

Fisheries

ENSURING A FAIRER DISTRIBUTION OF WEALTH GENERATED BY FISHERIES

- ▶ The Icelandic fishing sector is on a sound footing economically and environmentally, but consolidation has reduced its traditional role of providing jobs and an economic base in rural areas.
- ▶ The market-based approach to allocating fishing quotas is highly efficient and reforms should not undermine its benefits.
- ▶ Initial allocations of fishing quotas in the 1980s created windfall gains for a relatively small number of incumbents. These are a potential revenue source for the fiscally-strained government.
- ▶ How to share windfall gains through resource taxes and which tax rate to choose have become a politicised debate. Automatic compensating mechanisms built into the quota system could be a better approach.

What's the issue?

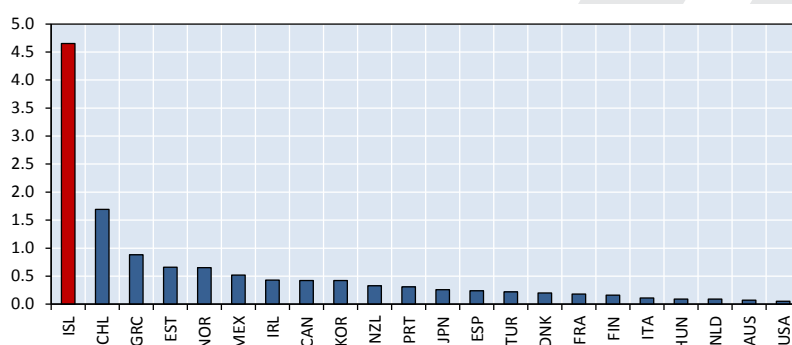
Iceland has one of the most economically efficient fishing sectors in the OECD, thanks to its market-friendly policies and strict management rules. Iceland's challenge now is to ensure that the wealth generated by the fisheries sector is fairly distributed and that future growth is inclusive. Calls for enhanced fiscal burden-sharing increased significantly after the financial crisis of 2008, which put pressure on other parts of the Icelandic economy, and there is now a lively debate on how to fairly distribute fishing rights and share resource rents.

In 1984, Iceland introduced Individual Tradable Quotas (ITQs) to prevent overfishing and achieve sustainability.

Such market-based measures have a proven track record of improving the sustainability and profitability of fisheries. The OECD has been promoting their use for more than two decades. However, there are two possible problems with introducing ITQs. First, initial free allocations of these quotas, typically made on the basis of historical participation in fisheries, can generate windfall gains for holders. Second, such systems can lead to industry consolidation that can have undesirable distributional effects for a sector with strong regional and traditional roots. Iceland has been dealing with the consequences of these two problems since the outset of their ITQ system.

» Fisheries are a major employer in Iceland, accounting for nearly 5% of the labour force

Fisheries employment as percent of civilian labour force, most recent year available



Note: The employment figures refer to fishing only and do not include fish processing.
 Source: OECD Agriculture Statistics database, <http://dx.doi.org/10.1787/data-00219-en>.

Initially distributing ITQs at no cost to current fishers is usually necessary to gain industry consent, and more politically acceptable when initial values are low due to depleted fish stocks. But the value of these quotas can soar when the stock recovers and profitability grows. To claw back some of these gains, the industry has been subject to a fishing fee since 2002 and a special resource rent tax on extra profits was introduced in 2012.

Initially distributing fishing rights via an auction can avoid the windfall gains problem, but it is too late for Iceland to take this approach. So, what is the best approach at this stage? Resource taxation can be a good approach in principle, but in practice it has led to a highly political debate on the best tax rate. Fishers complain that this leads to uncertainty about their potential tax burden, thus discouraging investment (though this effect may be strategically overstated by fishers opposed to resource taxation).

A better approach would be to have mechanisms built into the quota system that systematically address benefits sharing. Such mechanisms cannot easily address existing quota rents, but they could still be beneficial in the long run as productivity gains lead to continued growth in resource rents. One example would be for quota holders to issue call options that could be exercised by the government if the rent from the annual catch exceeds a predetermined threshold. The value of the call option would vary in direct proportion with the value of quota rents. The earlier such a system is established, the more the government can share in any run-up of quota values (resource rents).

In order to prevent undue consolidation of fishing rights, limits on ownership of quota by individual firms have been set which range from 12% to 35% of the total for each species. No fishing company or group of companies is permitted to hold more than 12% of the value of the combined quota shares for all species. To maintain access for smaller fishers and maintain rural activity, a separate system is in place for smaller vessels. These boats get quotas for many major species and can freely transfer the quotas within this system. While setting limits on consolidation of quotas is effective, it comes at a cost of reduced overall efficiency.

Why is this important for Iceland?

In 2013, fish products accounted for 26% of total exports and fishing and fish processing represented 9.4% of GDP. The fishing industry is also a major source of employment, accounting for 4.7% of the civilian labour force in 2013 (see Figure). Maintaining a healthy fishing sector is crucial to the overall economic success of the country.

The windfall rents enjoyed by quota holders who were part in the initial allocation process combined with the strong profits enjoyed by the sector have led to an uneasy social situation, in particular in light of the general economic difficulties. The challenge is to find a more inclusive arrangement that fairly shares the benefits of Iceland's fishing stock and generates additional government revenues without reducing efficiency in the fisheries sector.

What should policy makers do?

- ▶ Define a mechanism to share resource rents that all stakeholders can agree on in advance, recognising that resource rents will vary over time but likely trend upward. One example would be call options on quotas that would provide an automatic market-based redistribution mechanism as values change.
- ▶ Focus on economic diversification, such as seen in the rapid growth of tourism, as a source of rural economic development, while avoiding to put additional pressure on the environment.



Further reading

OECD (2013), *OECD Review of Fisheries: Policies and Summary Statistics 2013*, OECD Publishing. http://dx.doi.org/10.1787/rev_fish-2013-26-en

Haraldsson, G. and D. Carey (2011), "Ensuring a Sustainable and Efficient Fishery in Iceland", *OECD Economics Department Working Papers*, No. 891, OECD Publishing. <http://dx.doi.org/10.1787/5kg566jfrpzzr-en>