

# The pros and cons of fishing fees: the case of Iceland

by Thorvaldur Gylfason

**In the debate on alternative means of controlling fishing in Icelandic waters, various arguments for and against the sale or lease of fishing rights (i.e. quotas) by the Government have been put forth on both sides. This article covers the main arguments, and explores the relevance of the debate for the serious economic (and political) difficulties confronting Iceland at present, including Iceland's reluctance to apply, like her partners in EFTA, for membership in the EC.**

The article begins by reviewing the main arguments that have been used against selling or leasing quotas as opposed to giving them to fishing vessel owners free of charge, as is done presently (with minor exceptions). These arguments reflect, in the main, concerns that selling fishing rights may (a) lead to increased taxation and government spending; (b) impose a heavy burden on the fishing industry; (c) jeopardize the viability of fishing towns around the country; and (d) concentrate quotas in the hands of fishing vessel owners who may have special, perhaps politically motivated, access to State-controlled credit. Then, attention is turned to the arguments for selling quotas or, equivalently, levying fishing fees. These arguments, as we shall see, concern both efficiency and fairness as well as macroeconomic stability and, conceivably, Iceland's future relations with the EC. Many of the arguments reviewed below apply also to Norway, *pari passu*.

## 2. Fees versus taxes

Let us first take a look at the tax-and-spend argument. Will the sale of fishing rights by the government lead to increased taxation and an expansion of the public sector? Not necessarily. The revenue from the sale of fishing rights is not like regular tax revenue. Rather, it is a payment for the exploitation of common fishing grounds. For the use of the property of others we pay rent; such payment for the use of housing is not to be seen as a tax even if the property

belongs to the State. Thus, the income from selling quotas is a rent payment and not a tax even if it is collected by the State.

Of course, there is ample reason to be wary of ever-increasing tax collection by the State and municipalities. Yet, excessive reluctance in these matters must not be allowed to retard normal progress in public policy. The main point here is that economic efficiency can be increased by changing the composition of taxation without changing the overall tax burden. It is possible to raise one type of tax and lower other taxes commensurately to increase efficiency. Such changes have often been carried out successfully in the past. Recent tax reform in several European countries geared towards lower income taxes, financed by eliminating tax exemptions and thereby widening the tax base, is a case in point.

Pollution fees are another good example. Pollution is a better tax base than labor income because pollution fees promote cleaning up the environment whereas income taxes can act to decrease honest willingness to work. Fees for fishing permits are efficient just as pollution fees because they discourage fishing efforts, thereby promoting conservation of fish stocks and a smaller fishing fleet. A levy on pollution is thus not really a tax but rather a fee for the use of a clean environment.

Clearly, it makes good sense to replace inefficient taxes with efficient ones whenever possible. Thus, there is no reason to expect the Government to spend the proceeds from fishing fees. However, low taxes and expenditures are not the sole target of fiscal policy at present. With many urgent

projects waiting (poorly paid school teachers are a case in point), the Icelandic Government might actually consider spending more and refraining from cutting other taxes for a while, but that is another matter. Nevertheless, it is necessary to reduce or eliminate the Government budget deficit, broadly defined, to preserve price stability at present after many years of persistent double-digit inflation.

If the Government is unable to make ends meet by reducing spending it must raise new revenue in the most efficient way possible. Pollution fees and fishing fees are efficient levies from every angle. Through such fees, the financial position of the Government can be strengthened to create room for lowering direct and indirect taxes later on to stimulate the economy. Structural changes of this kind would be a natural continuation of recent tax reforms in Iceland and several neighboring countries.

## 3. Profitability

Let us now look at the next argument. Would a fee for fishing rights put too much financial strain on the fishing industry? My answer is: No, at least not in the long run. There is no reason to believe that the fee accompanied by appropriate supporting measures would burden the industry as a whole in the long term. On the contrary, the fee is intended to increase efficiency and thereby strengthen the firms that would remain in the industry. The earnings of the nation as a whole from fishing would not change - as before, maximum allowed fish tonnage would be caught and sold at world market prices. However, the total cost of fishing would decrease since the fishing firms would send fewer ships to sea and their profit would increase. Yet, fishing fees would decrease the profit net of the fees. Therefore, some have argued, the fishing firms should perhaps have a share in the receipts from the charges in the beginning. This would make up for some of the lost profit and ensure that a necessary increase in efficiency would not be held up

The author is Professor of Economics, University of Iceland, and Senior Research Fellow, Institute for International Economic Studies, University of Stockholm, and CEPR.

by quarrels over the distribution of the gains. Efficient fishing firms would have no difficulty in paying the fees, judging by the large sums many of them have paid other less efficient firms for transferable fishing rights in recent years - as has been permitted by law within limits.

