

**License to Govern:
The Institution of Agricultural Policy Making in Norway**

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Abstract

In the (agricultural) economics literature, agricultural policies are frequently explained by either specific policy objectives or by public choice arguments (voters, political power of specialised interest groups). This paper illustrates how the policy decision-making process itself can play a decisive role in explaining observed policies. For more than 60 years, the farmers' organisations in Norway have been granted the legal and exclusive right to enter into negotiations with the government about direct budget support and administered prices. The institution stands out when compared to institutions that govern agricultural policy decision-making in other developed countries, or to institutions that govern decision-making for the self-employed in other sectors of the Norwegian economy. We start out with a detailed description of the institution. A discussion of potential drivers of institutional change and evaluation of the institution's performance with respect to good governance follows. Finally, we provide a sketch of a formal model to study the institution's effects on policy design and sector performance. The model enables us to discuss the possible effects of institutional change on agricultural policy and the agricultural sector.

1. Introduction

Studying the consequences of (agricultural) policies on the well-being of groups of individuals in a market economy has a long tradition in economics. Welfare economic analysis usually abstracts from the political institutions (i.e., the decision-making processes) that lead to specific policy outcomes (Bullock and Salhofer 2003). Studies of the political economy of agricultural policies have sought explanations for the causes of agricultural policies. This has generated a large theoretical and empirical literature on the role farmers play as voters and/or well-organized pressure groups in the competition for government support (Becker 1983 and others). Still, most of this literature treats the decision-making process as a black box. In addition, the theoretical literature is to a large extent influenced by the pluralistic political model in which interest groups are given equal access to the political arena and exert influence through lobbying efforts.

In this paper we present and analyze the political institution of Norwegian agricultural policy making. This institution differs from the norm in one important aspect: Norwegian farmers' organizations enjoy the legal and exclusive right to annually enter negotiations with the government about agricultural policy. The assumption of the pluralistic political model is no

longer given in the case of agricultural policy making in Norway. The right to negotiate is unique for Norwegian farmers compared to farmers in other developed countries, and it is also special for self-employed people in Norway.

We will provide a description of the so-called *Basic Agricultural Agreement* (BAA) of 1950, which formally grants the farmers' negotiation rights. Our description is based on public documents and on semi-structured interviews with past and current stakeholders in Norwegian agricultural policy. We interviewed BAA negotiators, both from the farm organizations and from government, members of parliament, and representatives of interest groups that do not participate in the negotiations. As some informants have required anonymity, no direct citations will be provided.

The paper continues as follows. The next section contains a brief overview of agriculture and agricultural policy in Norway, followed by a detailed description of the agricultural decision-making process in Norway. The fourth section outlines the analytical and empirical work to be undertaken as part of the institutional analysis. The last section discusses the findings offers conclusions, and suggests directions for future research.

2. Agriculture and agricultural policy in Norway

Over recent decades, Norwegian agriculture (including forestry and the food industry), like agriculture in most other developed Western countries, has undergone considerable changes. The share of national GDP shrank from 7.4% in 1970 to 2.5% in 2005 (Statistics Norway 2011). Similarly, the sector's labour force declined from 13.8% to 4.4% during the same period (Statistics Norway 2011). Still, as only three percent of total Norwegian land area is productive in agriculture, agriculture and the public goods associated with it are of particular interest to society.

The agricultural sector in Norway is subject to extensive government intervention, including market regulations and subsidies. More than two-thirds of the total value of the sector's production depends on market price support (i.e., higher domestic prices compared to international prices) and budget support (OECD 2010). Within the legal framework of international and bilateral trade agreements, Norway uses trade policies such as tariffs to protect domestic food production from import competition. Support policies range from broad programs providing output subsidies and general payments for acreage and animals, to quite specific programs like agri-environmental support and payments to maintain endangered cattle species. Norway is a rich country due to natural resources (oil, gas and seafood). This enables the country to run a large public sector without deficit spending. As a consequence, budget support to agriculture accounts for less than 1.5% of total state spending (including social security) in 2011 (Ministry of Finance 2011).

