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HOW CAN POLICY COHERENCE ENHANCE GLOBAL AGRICULTURAL TRADE?

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Abstract

The paper looks at major policy incoherencies that affect global agricultural trade, and how the PCD agenda can contribute to enhancing global agricultural trade. Since trade policy is an instrument for growth and development, the focus of the paper is on how to incorporate the PCD agenda into domestic and international agricultural policies. Progress in coherence in select developing countries' market and trade policy is noted. The role of coherent policy sequencing is highlighted and exemplified in the cases of China and India. Further, since trade and investment interact, the central role of such links is elaborated on. The paper concludes that sound domestic and international trade policy must be an integral part of the PCD agenda. This has implications for the global trade policy agenda.

INTRODUCTION

Aiming for policy coherence is part of aiming for “good” policy.¹ The more narrow purpose of this paper is three fold; first it is to examine some of the major policy incoherencies in global agricultural trade; then, it is to review the linkages between global agricultural trade and growth and poverty reduction in developing countries while focusing on their international trade and domestic market policies; and finally it is to suggest actions that would improve policy coherence, which would in turn translate in enhanced global agricultural trade that would serve development.

In approaching these issues we stress that trade policies are not goals, but instruments. PCD in relation to agriculture trade has to consider goals, such as growth, poverty reduction, environmental sustainability and improvements in health. We mostly focus on these goals, on poverty in particular.

We broadly follow Picciottio (2004)’s coherence taxonomy with some extensions.² The focus will be mostly on how developing country policymakers can incorporate the PCD agenda in their domestic agricultural and trade policies. Because of the dynamic and complex nature of policy-making, the need for a strategic approach towards achieving policy coherence will be highlighted. Further, since at the national level, trade and private investment (including foreign direct investment) are mediated through public investments, the central role of such investments will be elaborated too.

At least two questions need to be considered from a conceptual perspective:

- What are the principal driving forces of agricultural trade expansion and what might be the incremental contribution of policy coherence in facilitating further growth in agricultural trade? This question should lead us to normative assessments.
- What actual policy (in-) coherences stand in the way of agriculture trade expansion, and why so? This question will lead us into positive assessments. The “why” question in particular requires assessment in a context of initial condition. Quite different from a wonder-world of all-inclusive policy coherence, the reality of economies operating on different time-paths with differing initial conditions must be considered.

In the next section, we briefly look at some of the underlying theoretical concepts of policy coherence and examine their relevance to agricultural trade policies for development. Then in a second part, we review the existing incoherencies in global agricultural trade. In a third part, we review the linkages between enhanced global agricultural trade, growth, and poverty reduction. Finally, we conclude by suggesting some actions towards achieving better coherence in agricultural trade policies to reflect development objectives, as stipulated in the Millennium Development Goals (MDGs).

¹ An irrelevant but existing alternative is a state of policy being coherent but “bad,” as say in former planned economies.

² As summarized in Dahlsten (2005) in “Key issues for Policy Coherence for Development: Agriculture,” the Picciottio (2004) taxonomy distinguishes the following four different dimensions of policy coherence for development

1. Internal coherence: Is there consistency between the goals and objectives, modalities and protocols of an OECD government development policy (between bilateral and multilateral aid, technical assistance, and aid channeled through NGOs or private sector)?
2. Intra-country coherence: Is there consistency among aid and non-aid policies in an OECD member government in terms of its contribution to development?
3. Inter-donor coherence: Is there consistency of aid and non-aid policies across OECD member countries in terms of their contribution to development?
4. Donor-recipient coherence: Is there consistency of policies adopted by rich and poor countries to achieved shared development objectives?

I. SOME UNDERLYING THEORETICAL CONCEPTS OF PCD

According to the theory of economic policy elaborated by Tinbergen (1952), “economic policy systems” are distinguished and subdivided according to the targets that policymakers have set. Instruments of economic policy are then used to attain these targets. Tinbergen argued that there has to be at least as many instruments as targets in order to efficiently achieve the set targets, and because of the interdependence and inter-linkages among the set of targets, these instruments need to be coordinated and not used in isolation towards achieving one target individually (Tinbergen 1952).

In development policy, widely agreed targets are encompassed in the Millennium Development Goals (MDGs), which contain eight different objectives. Thus, according to the Tinbergen rule, since the development policy system is composed of multiple targets, it is first necessary to have as many instruments as targets in order to effectively achieve these targets, and second, to the extent possible, these instruments need to be coordinated, and therefore there has to be some type of coherence between the different policy instruments implemented (von Braun 2005b).

In a bid to improve such coherence, the Organization for Economic Co-operation and Development (OECD) launched the concept of policy coherence for development (PCD), which it defines as a “process whereby a government makes an effort to design policies that take into account other policy communities, minimize conflicts and maximize synergies” (OECD 2005a).

To fully understand the notion of PCD, it is important to first recognize the dynamic framework of policymaking and second, the complexity of the PCD agenda. Indeed, development policy is a dynamic concept with ever changing economic and social contexts both nationally and internationally. In effect, the PCD agenda is also ever evolving, as different policies are implemented to deal with changing contexts. As for the complexity of the PCD agenda, as well noted by Picciottio (2004), there are several dimensions that need to be considered. In addition, the policy field involves a wide set of actors at different levels of governance (international, regional, national and local) and these various actors may be advocating for different and conflicting objectives (Fresco 2004). Policymakers have to therefore reconcile these objectives through negotiations and compromise in order to come up with a coherent system of economic policies. This operates in a “market” of supply and demand of policies. However, as Rausser and Irwin (1987) warn, policymakers can be manipulated by powerful interest groups “seeking to enhance their own benefits to the detriment of society as a whole,” as “government policies, like markets, are sometimes imperfect and incomplete” (Rausser and Irwin 1987). Rausser (1982) further points out that there are two main forces of political economy whereby policies are motivated by either “political economic seeking transfers (PESTs),” referring to the influence of powerful stakeholders seeking to enhance their own benefits, or by “political economic resource transactions (PERTs),” referring to the legitimate role of policymakers to enhance the benefits of society as a whole. Thus, since the domain of policy-making in both developed and developing countries is imperfect, the influence of PESTs cannot be entirely removed. As a result, policy incoherence is endogenous to policymaking. Therefore, the economics of (in-)coherence must not only address costs of lack of coherence in a comparative static sense, but also be concerned with dynamics, and thus also about transactions costs of changing (increasing or decreasing) in-coherences. Out of such considerations of transactions costs of policy change, may result optimal (non-zero) in-coherences.

