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Special taxation of fisheries

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ITQ-systems and fisheries taxation

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Two fundamental fallacies

Fallacy I

Profits in fisheries are generated by the resource and not by the fishing firms.

Corollary: Un-earned profits

Fallacy II

Resource rents can be taxed without negative economic consequences (economic distortions)

Corollary: A ideal tax base

Fallacy I

- Falseness follows from standard economic theory. (Resource is just one of many inputs)
- Easy to see why the claim must be false:
- If it were true
  - Why little or no profits (rents) in the 19th century? (Stocks 2-3 larger than now)
  - Why no profits 1978-1983? (Stocks much greater, cod catch 300-400 thousand tonnes)

Real reason for increased profits

The ITQ system has allowed:

(i) Rebuilding of fish stocks
(ii) Reduction in fishing effort and fleets
(iii) Rationalization of fishing and fish processing operations
(iv) Improved quality of landings
(v) Greatly improved marketing of fish products
(vi) Generated investment capital to further improve operations

N.B: Undertaken at great cost to the fishing industry!

Fallacy II

(Resource rents can be taxed without economic effects)

- A myth based on naïve interpretation of Ricardo's theory of rents.
  - Main proponent: The populist Henry George (1839-97); Georgeism
- No formal economic analysis to support this claim!
- On the contrary
  - Plenty of analysis show it is false

To see this ……

1. If rents are taxed, firms will elect to reduce rents to reduce the tax payment
   – A different fishing policy
   – A less conservative stock rebuilding policy etc.

2. The taxation will
   – Move capital (physical, financial and human) from the taxed activity
   – Lead to less discovery and innovative behaviour (less productive)
   – Discourage co-ordination to further overcome the common property problem

So,

Resource rent taxes are

(i) No less distortive than profit taxes!

(ii) Possibly more distortive (can exceed profits)

So resource rent taxes must be regarded/ assessed in this context

Special fisheries taxation in the Icelandic context

Many significant drawbacks

- Here only mention a few -

1. Erodes international competitiveness of the Icelandic fishing industry
   - Competitors (Canada, US, Norway, New Zealand, many EU-countries etc.) also have ITQs
   - They do not pay special taxes (rather subsidies)

   ⇒ Will gain a competitive edge

   - Will squeeze Iceland out of the most lucrative markets

∴ Export prices will fall accordingly

2. Reduces the competitiveness of the fishing industry domestically

$\Rightarrow$ Physical, human and financial capital will move out of the fishery (to other less productive industries)

$\therefore$ An economic distortion which reduces the efficiency of the Icelandic economy

3. Reduces investment in the fishing industry
   - Less expected benefits of investments
   - Less retained profits to invest
   - More risk (less profit margin, one more tax to worry about)
   - Higher rate of interest (increased risk to lenders)

∴ Less productivity growth

4. Reduces discovery and innovation in the fishing industry
   - D&I activity is inherently risky
   - Less expected benefits of this activity (due to tax)

   $\Rightarrow$ Less incentive to engage in discovery and innovation

$\therefore$ Less progress; tendency to stagnation

5. Reduces overall investment in the economy

- Increased risk (All industries use natural resources $\Rightarrow$ similar taxes may be imposed)
- Interest on foreign capital increases (more risk, less domestic funds for investments)

$\therefore$ Less economic growth

All of this contributes to weaker the Icelandic economy and reduced economic growth

A significant effect because of the economic importance of the fishing industry

- It is a base industry!
- Direct contribution to GDP ≈11%
- Direct and indirect effects ≈25% of the GDP