The government's current official goals for Norwegian agriculture are formulated in the Parliament's White Paper No. 19 from 1999 (Ministry of Agriculture and Food 1999). Broadly stated, the objectives are much like those found in the preambles of agricultural legislation in comparable countries: to ensure a stable supply of food, a fair standard of living for the farming community, and sustainable production methods. Another official policy goal is to maintain the "multifunctional role of agriculture." Multifunctionality includes the production of public goods associated with agricultural activity, such as national food security, preservation of cultural landscapes, and maintenance of the livelihood of rural citizens. One might argue that the objectives of Norway's agricultural policy are ambitious when compared to those of Switzerland, the EU, or the US. This is especially true for the objective of supporting the farming community's standard of living, which seems to be the principal pursuit of agricultural policies actually in operation. The White Paper states that agricultural policies shall provide measures to

put farmers in a position to participate in an income development comparable to that of other groups.

3. The institutional structure of Norwegian agricultural policy formation

Similar to many other democratic countries, the arena for agricultural policy decision-making in Norway is open to individuals and all kinds of organisations with an interest in the topic. Contrary to many other countries, however, in Norway there is a formally established institution, the *Basic Agricultural Agreement* (BAA), that grants the two farmers' organisations¹ direct bargaining power in the agricultural policy decision-making process. The BAA was established in 1950, a period characterised by the rebuilding of the Norwegian economy after the devastation of the Second World War, and by favourable political conditions for agricultural interest groups. The BAA grants the farmers' organisations the legal and exclusive right to enter annual negotiations over agricultural support measures, and at the same time excludes all other interest groups from taking part in these negotiations. This feature places the Norwegian model into the corporatist view of interest representation as it constitutes "*a monopoly of representational activity*" (Schmitter 1970).

The BAA negotiations process can be divided into three periods: the preparation period prior to the negotiations, the period for the negotiations proper, and the period in which Parliament conducts ratification procedures.

An important aspect of the preparatory period is the collection of data on the agricultural sector's economic and environmental situation. The Budget Committee for Agriculture (BFJ – *Budsjettnemnda for jordbruket*) consists of government and farm representatives. Many of them

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¹ The Norwegian Farmers' Union (*Norges Bondelag* - NB) and the Norwegian Farmers and Smallholders Union (*Norsk Bonde- og Småbrukarlag* - NBS).

are also engaged in the negotiations. The BFJ's main products are two datasets: The Economic Accounts for Agriculture and the Farm Accounts. The Economic Accounts presents an overview of agricultural market income, costs and of direct government payments to agriculture. Together with data on the agricultural labour force, the Economic Accounts are used to calculate a widely recognized and politically important statistic namely the *net agricultural income per man-year*. This number is frequently used to compare agricultural income with industrial wages and income of other self-employed people. The Farm Accounts contain data gathered from about 850 representative farms, and describe the previous year's agricultural revenues, costs and receipts of direct government payments, which reflect Norwegian agriculture's current income situation. A third dataset stores information about the regional and national development of important indicators like production, input use (including land use and the employment of the agricultural labour force), farm structures, income, and trade. The government considers the EAA to be vital to its preparation for the BAA meetings, as it tells how agricultural income (defined as return to labour and own capital per man-year in agriculture) is expected to develop in upcoming years.

The preparation period starts in early autumn and lasts until the negotiations start in the end of April. The two farmers' organizations prepare themselves separately, then meet before the negotiations period to compromise on a uniform opening proposal. As a first step, the NB prepares a negotiation guide that explains the outcome of the previous negotiations and discusses potential issues relevant to the up-coming negotiations. The guide is distributed among members and lays the foundation for discussions in the farmers' organizations' upcoming local and regional meetings. At these meetings declarations are developed, which provide input to the national organization, which collects and analyzes them in preparation for the BAA negotiations. There does not seem to be much communication and flow of information between the two organizations in that period.