The PCD agenda is especially important in the context of agricultural trade in that most developing countries’ comparative advantage lies in agriculture, but it is the most protected sector in global trade. Reducing incoherencies between agricultural trade policies and development policies would increase developing countries’ participation in global trade, resulting in increased pro-poor growth.

To that regard, the PCD agenda in agricultural trade resonates with the Millennium Development Goals (MDGs), most directly with MDG 1 of “eradicating extreme poverty and hunger,” and MDG 8 of “developing a global partnership for development.” Indeed, since most of the poor rely on the agricultural sector for their livelihoods, trade driven agricultural growth can increase farm incomes through multipliers and linkage effects, and foster off-farm economic activities, resulting in enhanced job creation both on- and off-farm. As for MDG 8, its aim is to facilitate the coordination of the policies implemented by both industrialized and developing countries towards achieving development objectives (von Braun 2005b, Manning 2005).

II. INCOHERENCIES IN AGRICULTURAL TRADE

In this section we look at the existing incoherencies in agricultural trade policies in both OECD and developing country policies. Since the PCD issues of OECD country policies have been comprehensively documented elsewhere (see Matthews 2005), we will only very briefly review them here. The focus will be on PCD issues in overall international trade policy trends and developing countries’ policies.

In the first sub-section, when dealing with intra-country (in-) coherence, we extend the concept beyond OECD countries’ domestic and development cooperation policies to include developing countries’ domestic policies in order to also identify some inconsistencies in their internal policies. And, to illustrate how internal policy inconsistencies in developing countries can negatively affect trade and growth, we take the example of agricultural market reforms undertaken in Sub Saharan African countries in the 1980s.

In a second sub-section, we look at inter-donor and donor-recipient coherence. We first address PCD issues in the current agricultural trading system by discussing the current trends within the WTO negotiations, the concurrent bilateral and regional trade agreements, preferential market access schemes, and the increased use of Sanitary and Phytosanitary (SPS) measures in global agricultural trade. Second, we address the PCD issues that arise from the interaction between development cooperation policies and developing countries’ domestic policies.

a. Intra-country incoherencies

i. PCD issues in OECD countries internal policies

PCD issues can arise from OECD countries’ aid and other policies. Non-aid policies consisting of trade and domestic policies protect and support domestic producers from competition, while aid policies consist in supporting developing countries through financial flows and technical assistance. In what follows, we briefly examine how some of these internal policies can be in conflict with development objectives.

PCD issues in OECD trade and domestic support policies

The objectives of OECD trade and domestic agricultural policies include increasing agricultural productivity, ensuring distributional equity for domestic producers and the stabilization of domestic market prices. OECD countries use a complex set of policies to achieve these goals, which either directly restrict market access to competing agricultural producers through tariff and non-tariff barriers, or support farmers through market price support, payments per output and export subsidies. The underlying PCD issue with using such instruments to fulfill domestic objectives is that these instruments are generally in conflict with development objectives.

In the case of market access restrictions, industrial countries maintain average tariffs on agricultural products (for which developing countries have comparative advantage) that are two to four times higher

than tariffs on manufactured goods (World Bank 2005). Beyond this relatively high average tariff on agricultural products, some OECD countries maintain tariff peaks³ on certain agricultural imports and also apply escalated tariffs⁴ on processed agricultural product imports. This hinders the diversification of developing country exports towards higher value products and keeps them dependent on primary product exports (IMF 2002, Aksoy 2005). Further, in addition to tariff barriers, OECD countries are increasingly adopting non-tariff measures⁵ to restrict access to their markets. The PCD issue here apart from the restriction in market access, is that developing country exporters face uncertainty in whether or not they have access to OECD markets for certain agricultural products.

As for the various domestic support policies they indirectly impact development objectives by encouraging over-production in OECD countries and subsequently reducing international commodity prices and thus the incomes of farmers in developing countries.

PCD issues in OECD development cooperation policies

OECD development policy objectives are to promote economic and social development by contributing to the achievement of the MDGs, and to facilitate the integration of developing countries within the world economy. Some of the instruments used include general aid flows and food aid.

Aid can enhance economic growth in developing countries by expanding domestic savings, and thus promoting investments. However, there are some potential conflicts between aid flows and the export competitiveness of the recipient countries. Among some of these potential problems are (1) aid flows may cause the appreciation of the exchange rate of recipient-countries, which would make their exports less competitive on the world market, and (2) recipient-countries may develop an “aid induced trade dependency,” if the aid funds projects that require the importation of capital goods only produced in donor countries (Suwa-Eisenmann and Verdier 2005).

One particularly contentious area of OECD development cooperation is food aid. While food aid can be an effective way to alleviate severe hunger and malnutrition, it is often inadequately designed to meet these objectives. The main deficiency here is that donor countries use it not only as an instrument of development assistance but also as instruments of domestic agricultural policy, foreign and trade policies. With few exceptions, food aid has not had a significant positive effect on domestic OECD farmers either; it has not been effective in increasing producers’ prices nor in stimulating new export markets (Barrett and Maxwell 2005).

ii. PCD issues in developing countries’ domestic policies

There is a great deal of diversity in the policies adopted by developing countries. Some countries, mainly in East-Asia and the Pacific and more recently in India and China (as we will see in the next section), have made important progress in providing incentives to their agriculture and export sectors to spur trade and private investment through strategic public investments and appropriate sequencing of policies. Others, mainly Sub-Saharan African countries, have lagged behind.

³ Tariffs of 15% or more

⁴ Tariff rates increase along the food processing chain, resulting in higher tariffs for processed goods than for primary products.