However, it is likely that fishing fees might drive some inefficient firms out of business. This is natural. The fishing fleet has to become smaller; there is no dispute over that any more. The main purpose of fishing fees and free trade in quotas is precisely to ensure that the fishing rights land in the hands of the most efficient firms. This will ensure a smaller fleet and the greatest possible efficiency in the fishing industry and in the national economy as a whole in the long run.

#### 4. Would the small towns around the coast come to ruin?

Thirdly, some have expressed worries that the small fishing towns in Iceland would be jeopardized by fees for fishing

rights. These concerns are understandable. However, it must also be understood that new jobs will be created to make up for lost jobs in fishing. This will happen automatically but may take some time and require some relocation. A transfer of labour and capital from the fishing industry is a prerequisite for the development of manufacturing, trade, and services that must become the growth hubs of small towns around the country. It makes no sense to maintain inefficient enterprises in operation out of fear that nothing will replace them. A growing economy, on the contrary, needs efficient firms to replace less efficient ones all the time. In recent years, the fishing industry has provided work for 12 per cent of the labour force in Iceland, generating 12-15 per cent of the country's gross domestic product (GDP), a bit more than a half of total export earnings, and 70-80 per cent of merchandise exports (excluding services).

The preservation of a reasonable geographical balance in the distribution of the population is a natural objective of the

Government, in Iceland and elsewhere. The Government should choose a rational route towards this goal so as not to stand in the way of natural economic progress. Increased local autonomy and self-responsibility are a better way to improve economic conditions in coastal areas than continued government-sponsored credits to finance everlasting losses of unprofitable enterprises. If it is deemed right to use public funds to support rural areas this should be done directly by improving roads, schools, and other infrastructure, for example, through direct grants rather than by tying the assistance to fishing and farming. Indirect support, such as by granting fishing vessel owners free access to the fishing grounds, is less efficient and is, therefore, more costly in the long run.

#### 5. Banks and finance

Now we turn to the fourth and last main argument that has been used against charging fees for fishing rights in Iceland. Some have argued that government-owned banks and loan funds cannot be fully trusted to base their lending policies and loan decisions solely on economic considerations. If so, it has been said, fishing rights could end up in the hands of those who have the best access to banks and funds, perhaps through political connections.

It is urgent in my view that the political control of the main banks be abolished, as the Icelandic Government now intends. The planned privatization of the commercial banking system, two-thirds of which is presently owned by the State, is expected to lead to more efficient banking and financial intermediation. At the same time, it will, if all goes well, create a healthy environment for free trade in fishing rights and for business and commerce in general. Thus, the argument that public banks and loan funds have discriminated between customers in the past is not a valid reason to reject fishing fees and free trade in fishing permits at present, or to oppose free markets in general for that matter. It would do better to accelerate the restructuring of the bank-



