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Executive brief

CAP reform

1. Background and key issues

As the biggest importer and second largest exporter of foodstuffs, the EU is a major player in global agricultural trade. As a result, decisions on the future of its agricultural policy can carry important global implications.

"The future of EU agricultural policy carries global implications"

This is particularly the case for ACP countries, which traditionally enjoyed preferential access (in some areas quota-restricted) to the EU market allowing them to benefit from the EU's high producer prices. The EU's shift over from price support to direct aid payments to farmers, as part of the common agricultural policy (CAP) reforms initiated in 1992, saw these traditionally high prices lowered, to the detriment of some preferred ACP suppliers. After 20 years, the process of CAP reform is approaching completion. The ongoing process of reform nevertheless continues to carry important consequences for ACP countries.

The modernised CAP will continue to carry external consequences, as outlined by the WTO Secretariat in its 2011 Trade Policy Review of the EU. In this context, and in the light of the provisions of the Lisbon Treaty on policy coherence, priorities for ACP governments are:

a. identifying the specific areas of reform and the use of particular CAP policy tools that impact most acutely on specific food and agricultural sectors in individual ACP countries;

b. promoting policy initiatives to address the adverse external effects of the deployment of CAP policy tools through:

   i. the basic design of CAP reform measures;

   ii. extending the use of new policy tools to ACP–EU agricultural trade relations or, where appropriate, supporting the elaboration of similar policy initiatives within ACP countries;

iii. adopting flanking measures to assist ACP agricultural sectors in adjusting to the changes underway (e.g. the rum, banana and sugar assistance programmes).

The European Commission (EC) continues to highlight how reform of the CAP:

- has reduced the most distorting forms of agricultural support (although it has increased less distorting forms);
- allowed a gradual opening of EU food and agricultural markets; and
- ensured the application of only those sanitary and phytosanitary (SPS) and technical barriers to trade (TBT) arrangements allowed by the World Trade Organization (WTO).

The EC stresses the problems faced in identifying specific external effects of CAP policies (see *Agritrade* article 'The Common Agricultural Policy and development', 28 November 2011).

Further proposed reforms aim to ensure that price volatility does not cause excessive damage to the EU's agricultural production base, by:

- establishing effective 'safety nets';
- equipping European agriculture to respond robustly to market signals by focusing on quality-differentiated production and improving price competitiveness;
- increasingly diversifying the economic base of rural areas and improving rural living standards.

Key issues currently under discussion include:

- the future of the direct aid payment scheme;
- the future role of market management tools;
- the redefinition of existing food-safety and quality-related policies;
- the development of new policy initiatives designed to address unforeseen consequences of reform.

While the discussions over the future of the CAP after 2013 are intensifying, no conclusions have yet been reached.

2. Latest developments

Overview of the main elements of the October 2011 CAP reform proposals

The process of CAP reform has been underway since 1992, with a second major wave of reform, Agenda 2000, tabled in March 1999. A further round of reforms was tabled in 2003, with additional sector-specific reform in 2005 and a CAP 'health check' involving further reforms in 2008. A further round of reform is scheduled for 2014.

After a period of public consultation and deliberation within the EC services, in September 2011 the EC tabled proposals for reform which are now the subject of intense debate within the EU Council, the European Parliament and the agricultural sector in general. It is anticipated that formal regulations will be tabled in the course of 2012, with final approval to specific changes being agreed by the end of 2013.

The EC proposals for reform of the CAP can be divided into four components:

- reform of the system of direct aid payments;
- reform of market management mechanisms;
- reform of rural development policy instruments;
- other policy initiatives.

On direct aid payments, the EC proposes to introduce a new basic payment scheme from 2014, subject to simplified cross-compliance requirements and a gradual move over to complete convergence of payment levels across all EU member states after 2020 (consisting of a uniform payment per hectare by 2019). There is no consensus among member states on the time frame for payment convergence. New member states favour convergence by 2020, while some EU15 politicians argue for a 20 to 25-year period.

The proposed payment scheme will consist of a basic payment utilising 70% of the national budgetary envelopes and supplementary payments for 'greening' (i.e. supporting the environment) measures, and support to young farmers and small farmers (30%). This scheme would be simply and flexibly implemented. Organic producers would automatically be eligible for the supplementary payment. It is proposed to focus assistance on 'active farmers', with an upper limit of €300,000 per annum in total CAP payments per farm.