⁵ Non-tariff barriers can take on various forms including measures that are directly trade related (import quotas and anti-dumping measures); measures that limit trade through “technical measures” such as labeling, packing and sanitary requirements; and measures that arise from general public policy such as government imposed investment restrictions or the extent of intellectual property rights protection (UNCTAD 2005b).

Nevertheless, since the mid 1980s, developing countries as a whole have undertaken significant reforms in their agricultural and export policies moving from import-substitution favoring the manufacturing sector, towards export-oriented growth, concentrating on their comparative advantage. Despite these reforms however, some PCD issues still persist in their domestic policies, especially with regards to public investment choices and private investment promotion policies.

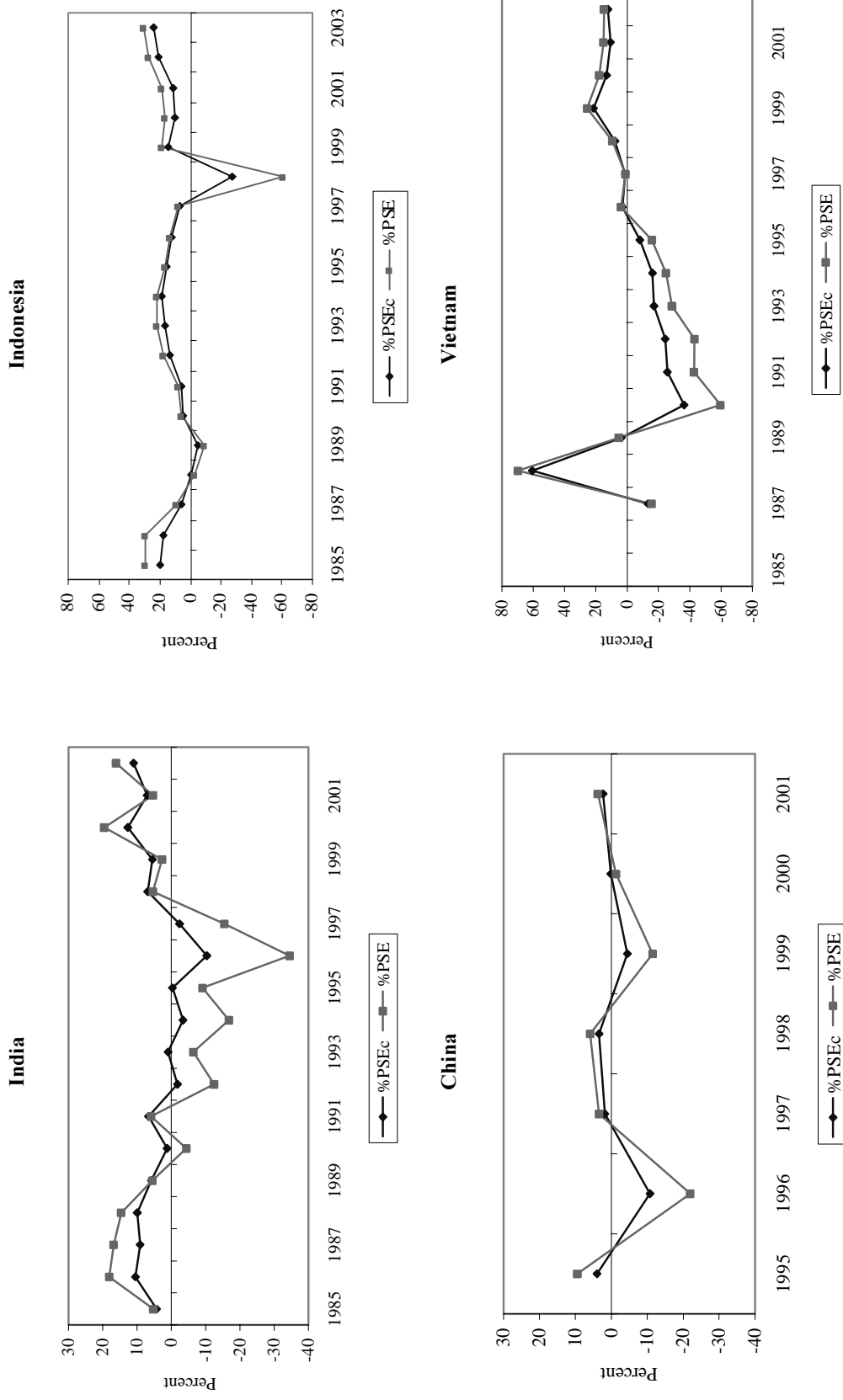
Towards major reforms

In the past, in pursuit of import-substitution ideals, many developing countries had taxed their agricultural sector in favor of manufacturing, through a wide range of instruments including export taxes on agricultural products in order to generate revenues, overvalued exchange rates to get cheaper imported inputs for the manufacturing sector (which penalized agricultural exports), and price controls that artificially kept food prices low for urban consumers (Aksoy 2005).

Since the mid 1980s however, developing countries have made great strides towards reforming their agricultural and export sectors. For the most part, the reforms eliminated the bias against their agricultural and export sectors; export taxes and price controls were removed and exchange rates were devalued (Aksoy 2005). In addition, developing countries as a whole have since substantially decreased their average agricultural tariffs from 30% in 1990 to 18% in 2000 (World Bank 2005).

Nonetheless, particularly among middle-income countries, many are moving towards protection, mostly as a reaction to OECD countries protection (Aksoy 2005). For example, when looking at total Producer Support Estimates (PSE) in India, Indonesia, China and Vietnam, Orden et. al. (forthcoming) find that most of these countries have moved towards protection of their agricultural sector. Indeed, while Indonesia has consistently subsidized its agricultural sector (except during the 1998 financial crisis), Vietnam and China are moving towards protection and India's support was counter-cyclical, i.e. support increased when world commodity prices were low, and decreased when world prices were high (Figure 1).