Before the two farmers' groups present their opening proposal, the NB conducts separate negotiations with representatives of the Federation of Norwegian Agricultural Cooperatives (*Landbrukssamvirke*), an umbrella organisation of farmer-owned cooperatives. Cooperatives are generally the immediate purchasers of the farmers' products, and include dairies, slaughterhouses, and grain storage facilities. The cooperatives act as the official regulators of the markets in which they participate, and are responsible for ensuring that farmers receive the (administrative) farm-gate prices once ratified by Parliament. For example, milk market regulation includes private storage, price support for certain industrial uses and feed, distribution of milk to schools, and subsidization of exports. The dairy cooperative has the exclusive right and duty to perform these tasks. Market regulation is financed through an obligatory "check-off" market regulation fee per unit of commodity output. The fee is collected from all farmers that deliver agricultural commodities eligible for market regulation to any food firm, whether owned by private investors or cooperatively. A commodity market board decides upon the levels of the fees and the levels of the various regulation measures to be implemented by the cooperatives. The board is comprised of government representatives as well as farm and food industry representatives, with the latter holding a simple majority. There is no government spending on market regulation which forces the sector as a whole to avoid commodity surpluses.

The NB and *Landbrukssamvirke* reach a formal agreement on the content of the farmers' organizations' opening proposal. Thus, the cooperatives are heavily involved during the preparatory period, so while they take no formal seat at the BAA negotiations themselves, ultimately they do influence the BAA agreement, and at the BAA meetings the farm group's negotiators balance several interests. The farm groups' negotiators' strategy behind the first proposal generally is to propose administrated prices high enough to signal to their members that

their initial stance is a firm one, but low enough to signal to government negotiators (and to the Norwegian public in general) that they are sincerely willing to negotiate.

The government starts its preparatory period with a budget conference in early March, at which all Ministers assemble for several days to agree upon the major principles and directions of the next budget process. Under the lead of the Ministry for Agriculture and Food (LMD – *Landbruks- og matdepartementet*), the Ministers put together what will be the government's counter-offer, to be presented at the BAA negotiations after it has received the farm groups' opening proposal.

The negotiations themselves take place in the second phase of the process, which begins with the farmers' organizations putting forward their first claim. The government responds with its initial offer to farmers. Commonly there is a large discrepancy between the first claim and the first offer. The negotiators spend several days studying the other's position, after which they resume negotiations. In general this phase of the process may take a maximum of one week, and the parties manage to resolve those issues that do not require formal approval from leadership in the legislative or executive branches of government, as only relatively minor bureaucrats represent government at this stage of the negotiations. Later, the executive branch involves itself in determining the 'frame' of Norwegian agricultural policy for that year (where 'frame' is defined as the annual change in support to agriculture paid for either through taxes that go to agricultural budget support, or by way of the food bill, which is affected by administrated prices). The Minister of Agriculture and Food and the Minister of Finance take roles in this determination, and, especially in case of a coalition government, so does the office of the Prime Minister. At this point in time, the negotiations take place between the heads of the two delegations and some key personell involved from both sides.

The second phase ends when these negotiations end. They may or may not result in agreement. In case of agreement, the parties pass on to Parliament for its approval the ‘set of agreements for agriculture’ which describe the (new) agricultural policy instruments to be instituted and used until the next year’s agreement. If negotiations break down, the government sends its offer to Parliament, even though it has not been accepted by the farmers’ organizations. Either way, Parliament must approve a policy to be instituted. The farmers’ right to negotiate in the coming year is not affected by whether agreement is reached. As has been mentioned, however, ultimately frequent farmer agreement is necessary for the negotiation system to survive.