The option is maintained to provide product-specific coupled support in the beef and cotton sectors.

Increased flexibility in transferring funds between direct aid payments and rural development measures is also proposed.

In terms of market management measures, one proposal of particular interest to the ACP relates to the abolition of sugar production quotas (for more details, see *Agritrade*, 'Executive Brief Update: Sugar', 2012). Two scenarios for abolition are proposed:

- a rapid abolition by 2015/16 and
- a phasing out to be completed by 2017/18.

The EC favours rapid abolition, with this seen as 'the only option for providing the sector with a long-term perspective'.

Significantly, quota abolition both addresses the regulatory causes of the problems faced on the EU sugar market in 2010 and 2011, and frees EU operators from WTO constraints on exports (linked to the deployment of export refund support and cross-subsidisation), enabling EU companies to capitalise on high global prices and shifting patterns of global sugar demand.

The EC acknowledges that 'the end of the sugar quota regime will have important implications for the sugar sector'. According to the EC, the removal of sugar quotas is expected to lead to higher production and lower prices. Estimates of the price effects range from price reductions of 8.2% and 10% for sugar beet and 3.5% and 5.7% for white sugar under the rapid and phased options for abolition respectively. The EC suggests that under both scenarios, 'prices are projected to fall below the current support prices for sugar beet and white sugar'.

Under both scenarios, the EU would continue to be a net sugar importer, but with a better net trade balance than at present. The impact assessment notes that 'extending the life of the quota system … prolongs the inefficiencies of the industry.'

The EC argues that in the post-quota period, 'standard provisions for agreements between sugar factories and growers should be established.'

"Reform should not involve complete abandonment of market management measures but should involve their modernisation"

EU Agriculture Commissioner Dacian Cioloş argues that reforms would not involve the complete abandonment of market management measures, but would establish 'a framework of modernised market management instruments with true safety nets, a clearer, strengthened role for producer organisations and obligatory contracts, before sowing, between growers and processors' (see *Agritrade* article 'EC proposals for sugar sector reform', 28 November 2011).

This strongly suggests that EC policy initiatives to strengthen the functioning of food supply chains that were developed in the dairy sector are to be extended to the sugar sector. The EC impact assessment of October 2011 on CAP reform proposals noted that 'the dairy crisis … raised awareness of the significant tensions in contractual relations between actors of the chain' and described the imbalance in bargaining power along food supply chains as 'a structural problem'. Particular concerns were expressed about the 'lack of transparency on price formation' along certain supply chains.

The EC takes the view that 'improving the functioning of the food supply chain … to rebalance the bargaining power along the food supply chain' is necessary in the context of increased market orientation, and an environment of high input costs (which have increased much faster than farm-gate prices). Proposals advanced as part of the discussions in strengthening the functioning of supply chains include:

- support for the establishment and operation of producer organisations;
- the strengthening of inter-professional organisations, drawing on experience to date in the fruit and vegetable sector;
- support for the establishment of shorter marketing chains (via direct farmer sales or via farmers or intermediaries), using rural development funding.

Consideration is also being given to some level of regulation of contractual arrangements within given food supply chains, as well as other sector-specific regulatory modifications. Three alternative sector-specific approaches are seen as options:

- flexible cooperation;
- enhanced cooperation;
- regulated cooperation.

The other major development regarding market management tools relates to EC proposals to expand the EU's safety-net policy. While the system of direct aid payments remains central to the EU's safety-net policy, this has traditionally been supplemented by the use of a range of market stabilisation tools. These include:

- aid for private storage;
- intervention buying;
- disposal programmes;
- export refund support.

The EU remains committed to the use of these tools, with their use being made more systematic and tailored to 'the specific needs of each sector', through certain sector specific modifications (e.g. for beef, butter, or skimmed-milk powder).

The aim of this refocused safety-net policy is to minimise the use of such traditional policy tools 'under normal market conditions', while allowing 'the EU to act faster and efficiently' where exceptional market conditions arise. This would be supported by a proposed €3.5 billion emergency reserve for the period 2014–2020, with funds available to deal with 'exceptional circumstances' (see *Agritrade* articles 'Multi-annual budget framework sets scene for CAP reform proposals', 6 September 2011 and 'Policy tools critical to turning around crisis in the EU dairy sector', 4 May 2010).