Figure 1: Total Producer Support Estimates for India, Indonesia, China and Vietnam(% PSE)



Source: Orden et. al., forthcoming
 Notes: % PSE gives a measure of support relative to domestic farm revenue

Despite this trend, protection of agriculture is much less of a PCD problem for developing countries than it is for industrialized nations. The main PCD issues in developing countries have to do with the inefficiencies of their domestic policies with regards to their investment climates, their insufficient public investments in the agricultural and export sectors, and their under-investment in productivity enhancing science and technology.

Domestic investment climates and public investments

Developing country governments need to first create the right incentives domestically for people to invest and to engage in international trade. To that effect, they have to reduce the incoherence of some of their domestic policies such as macro-economic, competition, foreign direct investment and regulation policies. Further, when undergoing economic reform, developing country governments need to pay special attention to the sequencing of their policies in order to avoid short-run disruptive economic shocks.

Macroeconomic stability is fundamental for the proper functioning of markets and to attract long-term investments. This entails that policymakers implement sustainable macroeconomic policies including adequate foreign exchange policies that will not penalize the agricultural sector. In addition, in the short-run, governments need to consider price levels in order to avoid excessive price volatility.

Next, domestic market institutions need to be reformed in order to foster competition. This entails breaking up any types of monopolies and monopsonies, and also better regulation of barriers to market entry and market exit. It may also entail privatization of state-owned enterprises and reformulation of foreign direct investment policies in order to attract the desired type of foreign investors. To that effect, governments might want to run targeted investment promotions and/or implement performance requirements (UNCTAD 2005a).

Regulation policy is another area that requires reforms in many developing countries. Regulations can sometimes be excessive and costly, which is an impediment to trade and investments. For instance, cumbersome customs procedures can be a disincentive for traders to engage in import and export activities. Thus, streamlining procedures in order to remove unnecessary transaction costs should be part of the reform process (World Bank 2004).

Further, in many developing countries, especially in the least-developed ones, public investments to improve the agricultural and export sectors are necessary to spur agricultural trade. Indeed, investments in rural infrastructure and transportation improves market access for agricultural producers and access to new technologies and also enable better price transmission to rural areas. It also improves access to new technologies that would enable increased productivity. Also, investment in telecommunications technologies can enhance the market integration of rural population by enabling better access to goods and services as well as information, and also reducing the cost of communications for producers and small businesses (Torero and von Braun 2005).

Example of domestic policy incoherence as an obstacle

Similarly to other developing countries, many Sub-Saharan African countries undertook market reforms in the 1980s to reduce government intervention in agricultural markets. The main objective of the reforms was to increase producer prices of tradable agricultural commodities. With the reforms, it was expected that a vibrant private sector would intervene to take over the functions previously undertaken by inefficient state-owned enterprises (SOEs) or state marketing boards. However, in many cases, the private sector response failed to materialize because of inadequate implementation of reforms, the persistence of institutional deficiencies and inadequate provision of public services, along with the high susceptibility of Sub-Saharan African countries to risk factors such as droughts and floods, conflicts and diseases (Kherallah et. al. 2002).

In terms of inadequate implementation of reforms, many governments' policies were inconsistent. In some countries, governments liberalized internal trade while still maintaining their monopolies on external trade. For example, in Benin, the government maintained control of cotton exports despite the liberalization of the internal trade of cotton. In addition, in some countries reforms were not sustained; there were instances of policy reversal due to external shocks or changing political circumstances such as a regime change (Kherallah et. al. 2002).

In terms of institutional deficiencies, most Sub-Saharan African countries lacked basic property rights protection and proper enforcement of contracts before the market reforms were taken. Thus, there was little institutional incentive for private companies to enter agricultural markets (Kherallah et. al. 2002). Further, as pointed out by Badiane (2000) and Fafchamps (2005), in certain countries, entry to markets is restricted informally by networks of traders that create barriers to entry.

Finally, in terms of inadequate provision of public services, many countries did not invest in structural factors such as roads and communication networks, which seriously hampered market access, the availability of marketing services and the accessibility of new inputs (Kherallah et. al. 2002).

b. Inter-donor coherence and donor-recipient coherence

Inter-donor and donor-recipient coherence issues arise in two settings: within the current international trading system, and within the interaction of aid policies and developing countries' domestic policies. In this sub-section, we address the potential PCD issues within these two contexts.

i. PCD issues in the current international trading system

Several PCD issues arise from global trade trends. First, there is a lack of consistency in the positions of developing countries and donor countries in international agricultural trade negotiations. The World Trade Organization (WTO)'s Doha "Development Round" of negotiations was launched in 2001. The long-term objective of the talks with regards to agriculture are "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" (WTO 2001). However, agriculture has become an impasse to the advancement of multilateral trade talks with the trading blocks refusing to make any substantial concessions. The objective for negotiations on agriculture and non-agriculture market access is "to agree on formulas and other details that will determine the scale of reductions in tariffs on thousands of products and on farm subsidies" (WTO 2005). However, this agreement is going to be difficult to obtain as the current proposals still vary widely.

Second, within the international trade system, there is an increasing volume of regional and bilateral trade agreements.⁶ Although these agreements provide reduced barriers to trade for partner countries and sometimes create common regulatory frameworks, which can translate in enhanced trade and investments (World Bank 2004), they may be undermining multilateral negotiations. Indeed, bilateral and regional trade agreements (RTAs) go beyond the agreed multilateral rules and usually supersede them. Further, there are increasingly complex structures of agreements as well as overlap. The risks here are that (1) multilateral negotiations can be undermined because developing country coalitions are being fragmented as they sign onto different bilateral agreements and RTAs; (2) traders may experience higher costs in meeting rules for the different bilateral agreements and RTAs; (3) the "spaghetti bowl" problem may arise with multiple tariffs and increased inconsistency in trade rules and regulations between the various

⁶ As of January 2005, there were 312 RTAs that have been notified to the GATT/ WTO, of which 170 are currently in force. Beyond the RTAs notified to the WTO, there are an estimated 65 that are currently in operation.(Crawford and Fiorentino 2005)

bilateral agreements and the RTAs, and between the bilateral agreements/ RTAs and multilateral agreements; and (4) there may be increased regulatory confusion in regional markets and implementation problems (Bhagwati and Panagariya 2003; WTO 2005). There is clearly a need for a review of the (in-) coherent trade policies resulting from RTAs for global agricultural trade regimes.