In the third phase of the process, Parliament begins work, starting with the negotiation results. The Standing Committee on Business Affairs takes the information about the concluded negotiations, and from it prepares a brief for Parliament. This brief is adopted by Parliament after a short debate. The conclusion of the negotiations in mid May and the preparation of the brief result in only short time for Parliament to debate the negotiation result. Usually, the negotiation outcome is adopted after a brief Parliamentary debate in the last week before the Parliament’s summer break.

4. Analysis

The policy institution is analysed in different ways. First, a regression model is developed to test the main drivers of the ‘frame’ and its distribution. Second, we discuss the potential elements of a formal model that aims to bring insight to the main features of the decision-making process.

4.1 Regression model

We will analyse two regression models. In the first model the dependent variable is the ‘frame’, defined as the annual transfer provided by government policy, and received by farmers from

taxpayers and consumers. In the second model, the dependent variable is budget support (i.e. direct transfers from taxpayers to farmers) only. We will conduct statistical analysis whether how direct transfers are dependent upon the following variables, and how any such dependences differ between the two models:

Variables that Affect the Size of the Frame but Are Exogenous to Agricultural Policy Makers:

- the market interest rate (We expect a positive sign as a low interest rate reduces costs and the amount of money necessary to maintain agricultural incomes.)
- the export value of oil and natural gas (We expect a positive sign as high values create budget surpluses that make it “easier” for government and non-farm interest groups to accept higher support to agriculture.)
- the industrial wage rate (We expect a positive sign as high industrial wages increase the income gap and allow farmers to argue on equity grounds for increased transfers.)
- the unemployment rate in the non-agricultural sector (We expect a negative sign as a high unemployment rate tends to require government payments to the unemployed, potentially withdrawing resources that otherwise might be used to support farm income. Also, a high unemployment rate is an indication of a weak economy, in which decreased tax revenues encourage tighter budget discipline.)
- world agriculture prices (We expect that the sign could be positive or negative. As higher world prices would make liberalization of Norwegian agricultural policies less harmful to farm income, and therefore politically less objectionable. On the other hand, with higher world prices, the cost of using policy to achieve a given level of farm income falls, which would encourage additional support.)

Variables that Affect the Size of the Frame And Are Determined Endogenously within the Agricultural Political Economy:

- domestic agricultural income (Setting higher administered agricultural prices increases the value of farmers' production, but increased farm revenues might tend to discourage government support.)
- agricultural area (Well-kempt land in agriculture is valued by many Norwegians, and thought to have positive external effects. Norway is mostly forests and mountains, and Norwegians enjoy to civilized beauty offered by prospering farms. The amount of land in agriculture, and the ability of farmers to maintain their land and buildings, depends on policy, and policy may be influenced by the amount of farmland and how well it is maintained.)

In sum, we use exogenous variables and endogenous variables in order to test whether the main drivers of the negotiation outcome can be related to aspects that are not controlled by agricultural policy-makers (exogenous variables) or whether agricultural variables indeed have an impact on the negotiation result. The endogenous variables constitute a problem of econometric identification as the direction of causation may not always be clear: Is it policies that maintain agricultural area, or is it the amount of agricultural area that keeps government support at high levels. This econometric challenge will be deal with in the analysis.

4.2 Formal model

The political economy modelling question to be approached by the formal model is whether the institution of the BAA can be explained by transaction costs (Dixit 1996) or by the existence of a small focused interest group (Becker 1983). Regarding the latter, Norwegian farmers are obviously a small focused group in contrast to the unorganized heterogenous group of consumers

and taxpayers. This feature, however, applies to many countries in the developed world, and is, as such, not specific to Norway. In the US, the legislature writes a new Farm Bill every five years. All interest groups have formal avenues of input and legislators from rural and urban districts can influence the writing of the bill. In the EU, legislation is also passed periodically to change the Common Agricultural Policy. All member states have input to EU policy, and there is not exclusion of non-farm interest groups from a nation's formal debate. Dixit (1996) argues that the smallness and homogeneity of a country may play an important role in the evolution of a political system. In particular, it may enable those countries *“to cope with transaction costs in a way that would be difficult for a larger or more heterogeneous country to match (...) In a homogenous country with a greater sense of identity and common purpose, or a small country where such opportunism can be more quickly observed and exposed, it may be possible to develop long-term reputation or punishment arrangements that limit the costs of the moral hazard”*.