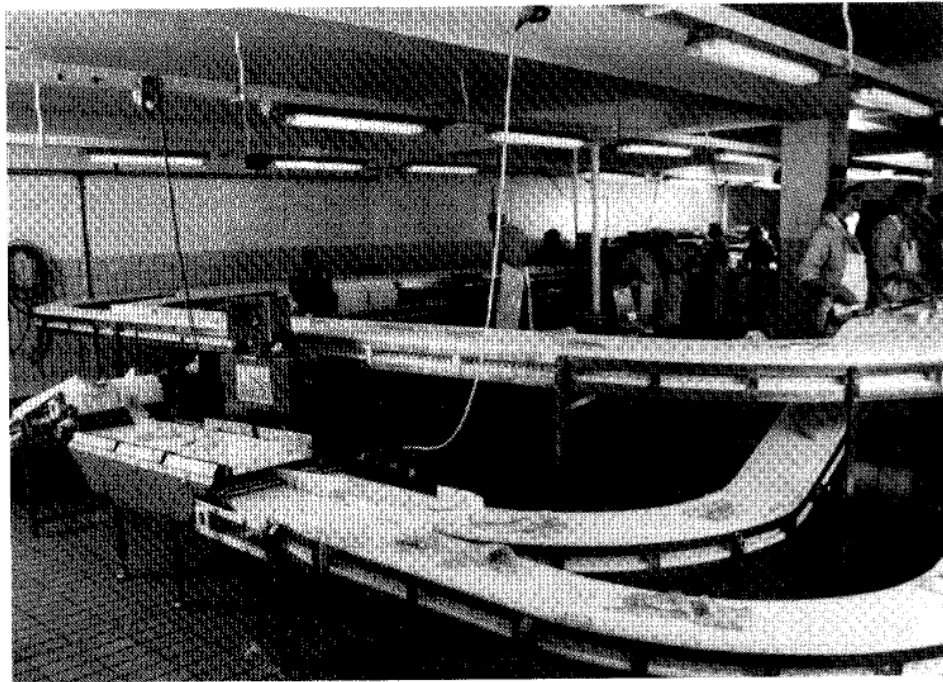
ing system to reduce political influence on lending policies and loan decisions.

There is another aspect to this argument. Some have maintained that fees would cause fishing rights to come disproportionately into the possession of the wealthiest fishing vessel owners as the poorer ones could not afford to purchase any fishing rights. This is not a good argument, for it could be used against free trade in general. Should the Government want to equalize the incomes of fishing vessel owners and the rest of the population, it ought to bring this about by general changes in tax and transfer policy, rather than by selective methods that disrupt healthy price formation and hamper efficiency in the economy.

## 6. Efficiency and fairness

The proponents of fees for fishing rights have based their case on two main types of argument. First, they have claimed that charging a fee is more efficient than the present "free" allotment of transferable fishing rights. Specifically, they have argued that selling fishing permits rather than giving them away for free would (a) accelerate the necessary rationalization of the fishing industry; (b) improve the Government's financial position through a more efficient composition of revenue and thus contribute to the fight against inflation; (c) pave the way for policies to diversify the economy by stimulating manufacturing, trade, and services; and (d) possibly clear the way for Iceland to join the EC. Second, charging fees for or selling fishing rights rather than giving them to fishing vessel owners free of charge has been called for on grounds of fairness - in order to grant the nation as a whole, the rightful owner of the fishing grounds by Icelandic law, just dividends from their common property resource.

Consider the efficiency arguments first. It is now widely agreed that the maximum allowed fish catch could be brought on land by about 60 per cent of the present



fishing fleet. By gradually reducing the fleet down to an efficient size, each year a sum of money amounting ultimately to about 4-5 per cent of gross national product (GNP) could be saved. (This amount, incidentally, is equivalent to all personal and corporate income taxes levied by the Icelandic State.) Similar logic holds for other fishing nations as well. Efficient management of fishing grounds all over the world could lead to total savings of the magnitude of \$20-30 billion (i.e., 15-20 billion ECU) per year.

It makes no major difference in this context whether fishing rights are subject to a rent payment collected by the Government or sold on a market (by auction, for instance). Both methods would, in principle, ensure the same results. It does not make much difference either if the returns from the fee are retained by the Govern-

ment or redistributed among the public. However, in a country that for a long time has been plagued by government budget deficits, high inflation, and mounting foreign debt, it seems reasonable to use the revenue from fishing fees to balance the budget to keep inflation and external indebtedness in check.

We can examine the argument for fishing fees from another point of view. Continued development of manufacturing, trade, and especially services is a prerequisite for rapid economic growth in Iceland as in other high-income countries. In order to create a sound environment for growth in these sectors, it is necessary to free redundant capital and labour now tied up in the fishing industry (and in agriculture). Charging for fishing rights (along with something similar in agriculture) seems to be a better way of bringing this about than the giveaway quota system in use at present. Yet, it is possible that free trade in transferable quotas (initially distributed free of charge according to the mean catch in 3-5 prior

<sup>1</sup>Arnason, Ragnar: "Efficient Management of Ocean Fisheries", *European Economic Review* 35, April 1991, pp. 408-417.

years) would suffice to release capital and labour from the fishing industry little by little under the present system. This process would, however, probably take a longer time than under the proposed system of fees combined with free trade in quotas.