Third, many developed countries offer low-income countries preferential access to their markets, but these schemes are also accompanied by several PCD issues. In theory, these schemes can help low-income countries boost their exports to developed countries. However, in reality, preferential schemes have several shortcomings as effective instruments for the promotion of developing country participation in international trade. First in their design, the preference schemes offered by OECD countries differ from each other, which means that there is no uniformity in preferential access. Further, many of these schemes exclude or restrict major agricultural products in which low-income countries have a comparative advantage, as well as processed agricultural products (Brenton and Ikezuki 2005). Second, from the perspective of a developing country exporter, there is sometimes a high cost in complying with preferences. For instance, satisfying the rules of origin⁷ can imply a high cost for the exporter relative to the expected gain from the preference, especially if the exporter deals with processed agricultural goods (Brenton and Ikezuki 2005). In addition, preference schemes (with the exception of the European Union's Anything But Arms program) are uncertain and unpredictable in the long-run in that they are subject to legislative renewal. This creates a disincentive for the developing country exporter to incur long-run investments (Badiane 2005). Lastly, for recipient-countries, preference schemes may create a dependency on exports of certain products, which can in turn hamper the diversification of their exports. Also, because of the current negotiations within the WTO for tariff reductions, the long-term viability of preference schemes is in doubt, and as a result, countries benefiting from preferences are at risk of preference erosion (Brenton and Ikezuki 2005).

Finally, due to the health and environmental concerns of developed country consumers, increasingly strict sanitary and phytosanitary (SPS) measures are being applied in these countries, and are serving as barriers to entry for developing country exports. This trend presents a series of PCD problems. First, although protecting oneself from food borne and agriculture related diseases is a legitimate goal, the underlying risk here is that some countries maybe using such measures for protecting their producers under the guise of SPS measures (essentially as non-tariff barriers), as tariff-barriers are coming down due to the multiple multilateral agreements. Although international standards⁸ exist, the WTO's SPS agreement allows countries to set up their own standards (based on scientific evidence), so there is no uniformity in standards between countries. The problem with this is that developing country exporters may find complying with different SPS requirements to be very costly. Furthermore, many developing countries do not have the financial resources or the technical expertise to participate in international standard setting bodies, so their needs and concerns are rarely covered by the resulting agreements (Josling, Roberts and Orden 2004; Matthews 2005; Jensen 2002).

⁷ Rules of origin are used to certify that preferences are granted only to exporters from eligible countries. For primary products (products produced in a single stage or wholly obtained in one country), origin is fairly easy to establish. This is not the case for processed products; rules of origin specify "how much or what kind of domestic processing must take place (Brenton and Ikezuki 2005).

⁸ The Codex Alimentarius Commission was created in 1963 by FAO and WHO to develop food standards, guidelines and related texts such as codes of practice. The main purposes of this Programme are protecting health of the consumers and ensuring fair trade practices in the food trade, and promoting coordination of all food standards work undertaken by international governmental and non-governmental organizations (FAO/WHO 2005).

ii. PCD issues in the interaction between development cooperation policies and developing countries' domestic policies

Development cooperation policies are supposed to support the domestic policies of developing countries in order to achieve the agreed targets of the MDGs. However, there are often incoherencies between (1) the different donors' objectives and/or (2) between the objectives of donors and developing country policymakers' objectives. The risk associated with the first one is that the differing objectives could result in contradictory policies. For example, when Malawi was undergoing agricultural sector reform, one of the obstacles was the conflicting donor conditionalities; while USAID was pushing for the elimination of subsidies for fertilizers to small farmers, the World Bank and the European Union were funding the distribution of free fertilizers and hybrid seeds to poor smallholders (Kherallah et. al. 2002).

The risk with the second type of coherence issue is that developing country policymakers would not be receptive to the reforms suggested by donors, and would either not implement them or would implement them partially. We illustrate this point with the example of Vietnam, becoming one of the world's leading rice trading nations. In the late 1980s, the government of Vietnam started implementing market reforms in rice by undergoing macro-economic reforms (establishment of positive real interest rates, devaluation of the exchange rate and liberalization of trade), eliminating subsidies and price controls, cutting export duties, and strengthening of property rights. These initial reforms led to a five percent annual increase of rice production from 1985 to 1995, of which 57% were derived by yield increases, 38% from cropping intensity and 8% from the interaction of the two (Ryan 1999). By 1995, the government of Vietnam had engaged the country into transition from a planned economy towards a market economy. However, the country had little experience with institutions of market economies. As a result, the government was receptive to research on the appropriate policy environments that would allow the sustained positive impacts of the reforms undertaken in the rice sector. Supported by other multilateral organizations (mainly the World Bank and the Asian Development Bank), the International Food Policy Research Institute (IFPRI) undertook relevant research that helped reduce incoherence in the rice sector by providing new information, as well as by influencing the timing of the rice policies (Ryan 1999).

III. LINKAGES BETWEEN ENHANCED GLOBAL AGRICULTURAL TRADE AND GROWTH AND POVERTY REDUCTION

In theory, enhanced agricultural trade offers opportunities for economic growth and poverty reduction for two main reasons. First, trade offers consumers a wider variety of food products at cheaper prices. Since the poor spend a substantial amount of their incomes on food, the availability of better and cheaper foods is poverty reducing. Second, since most of the poor live in rural areas and partly depend on the agricultural sector for their livelihoods, trade offers opportunities in terms of market access and therefore enables poor producers to increase their incomes. This can in turn lead to more dynamic effects such as increased opportunities for producers to diversify towards high-value production, and increased non-farm economic activity in rural communities, offering job opportunities both on-farm and off-farm. Further, the availability of non-farm job opportunities provides rural populations with an incentive to invest in their education and skills to take advantage of the new off-farm job opportunities.