"The EU retains traditional policy tools while alternative measures are set in place"

The development of policies to strengthen the functioning of food supply chains can be seen as part of this expanded safety-net policy, which also included risk management tools to deal with increased global price volatility.

Currently provision is made under the CAP for:

- public support to mutual funds (with farmers' contributions matched from public sources);
- public subsidy to agricultural production insurance schemes (up to 65% for addressing natural disasters and disease outbreaks);
- state aid in the case of particular adverse events (e.g. floods, earthquakes etc).

More recently the EC has been encouraging greater use of market-based risk management tools, such as forward contracts (which seek to lock in specific prices in advance of production) and even use of agricultural derivative tools to hedge against risk.

In terms of further reform, the aim is to create a 'toolkit' of options for helping EU farmers to manage risks, with member states being allowed flexibility in addressing risks facing farmers. The EC is leaning towards a system of enhanced insurance subsidies and the creation of an income stabilisation tool. Specific options under consideration (see Table 1) include:

- broadening the scope of risks to be included in agricultural insurance schemes beyond production risks to include revenue risks and a lowering of the level at which support is triggered;
- the creation of an income stabilisation tool to compensate farmers who experience severe income falls relative to the preceding 3-year average (market income minus input costs), with compensation being paid regardless of the cause;
- the creation of a revenue stabilisation scheme that addresses variations in revenue but takes no account of income costs (based on a moving 3-year average of national yields and prices);
- the creation of a crisis fund in the form of a 'global agricultural risk management fund'.

The EU approach of retaining traditional policy tools while alternative policy measures are set in place to deal with evolving global trade challenges potentially holds important lessons for ACP governments (see *Agritrade* article 'Agricultural dimensions of the WTO EU trade policy review', 30 August 2011).

Table 1: Overview of risk management options

Options	Tools	Changes
Strengthening current tools	Insurance subsidies, mutual funds	Expanding to include revenue and index insurance and reducing the limitations for payouts
Income stabilisation tool	Income stabilisation tool	New tool
Crisis fund	Agricultural calamity fund	New tool

Source: EC, 'Impact Assessment: Common Agricultural Policy towards 2020', Annex 6: Risk management, Commission Staff Working Paper, October 2011. http://ec.europa.eu/agriculture/analysis/perspec/cap-2020/impact-assessment/annex6_en.pdf

Within the rural development policy, clearer performance targets are to be established, with the attainment of these targets being linked to the mobilisation of funds from a 'performance reserve' (5% of the national rural development envelope). Deployment of rural development funds will be linked to six priorities:

- Fostering knowledge transfer and innovation;
- Enhancing competitiveness;
- Promoting food chain organisation and risk management;
- Restoring, preserving and enhancing ecosystems;
- Promoting resource efficiency and transition to a low-carbon economy;
- Promoting social inclusion, poverty reduction and economic development in rural areas.

Member states will be required to deploy 25% of their national envelope 'on issues related to land management and the fight against climate change'. The EU co-funding rates will be modified with co-funding of up to 85% of costs possible in 'less developed' and outermost regions of the EU, and 50% for most other regions.

In terms of other policy initiatives it is proposed that the future CAP should include higher levels of investment in research and innovation, to produce 'more from less'.

A further area of EU policy development impacting on the ACP relates to the EU's evolving agricultural product quality policy and associated labelling requirements. It is commonly asserted by EU farmers that the failure of third-country suppliers to fully comply with EU standards gives imported products an unfair advantage on EU markets.

This has given rise to considerable pressure from EU farmers to ensure that EU standards are applied equally to imports from non-EU countries. However the British Retail Consortium has rejected such claims, arguing that all its members' imports meet equivalent standards to those required by the EU. The situation however appears to vary from sector to sector, with the British Pig Executive for example estimating that 70% of pork imports in 2005 would have been illegal to produce in the UK on animal welfare grounds.

Evidence submitted to parliamentary hearings led the UK Parliament to urge the EC to 'argue more strongly for recognition of standards of production … within trade agreements' (see *Agritrade* article 'Impact of EU standards on competition and world trade', 10 June 2011). This is likely to be an accompanying development alongside the process of CAP reform.