There is yet another aspect to this argument. It is impossible to beat inflation in Iceland permanently unless at least two conditions are met. First, the government budget deficit, broadly defined, must be brought under control. Second, wasteful economic policies must be abandoned to create conditions for substantial rationalization, especially in fisheries and agriculture.

Continued budget deficits call for monetary expansion, persistent pressure on inflation and interest rates, and mounting foreign and domestic debt. Recurrent problems of many fisheries lead to repeated calls for help from the Government, be it through devaluation or foreign loans funnelled to troubled firms, for instance. Both types of assistance tend to increase inflation. The persistent problem of inflation in Iceland over the years can be traced to a considerable extent to insufficient fiscal and monetary restraint and to misguided efforts to rescue the fishing industry.

Fishing fees would make it easier to balance the government budget, but not necessarily by creating extra income for the Government. It would yield essentially the same result to issue a transferable bond representing a share in the economic rent of the fisheries to each and every Icelander of legal age. This would strengthen family finances considerably and thus, in time, enable the Government to reduce or eliminate the budget deficit by spending cuts or tax increases, including higher fees for various government services. Thus, a major cause of high inflation in recent years would be history.

Unsurprisingly, opinions differ as to whether the proposed charge for fishing rights is fair or not fair. Some consider it fair that a handful of families be allowed to collect the entire economic rent from the fishing grounds around Iceland. Some also consider it fair that fishing quotas are handed out free of charge to relatively few individuals (the "insiders"), while others in the industry (the "outsiders") have to pay high prices for them. A more equal distribution of the economic rent among all Icelanders seems likely to be considered more equitable by most people. This was indicated by recent opinion polls conducted by the Institute of Social Research at the University of Iceland and by Gallup.

## 7. Icelandic membership of the EC

There is one more argument in this debate that needs to be discussed. It has been claimed that Iceland should not even consider joining the EC because the Common Fisheries Policy of the EC now in force is fundamentally incompatible with Iceland's national interest. This is essentially the position of the Icelandic Government (and, especially, of the opposition in Parliament) at present. Now it seems likely that most or all of Iceland's partners in EFTA will join the EC in a few years. Iceland might thus face economic and political isolation outside the Community, unless a way is found to resolve the deadlock.

The adoption of fees for fishing rights could lower or remove this obstacle separating Iceland from the EC. By imposing fees, Iceland could, in principle at least, offer EC nations formal access to the Icelandic market for fishing rights without

<sup>2</sup>For a more detailed outline of this proposal, see Gylfason, Thorvaldus: "Iceland on the Outskirts of Europe: The Common Property Resource Problem", *EFTA Bulletin* No 2/91, Vol. 32, April-June 1991.

offering them free access to the limited resource itself, in exchange for reciprocal access to European markets. If Iceland offered EC nations some fishing rights at a price, such rights would also have to be sold to domestic fishing firms in order to avoid discrimination by nationality in violation of the Treaty of Rome. It seems unlikely, however, that European fisheries could compete successfully with Icelandic firms in a free and fair market for quotas because the productivity of Icelandic fishing vessels is much greater than that of EC ones (with the possible exception of Spain). The annual catch of Icelandic fishing vessels is on average six times that of European vessels. In negotiating with the EC, Iceland ought to be able to make sure that fishing in Icelandic waters remains in the hands of Icelanders for the most part. After all, the objective of this proposal is not to open Iceland's limited and already overexploited fishing resources to further exploitation by EC nations, but rather to suggest a formal way of enabling Iceland to follow its EFTA partners into the EC to the benefit of all.

## 8. In conclusion

A rationalization of the Icelandic fishing industry must take place. If the fleet remains too large and the fishing industry keeps returning to the brink of bankruptcy every now and then, the Government will most likely continue to consider itself obliged to come to the rescue by devaluing the króna or by making other arrangements to the same effect at public expense. Inflation will then be impossible to keep at bay for long and living standards will decline. By charging for fishing rights and thus laying a firm foundation for improved efficiency and sustained profitability in the fishing industry, the need for recurrent rescue efforts by the Government could be eliminated. An important source of persistent inflation and economic waste in the past could thus be removed.