However, global agricultural trade and global agricultural growth are in a complex, non-linear relationship. There should not be any doubt about the power of trade for enhanced allocative efficiency and economic welfare broadly defined. The last two decades have seen considerable expansion of agricultural trade with an average growth rate of 4.75 % from 1985 to 2003, exceeding those of the value-added of the global agriculture sector (which grew on average by 1.9 % during the same period) (World Bank 2005, FAO2005). Thus, the ratio of the two growth rates actually declined which may be interpreted as declining power of trade for growth effects.

Even more complex is the relationship between agricultural trade and poverty reduction at the global scale. Poverty declined only slowly in the past two decades in terms of head count measures. Significant reductions are noted in Asia, in particular in China. Domestic market opening and more international trade have played a role. The stagnation in poverty reduction in Africa is paralleled by slow growth in trade and declining shares in global agricultural trade. PCD and agricultural trade policy must avoid any “black box” approach where strong and direct linkages between trade expansion, growth and poverty reduction are taken for granted.

In this section we briefly review the current knowledge on trade reform impacts on the poor before turning our focus to developing countries’ domestic policies. We summarize the main drivers of agricultural trade expansion, and consider the role of the PCD agenda for the expansion of global agricultural trade. In doing this, we highlight the need for a strategic approach in sequencing policies and the central role agriculture in the early stages of development. We look at the progress in India and China as illustrations of how policy coherence can play a role in promoting trade and lead to increased growth and poverty reduction. Finally, we provide some insights on how to manage the dynamic risks and factors affecting global agricultural trade.

a. Trade reform impacts on the poor

The litmus test for policy coherence in development policy is the short and long term effect for the poor. The impacts of the macro-level changes induced by agriculture trade reform on poor households depend primarily on whether they are net consumers or net producers of food (Orden, Torero, and Gulati 2004). With increased openness, net consumers of agricultural products benefit from a larger variety of products and reduced prices with cheaper imports entering domestic markets, while net producers face increased competition from imported goods, which may lead to lower prices for their products, depending on their competitiveness. Net producers would also become more susceptible to higher volatility in agricultural prices.

In addition, the overall impact of trade policy reform will be determined by households’ ability to adjust to these changes through shifts in production and consumption patterns, such as switching production towards goods whose prices have risen and consumption towards goods whose prices have fallen (McCulloch et al. 2001) or changed opportunities in labor markets. The ability to make such shifts will in turn depend on the household’s access to markets, its physical assets, individuals’ skill sets, and its access to credit and insurance markets. Labor mobility across sectors is an important consideration because labor is the main resource owned by many poor households. Price transmission to rural markets for inputs and outputs are also significant as there are many stages between border prices and prices faced by rural households.

Current knowledge on trade reform impacts at the household level is rather limited. Top-down approaches use detailed economy-wide data and build on the microeconomic assumption of a representative agent, while bottom-up approaches use detailed household expenditure data and emphasize heterogeneity of households (Reimer 2002). In general, very little consent comes out of this literature.

Ivanic (2005) conducts a multi-country analysis of the poverty effects arising from trade reform on different household groups. His analysis differentiates households by income sources and regions (urban and rural). He uses the GTAP model along with data from the GTAP database 6 and detailed household surveys from fifteen countries. The author finds that in some of the countries (Chile, Indonesia, Malawi, Mozambique, Peru, the Philippines, Thailand, and Vietnam), the extent of trade reform has a positive impact on poverty levels. However, he finds that this is not always the case in other countries. For

instance, in seven of the countries (Bangladesh, Colombia, Mexico, the Philippines, Uganda, Venezuela, and Zambia) full trade liberalization increases poverty levels in agriculture dependent households.

From the above studies and others on the issue (see for a review von Braun, et. al. 2005) we can conclude that the majority of poor households will gain from trade reform while some will loose. The results vary across countries, and according to these estimates, the effect of trade openness on poor households' income is not large. Thus, policymakers in each country need to consider complementary actions targeting vulnerable households in order to avoid potential negative impacts on these populations. This integration of social policies with trade reform policies is a major challenge for the PCD agenda.

b. Principal driving forces of agricultural trade expansion and the role of policy coherence

In order to promote agricultural trade, policy in developing countries has to first make sure that the macro-economic environment is conducive to trade. This involves adequate access to investment capital and exchange-rate policies. Further, institutions that foster economic activity need to be in place. In many countries, this requires significant institutional reforms, for which good governance fostering public order and political stability and security is a necessary pre-condition (Birner and Resnick 2005).

Beyond providing a favorable political environment, policy has to provide the right economic incentives not only through reforms of markets as earlier pointed out, but also through secure property rights and adequate contract enforcement mechanisms in order to provide incentives for agricultural producers to invest in the improvement of their lands and also to facilitate their access to formal financial markets (World Bank 2004).

In addition, key public investments in agricultural research and technology, infrastructure and education can enhance agricultural trade and contribute to economic growth and poverty reduction in developing countries. Investments in agricultural research and technology enable productivity growth by providing farmers with more productive seeds and new technologies for more efficient production. Indeed, research has shown that investment in agricultural research has high returns in terms of promoting agricultural growth and poverty reduction. For instance, as shown in tables 1 and 2, investments in agricultural R&D had the second highest and the highest return among public investments in China and India respectively in terms of poverty reduction.

Table 1: Returns to poverty reduction from public investments in China

Returns to poverty reduction from investments in	Number of poor reduced per 10,000 Yuan expenditure (average from all regions)
Education	8.8
R&D	6.79
Roads	3.22
Electricity	2.27
Telephone	2.21
Irrigation	1.33
Poverty loan	1.13

Source: Fan, Zhang and Zhang, 2002

Table 2: Returns to poverty reduction from public investments in India	
Returns to poverty Reduction from investment in	Total poor reduced per million Rs. 1995
Ag. R&D	156.61
Rural roads	152.19
Rural education	48.43
Irrigation	17.01
Rural development	31.37
Soil and water conservation	27.75
Rural health	22.35
Rural electricity	5.24

Source: Fan, 2002

Investments in rural infrastructure are also crucial in order to facilitate market access and facilitate price transmission to rural areas. Such investments also enable the reduction of transportation and communications costs. In China, in terms of reducing poverty, investments in roads had the third highest return while in India they had the second highest return. Finally, investment in education can also contribute to enhancing agricultural growth, by improving rural population mobility between on-farm to off-farm sectors. In China, investments in rural education had the highest returns in terms of poverty reduction, while in India they had the third highest return (Tables 1 and 2).