The debate in the EU Council

While many of the EC's proposals have been well received, there remains no consensus on the scope and time frame for further reform. The contrasting positions can best be seen by considering the positions of the UK, Spanish and French governments.

The UK government has called for the establishment of a CAP policy framework that is up to meeting the 'challenges and opportunities of 2050 and beyond'. Specifically, the call is for a CAP that enables the agri-food sector to 'respond to and earn improved returns from the global market', with a shifting of funds to CAP Pillar 2 activities, focusing on 'investment support rather than production subsidies'. From the UK perspective, the aim should be 'to create a more competitive farming industry that is not reliant on any direct subsidies' (see *Agritrade* article 'UK and Poland state their positions on the future of the CAP', 25 October 2011).

The Spanish government supports the ongoing shift from product subsidies to payments to farmers. However, in contrast to the UK position, it described the EC proposals for reform of the direct aid payment scheme as 'unacceptable', since they would 'generate significant regional and productive imbalances for Spain'. Earlier Spanish proposals had called for 'a farmer-paid assistance system' that would pay farmers to 'cultivate their land for food production', while rewarding sustainable practices. Spain supports payment convergence through the mobilisation of funds, while rejecting proposals to increase co-financing by member states of rural development programmes.

Some member states lean more towards the UK perspective, while others lean more towards the Spanish perspective, with some EU governments combining selected aspects from both of these divergent positions.

The French government continues to push for more effective safety nets, adopting a far more proactive position on the regulation of relationships along the supply chain than that favoured by the UK government.

It should be borne in mind that the EU member states have different agricultural structures and different levels of global orientation and global competitiveness, which account for their perspectives and aspirations for the reformed CAP.

Given the lack of consensus among member states, any process of change in the CAP is likely to be gradual and carefully managed, with traditional tools only being abandoned when the effectiveness of new policy tools has been convincingly demonstrated. In addition, the lack of consensus means that a voluntary, non-compulsory 'tool-box' approach is likely to be adopted in new policy areas.

This cautious approach extends to the associated process of agricultural trade policy changes.

Given the contrary forces at play within the EU Council, member-state governments may prefer to keep their negotiating capital for the debates on the financing of the CAP.

The future of CAP financing

In June 2011, the EC tabled a regulation proposing a multi-annual framework for the financing of the CAP from 2014 to 2020. Under this proposal market-related expenditures and direct payments (Pillar 1 of the CAP budget) are projected to decline by 10% over the period from €42,244 million in 2014 to €38,060 million in 2020. Overall however, in nominal terms the level of expenditures for the 2014–2020 period is broadly similar to that for the 2007–13 period.

The EU farmers' organisation Copa-Cogeca described the proposal as 'a reasonable starting point' (although the overall budget was seen as 'tight') and welcomed the decision to increase spending on research and crisis management. France, Poland, Spain and the Netherlands all supported the maintenance of CAP expenditures at their present level, while the UK and Sweden wanted to see significant cuts in CAP spending.

Table 2: Market-related expenditures and direct payments: Multiannual Financial Framework (€ millions)

2014	2015	2016	2017	2018	2019	2020	Total 2014–2020
42,244	41,623	41,029	40,420	39,618	38,831	38,060	281,825

Source: EC, 'Proposal for a Council Regulation laying down the multiannual financial framework for the years 2014-2020: Annex', 29 June 2011, COM(2011) 398 final.

The decline in market-related expenditures and direct aid payments from 2014 to 2020 can be seen as consistent with the existing trend towards an expansion of rural development programmes (moving to what is seen as 'investment support', and away from traditional farm subsidies). Since rural development expenditures are co-financed with member states and reach beyond agriculture and agro-processing activities, it is unclear what the overall impact of the proposals will be on total agricultural and agro-processing related expenditures (see *Agritrade* article 'Multi-annual budget framework sets scene for CAP reform proposals', 6 September 2011).

In February 2012, a joint Franco–Spanish statement was issued reiterating established positions and rejecting any overhaul of the budget that 'fails to preserve the EU's current level of farm spending' (see *Agritrade* article 'State of play in the CAP reform debate', 25 February 2012).

3. Implications for the ACP

Responding to the abolition of sugar production quotas

Given that reforms are likely to lead to sugar prices falling below 'current support prices', increased attention will need to be paid to strengthening the functioning of ACP–EU sugar supply chains.