The description of the different phases of the negotiations indicates so far that there exist at least two interconnected principal-agent relationships:

- A principal-agent relationship between the Parliament (principal) and the negotiation bodies (agent). It seems that the Parliament has outsourced the task of searching for and designing agricultural policies. The Parliament is still in charge of approving the negotiation result. However, our hypothesis is that there is an information bias between the Parliament and the negotiators, with the latter being better informed. Hence, the political system allows the negotiators to extract an informational rent that probably materializes into higher support agriculture than would be the case otherwise.
- A principal-agent relationship within the negotiation body. The overall body constitutes the principal, while the heads of the two negotiation committees are the agent. There is

evidence that the final result is brought about in small informal meetings between the heads of the two negotiation committees indicating an informational rent for the agents. It is not clear how this informational rent materializes. One working hypothesis would be that the rent materializes in higher support, but this would also assume different preferences between the bureaucracy in the ministries and the Ministers. We also think that the principal-agent relationship within the negotiation body is less pronounced if there is a coalition government compared to a minority one-party government. In a coalition government, the head of the government's negotiation committee has less power, because the coalition parties must compromise on the government's negotiation mandate, which make the office of the Prime Minister the key player in the negotiations.

Apart from the two principal-agent relationships, we believe that it is important to study the relationship between the ministry of agriculture on the one hand and the ministry of finance on the other. This concerns not only the size of the 'frame', but also its distribution. The Ministry of Finance seems to place a higher priority on keeping budget support at low levels, while it is less concerned about the size of the total 'frame' which then often leads to an increase in administrative prices.

5. Discussion

In this part, we will discuss the results of the regression models and the game-theoretic model. The results will be compared to pluralistic policy making that underlies agricultural policy making in most developed countries. The results will also be compared to policy making for other self-employed in Norway, namely private-practicing doctors.

In their role as farmers, Norwegian farmers are self-employed. As already stated, prices and income transfers to farmers are determined in negotiations between farm-sector

representatives and the government. Similarly, part of the Norwegian health sector includes private-practicing doctors not employed in hospitals, who are paid by the Norwegian government to provide health care to citizens. The fees that these doctors can charge the government for various medical procedures are established in negotiations between the government and representatives of the self-employed doctors' organization (*Legeforeningen*). Farmers and private-practicing doctors enjoy quite similar conditions with respect to their participation in the process of determining their economic conditions. Medical treatment, however, is not a public good to the same extent as public goods provided by agriculture. Medical treatment is primarily a private good which benefits the health of the citizen receiving it. There are public good aspects of health care, as healthy people are more productive for society. Also, the users of medical treatments do not have to pay specifically for their benefits – nor do the consumers of public goods provided by agriculture.

Contrary to their Norwegian counterparts, farmers in the EU, Switzerland and the US are not granted an institutional role of direct participation in policy decision-making. They exercise their influences through lobbying activities, in line with the lobbying activities of all the other interest groups in a pluralistic and democratic society.

The anticipated main result of this research is that the institution of agricultural policy making has a significant impact on policy formation. The study of institutions thus becomes essential, therefore, when it comes to the explanation of observed agricultural policies. Quite frequently, agricultural policies are explained by either specific policy objectives (e.g., like public goods aspects of agricultural activity or income concerns) or by public choice arguments (voters, political power of specialised interest groups). This paper illustrates that the policy decision-making process as such can play a decisive role in explaining observed policies.

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