Development assistance can play a key role in terms of supporting the above policies through financial and technical assistance. In the context of trade liberalization, industrialized countries can increase their support to facilitate improvements in the functioning of markets in developing countries (through for e.g. “aid for trade” program that would assist countries in making the necessary basic investments in infrastructure and also in modernizing their institutions in order to help them take advantage of the new opportunities offered by more liberalized trade).

A strategic approach to formulating domestic policies is an integral component of policy coherence for agricultural trade policies in developing countries. This requires that reforms be adequately sequenced and implemented in a gradual manner in order to maximize the benefits of enhanced trade for society as a whole. Indeed, in order to attain the benefits of a more liberalized agricultural trade system, domestic markets and institutions need to be developed to take advantage of the new opportunities. As we saw earlier in the example of Sub-Saharan African countries, domestic trade liberalization efforts were undertaken prematurely in that the required investments and institutional reforms were not carried out before embarking on the reforms. The results were that the reforms did not yield the expected outcomes (Kherallah et. al. 2002).

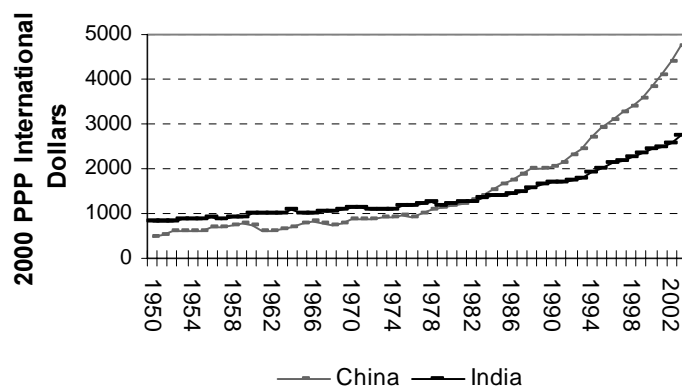
Further, agricultural trade reforms need to consider the potential impacts of liberalization on vulnerable populations, otherwise, reforms might lead to increased poverty. Appropriate risk management strategies that would minimize transitory poverty and enable vulnerable populations to better take advantage of the new trade opportunities need to be put in place before undertaking reform.

c. Policy coherence enhanced trade and development: China and India

China and India have in recent years made important progress in creating the right incentives in their agricultural and export sectors, albeit through different development strategies. Over the past two and half decades, both countries implemented significant economic reforms that have enabled their increased participation in world agricultural trade. The aggregate effects of these trends have led to high economic

growth and spectacular poverty reduction, especially in China (Figure 2). The underlying lesson from the experiences of both countries is that strong national initiatives with a strategic approach are necessary in order to propel a country's development. Also, trade is part of the story.

Figure 2: GDP per capita in China and India, 1950–2003



Source: von Braun, Fan and Gulati 2005

Further, in a comparative study of the two countries' development policies, Gulati et. al. (2005) show that the different strategies of development followed by the two countries explain the differences in their achieved growth and poverty reduction rates. While China focused on reforms in the agricultural sector at the beginning of its reforms and then undertook macro-economic and non-agriculture reforms, India followed the reverse path.

During the agricultural reforms, China first created strong incentive structures and institutions to enable the increased productivity of agriculture and the proper functioning of agricultural markets. Then, in a second phase, they liberalized and opened up markets. Indian policymakers on the other hand, opened up their agricultural markets before reforming incentives. Nevertheless, reforms were undertaken afterwards which resulted in export-oriented agricultural growth (Gulati et. al. 2005).

In addition, the two countries' strategies differed in their pace of reforms. In the Chinese case, although, policymakers made sure that each new measure that they implemented was successful before moving forward with another measure, reforms were implemented relatively faster than in India due to the more pluralistic and bureaucratic nature of political processes in India (Gulati et. al. 2005).

d Management of dynamic risks and forces that shape the factors affecting global agricultural trade