With the changes underway in ACP–EU sugar sector relations – the abolition of price guarantees, greater concentration of ownership in the EU sugar sector and increased vertical integration along the supply chain – the EC's implicit extension to the sugar sector of new policy initiatives to strengthen the functioning of supply chains could potentially hold important lessons for ACP sugar exporters.

Elements of this new policy initiative that are potentially relevant to the ACP include:

- the establishment of a regulatory framework for contractual relations (setting out minimum requirements for contracts and disclosure of corporate linkages along the supply chain where these have a bearing on price formation); and
- support to strengthening producer organisations.

As within the EU, the impact of vast inequalities in power relationships along supply chains on the production base, in an era of heightened price volatility, is a source of concern. Developing a policy framework to strengthen the functioning of supply chains in order to reduce the adverse effects of price downturns on production, is relevant not only in the sugar sector, but beyond.

A dialogue on potential policy tools that could be deployed within this new, modern market management mechanism could constitute an important new area for ACP–EU cooperation, assisting affected ACP sectors to adjust to post-preference market realities.

Implications of the EU's expanded safety-net policy

In the face of heightened price volatility and the growing gap between input cost increases and agricultural commodity price increases, the new €3.5 billion emergency facility will finance the types of emergency measures seen in the dairy sector in 2009. A particular concern has been the potential adjustment displacement effects of the expansion of purchases into and subsequent sales from intervention stocks. According to a review by the US Department of Agriculture (USDA) of the EU dairy sector, the expansion of intervention buying for SMP from the nominal ceiling of 109,000 tonnes to 282,587 tonnes was followed by a major surge in EU exports of SMP in 2010 (+63%) (see *Agritrade* article 'USDA review of EU dairy sector development', July 2011). This high level of exports continued into 2011 and 2012. A more detailed analysis subsequently showed that milk powder exports to sub-Saharan African markets had increased by 62%, with fully 74.3% of these exports destined for Nigeria (+69%) and Ghana (+72%).

Potentially the availability of increased volumes of SMP could disrupt the development of supply relationships between local milk producers and local dairy processing companies, significantly reducing farm-gate prices for milk. A dairy-sector workshop in West Africa in 2010 called not only for greater investment in developing the production and marketing of milk, but also for the regulation of the flow of milk powder and other dairy imports, in line with national milk sector development strategies (see *Agritrade* article 'Developing a value-added dairy sector in West Africa', May 2011).

It is this type of external effect of the use of CAP policy tools that needs to be subject to careful monitoring and evaluation, and efforts need to be made to use existing EU policy tools in ways that avoid adverse consequences for emerging ACP dairy farming sectors (for more details see *Agritrade* 'Executive Brief Update: Dairy', 2012 forthcoming).

> *"Existing EU policy tools need to avoid adverse effects on ACP agriculture"*

Direct aid payments: Giving EU organic farmers an edge

The proposal to make EU organic producers automatically eligible for any supplementary 'greening' direct aid payments potentially gives EU organic producers a competitive edge over ACP organic producers in the EU marketplace. There may therefore be a need to establish flanking measures to assist ACP organic producers by:

a. supporting the establishment of local organic certification regimes, consistent with EU market requirements;

b. promoting mutual acceptance of recognition of third-country organic certification under the recently concluded EU–US mutual recognition arrangement for organic certification (see *Agritrade* article 'EU and US sign mutual recognition agreement for organic products', 11 March 2012);

c. supporting the development of ACP organic producers' organisations;

d. supporting ACP organic producers with the costs of accreditation;

e. establishing 'model contracts' for ACP organic suppliers based on EU best practice.

Direct aid payments: Maintenance of coupled support in the cotton sector

According to USDA analysis published in March 2012, the maintenance of coupled support in the cotton sector is likely to sustain and even promote EU cotton production. In this review of the EU27 cotton sector, the USDA maintained: 'following the cotton reforms in MY 2009/10 the EU-27 planted area and production have progressively increased and are forecast to remain stable during MY 2012/13.' Indeed, EU27 cotton lint production is projected to rise 42% between 2010/11 and 2012/13.

