18.6 percent, respectively (Millennium Project, 2003). For some products, like groundnuts, the highest tariffs are to be found in DCs (India and China, 45%) (Beghin, Aksoy, 2003).

Close attention should be paid to reduce these tariffs, as they constitute an obstacle to trade amongst DCs. Three different categories of impacts can be distinguished:

- preferences granted by developed countries reduce the incentive of DCs to negotiate lower tariffs at the multilateral level;
- dependence of DCs vis-à-vis developed countries is increased – as part of trade is diverted due to preferences;
- trade amongst DCs would encourage diversification of their production – as tariff escalation limits their ability to do so in systems of tariff preferences.

Renouncing to a multilateral agreement on agriculture in favor of a system based on preferences would leave out of the liberalization process a significant part of trade. The share of DCs' agricultural exports going to other DCs represent more than 40% of total (Martin, 2001).

A major concern is also that preferences, if not granted to all DCs, create distortion of competition amongst DCs. As a result, not all DCs can benefit the same way from their comparative advantages, and the cost of trade diversion is partially borne by other DCs. For example, a study showed that every dollar of benefit the E.U. banana policy brought to ACP countries harmed non-ACP banana producers by the same amount (and harmed the E.U. consumers by 13 dollars)(Borrell, 1999).

Because of preferences the allocation of resources is not optimum: (1) within each DC – as production is encouraged in sectors having a preferred access, and (2) amongst DCs – as not all countries can benefit from their comparative advantages.

#### **4.2. *A reality check on the utilization of preferences***

- **The examples of “Everything but arms” and AGOA initiatives: A limited impact**

(1) Everything But Arms

Some studies have recently undertaken to measure the impact of EBA, which came into effect in March 2001. EBA grants duty-free access to imports of all products from the LDCs, with the

exception of arms and munitions, and without any quantitative restrictions. For bananas, rice and sugar tariffs will be progressively reduced to zero by 2006 (bananas) and 2009 (sugar and rice). Although these studies are still preliminary, it appears that EBA is not a miracle cure for LDCs, and does not substantially alter the terms of trade.

First, the vast majority of products from LDCs already received duty free treatment under the GSP or the Cotonou Agreement (ACP). EBA extended duty free treatment to less than 10% of all tariff lines, representing 0.5% only of total value of LDCs exports to Europe (Brenton, 2003).

Second, most of LDCs from the ACP region continue to export under the Cotonou Agreement and have a limited use of the EBA. In part, those countries want to avoid administrative complications, and rules attached to the EBA (such as the rules of origin) are often more complex and stringent than the ones contained in the Cotonou Agreement.

Third, despite their eligibility under the EBA initiative or the GSP, more than half of exports from non-ACP LDCs to the E.U. still do not receive preferential access and are taxed at the MFN rate. This under-utilization of preferences can be explained by the cost of administrative transactions and the nature of rules of origin (Brenton, 2003 ; Gallezot, 2003).

#### (2) The African Growth and Opportunity Act

Similar concerns exist about the U.S. AGOA initiative. Recent studies confirmed that the AGOA provides real opportunities to African countries, but the gains are limited due to restrictive rules of origin and an exclusion of certain items from its coverage (Mattoo et al., 2002). In addition, the AGOA offers preferential treatment to some African countries, but ignores other LDCs. In particular, Asia – where the bulk of the poor lives – is excluded. Also, unlike EBA, the AGOA initiative is limited in time and subject to review. Thus, it does not provide security for long-term investment in the region.

#### - **The rules of the game: A world of illusions**

Rules of origin are necessary to prove that a product receiving preferential treatment originates in a country eligible for preferences. However, these rules can be so strict that an exporting country might renounce to the preferential treatment.

Rules of origin restrict the sourcing of products in neighboring countries which are not eligible for preferential access. As such, they discourage regional trade integration of DCs (Short, 2003), and discriminate against small countries where the possibilities for local sourcing are limited or non-existent (Brenton, 2003)

The cost of documentation related to the rules of origin is particularly important. If this cost is superior to the preference margin (MFN rate minus preferential rate), then the country will not ask for preferential access. It is also sometimes difficult for LDCs to collect all the necessary documentation, and to prove that the rules of origin have been respected.

It appears that exporters in DCs are confused as to what rule is applicable. The multiplication of preferences schemes increases not only administrative costs, but also creates a disincentive to use these schemes. For example, depending on how much an exporter sources products in a neighboring country, its production might fall under one preferences scheme and not another, depending on applicable rules of origin.

#### **4.3. *Re-thinking preferences***

##### **- Reinforcing multilateralism within unilateralism**

At the origin, the GATT contracting parties adopted a waiver (1971) and a more permanent “Enabling Clause” (1979) to authorize the establishment of GSPs derogating to the MFN principle. However, the system of preferences has been perverted in two ways: first, the multiplication of preferential systems within the U.S. and the E.U. created a second level of discrimination – this time not between developed countries and DCs, but amongst DCs; second, new conditions were attached to ‘super-preferential’ systems, imposing disciplines that were not agreed upon at the multilateral level.

These two perversions are not acceptable. Based on political considerations, preferences systems can create distortion in competition amongst DCs where the same economic conditions prevail. This is the reason why, nowadays, DCs are the first ones to criticize preferences system and eventually raise the issue by the dispute settlement body (see banana case). Conditions attached to eligibility can often be changed unilaterally, and a preference is not granted for ever. This lack of security acts as a constraint upon large-scale investment that is needed for development. Also, benefiting countries have no legal recourse if conditions change or if they are dropped of the system of preferences.

A major progress in the EBA was to grant preferences to LDCs for an unlimited period of time. However, this was partially undermined by the introduction of a broad safeguard clause, according to which preferences can be temporarily suspended in case of “massive increases in imports of products originating in the LDCs in relation to their usual levels of production and export capacity” (Brenton, 2003).

However, binding preferences should under no circumstances be a substitute to a multilateral liberalization.

##### **- Preferences as part of a global effort towards liberalization of agriculture**

Focusing on preferences is dangerous, because tariffs and quotas have already been considerably reduced for most products. Remaining major obstacles to trade in agriculture are rather domestic or export support measures, which are not dealt with in trade preferences schemes. The reinforcement of the preferences system should therefore not be an excuse for delaying a multilateral agreement on agriculture that would include all forms of farm protectionism.

As an illustration of this danger, for the majority of LDCs exports to the E.U. declined in 2001 despite the EBA initiative. It is not all about market access, and granting preferences to DCs or LDCs is not a serious way out of the negotiations.

- **Accompanying DCs in their efforts**

In order to remedy the under-utilization of preferences, one could imagine different forms of aid or technical assistance. For instance, more LDCs exports could benefit from a preferential rate if the documentation related to the rules of origin was better administered. Similar concerns exist for sanitary and phyto-sanitary standards. Assisting DCs in their efforts to comply with these rules or standards could help their better integration in the world trading system.

Further analysis of the economic impact of the rules of origin should also be undertaken, in order to determine (1) what level of protection is necessary, and (2) what level of protection would not undermine the purpose of systems of preferences.

Part of the reflection in the Doha round should also focus on accompanying DCs in their efforts to liberalize and progressively renounce to tariff preferences. The end of tariff preferences should not be the end preferential treatment.

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