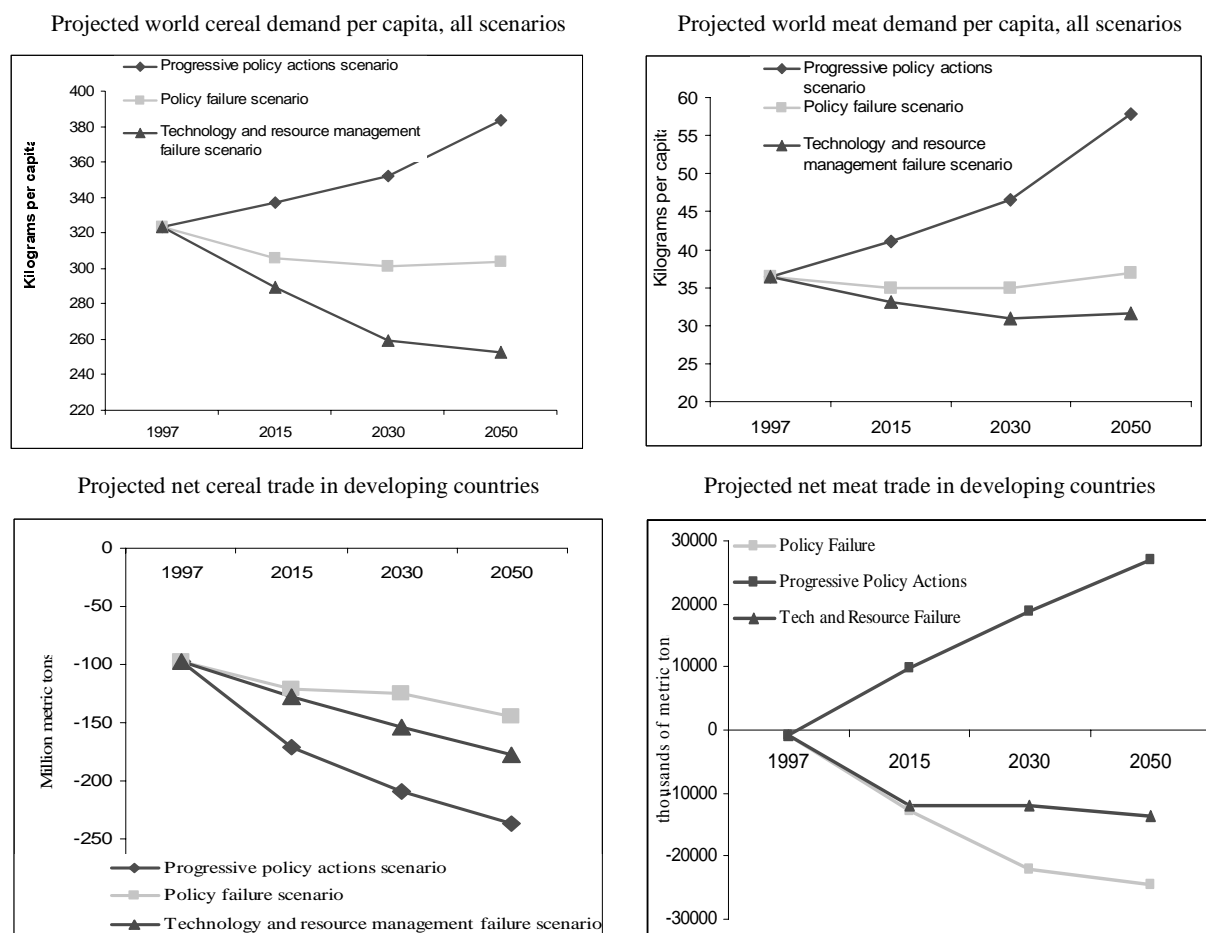
IFPRI's IMPACT model⁹ provides some insight on how policy actions (or inactions) can affect, among other things, commodity prices, demand, cereal yields, production and net trade. A progressive policy scenario outlines several of the most fundamental steps as reviewed above. In this scenario, national governments and the international community focus their policies on agricultural growth and rural

⁹ The International Model for Policy Analysis of Agricultural Commodities and Trade (IMPACT) model was developed by Mark Rosegrant at IFPRI to provide insights into the management of the "dynamic risks and forces that shape the factors affecting people's access to food and the links with malnutrition" through appropriate policy actions. The IMPACT model enables the exploration of the potential impacts of different policy alternatives to manage hunger, malnutrition, commodity prices, demand, cereal yields, production and net trade, by projecting future global food scenarios to 2050 (von Braun, Rosegrant, Pandya-Lorch, Cohen, Cline, Brown & Bos 2005).

development; developing countries increase their expenditure on agriculture and rural development between 2005 and 2015 (including their expenditures on agricultural research and development) and producer support to farmers in developed countries is substantially reduced. Further, developing countries progressively increase their investments in education, social services and health between 2005 and 2020. In the policy failure scenario, the crucial investments in agriculture and rural development are not undertaken and agricultural protectionism increases along with greater political discord. In the technology and resource management failure scenario, agricultural protectionism does not increase but the technology and natural resource failures are severe.

The simulations, as shown in figure 3, demonstrate that under the “ideal” conditions of the progressive scenario, because of rising incomes, world demand in cereals and in high-value products such as meat and fruits and vegetables increase. Further, net meat trade increases in developing countries, while net cereal trade decreases (Figure 3; von Braun, Rosegrant et. al. 2005).

Figure 3: Some results from the IMPACT model



Source: von Braun, Rosegrant, et. al. 2005.

CONCLUDING REMARKS

The changing weight of actors in the agricultural policy domain have induced some old incoherence issues to be overcome, while new incoherence issues have arisen. While many developing countries have made important improvements towards decreasing their protection levels in the agricultural sector, on the international arena there have been a number of setbacks in terms of multilateral progress in agricultural trade liberalization negotiations. The increased focus on bilateral agreements may have undermined progress towards multilateral progress.

Also, some old incoherence issues still persist. Since political markets are imperfect and incomplete, the risk that powerful self-serving interest groups influence the policy-setting and policy-implementation in agricultural trade still exists. Fortunately, a large number of developing countries have established parliamentary systems in recent decades, thus opening up political markets. The outcome of that for coherence in their domestic policies is yet to be seen. Increased transparency, rule of law and vibrant media should facilitate the reduction of incoherencies, but policy markets are difficult to predict.

Global welfare, development and poverty alleviation will be well served if rules-based, multilateral liberalization of agricultural trade can be achieved. This would bring gains for developing countries not just from new market opportunities created multilaterally, but from trade-based investment and the technological advances these opportunities induce. To complement trade policy reforms, public investments are essential. To make the Doha Round truly a “Development Round” requires an innovative combination of trade policy reform with enhanced development finance that facilitates market functioning. This requires closer coordination among the WTO and development finance organizations, such as the World Bank and regional development banks, a challenging matter of PCD across international bodies.

Gains for developing countries from strengthening markets will come from simultaneously enhancing their physical and institutional infrastructures for agriculture, reducing domestic marketing channel inefficiencies, and eliminating internal barriers to private investments. To turn the market opportunities created by either multilateral trade agreements or their own trade policy reform into concrete gains requires an investment to make markets work and endow the poor with the assets they need to compete. Responsibility lies primarily within the countries themselves, but developed countries and international institutions need to increase their support for these efforts.

Trade policy reform and international assistance to agriculture in poor countries are complements, not substitutes, in creating benefits for the poor people who are concentrated in agriculture. Progress in reducing agricultural support and protection among the world’s wealthy countries would be an important accomplishment for development and strengthening of the multilateral trade system. Developing countries also need to be actively engaged in the multilateral process of agricultural trade liberalization as they have much to gain. There are substantial grounds for agreement about agriculture between advocates of international development and poverty reduction and those advocating strengthened agricultural trade opportunities.

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