While this is unlikely to carry significant global market implications (given the relatively limited size of European cotton production), by legitimising the continuation of product-specific support schemes it will reduce pressure on the US to reform its cotton subsidy regime. This can be seen as running contrary to the aspirations of ACP cotton producers (see *Agritrade* article 'WAEMU cotton initiative launched', 3 April 2011, and *Agritrade* 'Executive Brief Update: Cotton', 2012 forthcoming).

Investing more in research and innovation

Given the huge potential for productivity increases in African ACP agriculture, a case can be made for extending EU research and innovation programmes to include a development dimension, focusing on research and innovation in African agriculture. This could build on existing EU-supported programmes, e.g. the Platform for African–European Partnership on Agricultural Research for Development (PAEPARD), or the seventh framework programme for research. This would be consistent with G20 Ministerial recommendations, and would constitute an important area for expansion of ACP–EU cooperation (see *Agritrade* article 'G20 agriculture ministers agreed on action plan on high food prices', 27 July 2011).

Building a development dimension into EU policies for SPS issues, food safety, animal welfare and agricultural product quality

The EU's evolving SPS, food-safety, animal welfare and agricultural product quality policies constitute increasingly important areas where EU policies impact on external trade. For ACP exporters, policy developments in these areas constitute increasingly important constraints on trade. This arises not from the inability of ACP suppliers to meet EU standards, but from the cost implications of compliance and compliance verification.

There is a need to support ACP producers in more cost-effectively complying with EU standards. This can be achieved through:

a. direct assistance;

b. establishing dialogues on the locally appropriate application of standards;

c. systematically improving information flows on future policy changes, so that adjustment to new requirements can be built into existing corporate and state investment plans.

Overall, this suggests the need for the incorporation of a 'development dimension' into EU SPS, food safety, animal welfare and agricultural product quality policies. This constitutes an important area where, in an era of tariff liberalisation, the EU could maintain some level of 'preferences' for ACP suppliers.

> *"A development dimension needs to be built into several EU policies"*

This is not about applying different standards to imports from the ACP, but rather about the quality and intensity of the dialogue process (and the extent of targeted 'aid for trade' interventions), with the aim of actively assisting affected ACP sectors in accommodating pending changes.

Building a development dimension into EU risk management initiatives

The EC is already supporting the elaboration of risk management tools in ACP countries under the All ACP Commodities Programme (e.g. the coffee price risk management training manual) and more recently under the new, innovative €4.7m Farm Risk Management for Africa (FaRMAf) project. As EU policies on risk management evolve, it would be appropriate and cost effective to build a 'development dimension' into these policy initiatives. This could be achieved by intensifying the dialogue over the utility of individual tools in addressing the ACP dimension of what is a common challenge –managing price volatility in order to prevent the undermining of the agricultural base.

There are commonalities to the challenges faced, and this is highlighted by the strong similarities between the EU proposals for an Income Stabilisation Tool and the earlier Lomé Convention STABEX facility.

Laying the basis for further tariff reform

Significantly, the EC notes that 'common import tariffs apply for most agricultural products', although 'tariff rate quotas are also used for various products' and safeguard provisions also apply. No specific proposals are made under the October 2011 CAP reform proposals to modify any aspect of the EU's agricultural tariff regime.

The principal effects of the CAP reform proposals thus take the form of erosion of the value of preferential access through the impact of the proposals on market prices (e.g. in the sugar sector via the market effects of the abolition of production quotas), rather than the erosion of margins of tariff preferences.

However, these proposals in some instances (e.g. sugar) do lay the basis for further tariff reforms. These could take the form of an expansion of duty-free access:

- under unilateral market opening measures (e.g. via an expansion of the use of tariff-rate quotas in sensitive sectors);
- under bilateral agreements (e.g. under an EU–Mercosur FTA); or
- at the multilateral level (as part of a WTO agreement).

Lessons from the EU rural development experience

From an ACP perspective, the most significant features of EU rural development policy are measures aimed at enhancing the competitiveness of EU food and agricultural sector enterprises. This provides public sector investment support to pump-prime necessary restructuring processes. This potentially holds important lessons for 'aid for trade' initiatives aimed at assisting ACP food and agricultural enterprises in adjusting to changing national, regional and international market conditions.

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About this update

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Technical Centre for Agricultural and Rural Cooperation (ACP—EU)
PO Box 380
6700 AJ Wageningen
The Netherlands
Tel: +31 (0) 317 467 100
E-mail: cta@cta.int - **www.cta.int**