An example

Economic statistics

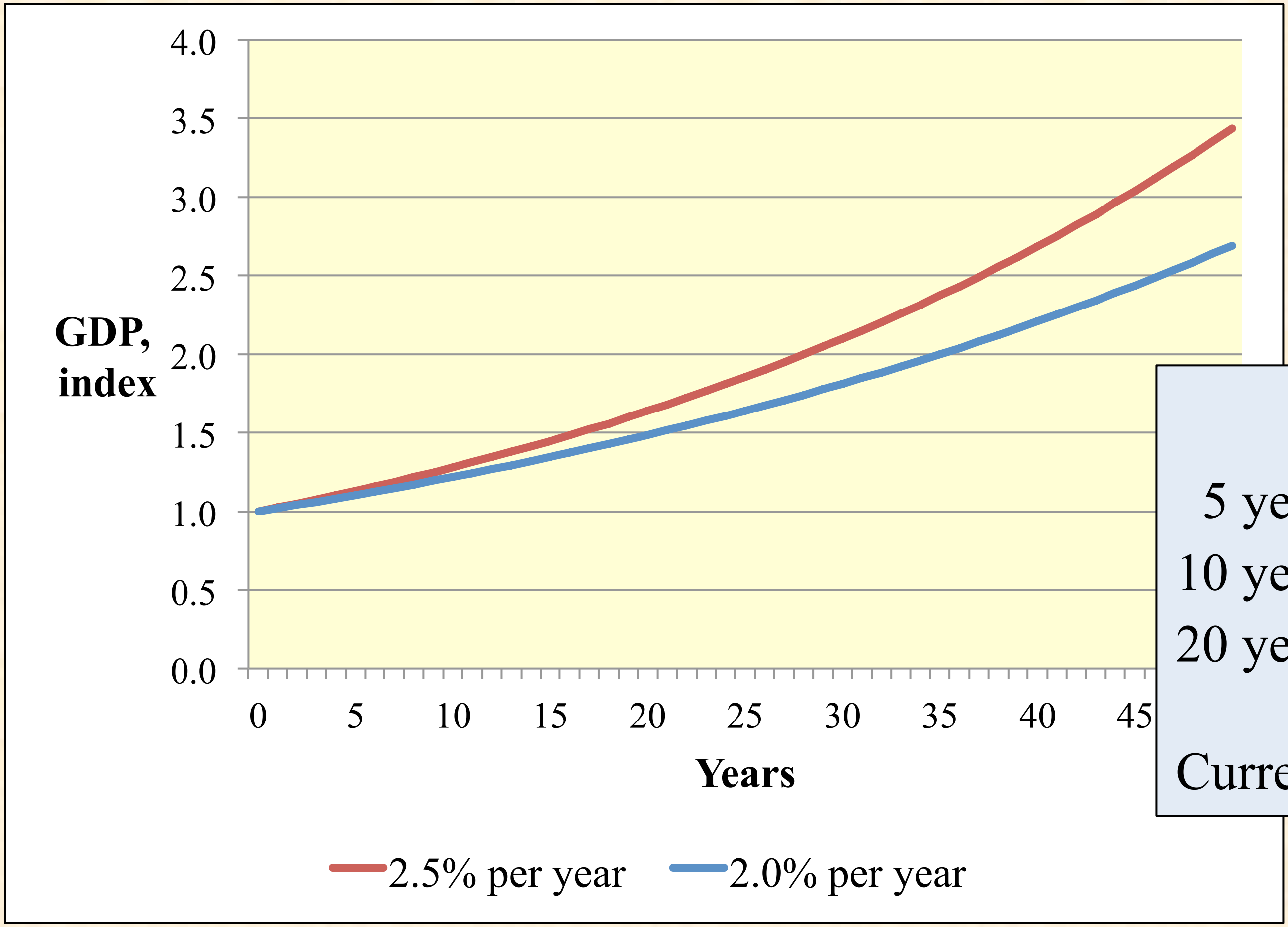
- Economic growth in Iceland has been ≈2.5%
- Fishing industry has contributed ≈0.7%

Assume:

Fishing industry contribution falls to 0.2%

$\Rightarrow$ Economic growth falls to 2%

Impacts on GDP



Difference

5 years=2.5% of GDP

10 years=5.0% of GDP

20 years=10.3 of GDP

Current GDP≈1750 mia

Motivation for special tax on the fishing industry

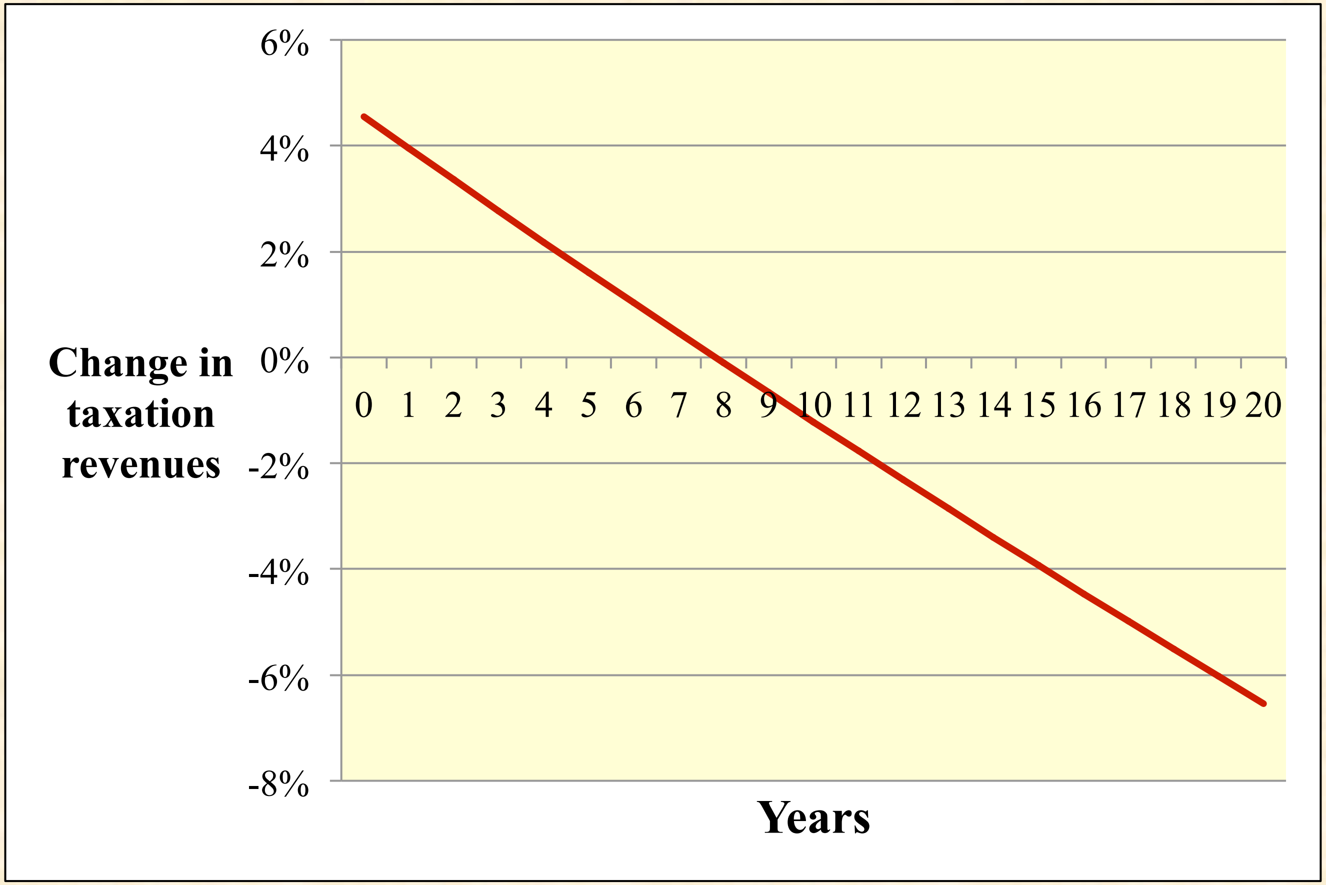
Generate revenues to pay for government services (hospitals, schools etc.)

But will this work?

Less economic growth counteracts fisheries tax

Change in total taxation revenues

(Initial resource tax 1.5% of GDP (≈26 mia))



Conclusions

- Special fisheries taxation will harm the Icelandic economy
  - Less economic growth
  - Fishing industry will be weaker
  - Fishing regions will suffer most
- Any increase in taxation revenues will be transitory
  - Taxation revenues will be reduced in the long run

END