

# EXECUTIVE COUNCIL

## CONFIDENTIAL

**Title of Report:** Fisheries Economic Efficiency Test and review of policy objectives  
**Paper No:** 85/11  
**Date:** 28 April 2011  
**Report of:** Director of Natural Resources

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### 1.0 Purpose

This paper sets out the status of the Economic Efficiency Test (EET) in Individual Transferable Quota (ITQ) fisheries. It also proposes a wider review of fishery policy objectives.

### 2.0 Recommendations

That Executive Council be advised to recommend that:

- (a) The economic efficiency test be applied as set out in paragraph 4.9, initially to the Loligo fishery and over a 6 month time scale.
- (b) The wider review of fishery policy objectives as set out in paragraphs 4.10-4.14 be undertaken on a one year timetable.

### 3.0 Summary of Financial Implications

None

### 4.0 Background

- 4.1** The subject of the economic efficiency test has been lingering on the Exco task status report. At various times it has become intermingled with the subject of resource rents and licence fee (or ITQ fee) levels. This paper deals with the EET and the wider review referred to in paragraph 1.

#### **EET**

- 4.2** In the policy discussion prior to the introduction of new fisheries law in 2005 the EET was articulated as

“The requirement for efficient use of rights is intended to encourage companies to make the best economic use of their rights. This means the

actual or expected economic return to the holder is commensurate with the value of the rights held and not inconsistent with the returns received by holders of similar rights over a reasonable period of ownership” (ExCo paper 290/03).

**4.3** Ultimately, the EET was enshrined in law as

“The Director shall refuse any application for registration of a company’s name upon an Individual Transferable Quota Eligibility Register unless he is satisfied —

(c) the company’s income and economic returns from taking, processing and sale of fish, or such of them as are relevant in the circumstances of the case represent, or as the case may be, if Individual Transferable Quota is thereafter granted, will represent, a sufficient return on the value of the rights held and one which does not, or as the case may be, will not, over a reasonable period represent a significantly lower rate of return than that received by holders of similar rights.” (Section 25(3)(c) of the Fisheries Ordinance)

**4.4** At its most basic the EET will measure turnover per unit of ITQ owned, together with turnover per unit of catch for comparison. The policy debate anticipated a test of that nature. Turnover generally equates to the sale value of the catch. Some thought has been given to whether other parameters could also form part of the test, such as gross profit, net profit, tax paid, level of assets/investment, etc. However, such parameters were not considered at the time of the policy debate and there may be all sorts of reasons as to why their value might vary. The essence of the EET is simply to ascertain whether the companies involved are getting a similar level of turnover per unit of ITQ or catch, and if not whether there is a sound explanation for the lower values. If companies 1-6 all achieve turnover of level ‘X’ per unit of ITQ or catch, and company 7 by comparison achieves ‘½ X’,

[REDACTED]

There may be an explanation but it would be investigated. FIG does not have to define what acceptable performance might look like it simply has to focus attention on those with what appear to be the poorest returns. There is obviously going to be some variation around the average. If the figures are  $\pm 10\%$  there might not be much ground for investigation whereas  $\pm 25\%$  would merit investigation (attention would be confined to those below the average).

**4.5** [REDACTED] Fishing companies generally report turnover as a single total figure for the accounting year. In order for the EET to be applied companies will have to breakdown turnover by fishery. This will then allow turnover to be standardised by level of ITQ ownership. If company A owns twice as much ITQ as company B then company A would be expected to have double the turnover of company B. This might be quite straightforward with what are largely single species fisheries such as *Loligo* [REDACTED]

[Redacted text block]

4.6 *Loligo* entered the ITQ system in 2006 so there should be sufficient data to apply the EET. Most of the finfish fisheries entered the ITQ system in 2008 and full financial data are only available for 2 years (08 and 09) and the level of change is likely to be modest. In view of this it is proposed that the EET be applied first to the *Loligo* fishery and subsequently to other fisheries.

4.7 Turnover is of course only one side of the equation. The other side is the cost of sales. It is possible to do some comparative analysis of such data across companies. Big budget items such as fuel costs, crew costs, and transshipment costs might be expected to be similar on a per vessel basis and allowing some variation for vessel size.

[Redacted text block]

4.8

[Redacted text block]

4.9 In order to apply the EET, information will need to be provided by fishing companies in a specific format. Section 32 (Duty to provide documents and information to the Director) of the Fisheries Ordinance provides the power for collecting such information. ITQ holders will be informed of how the EET will operate and be applied as part of the process of collecting the necessary data. There are likely to be a number of complicating factors including vessels having multiple licence types and the potentially distortionary impact of by-catch. The timetable for trialling the EET in the *Loligo* fishery could be up to 6 months, with application of the test being undertaken by the Director of Natural Resources. It should be achievable by November 2011. In the first instance the test will be limited to measuring turnover per unit of ITQ and turnover per unit of catch. The process can be modified in the light of experience and then extended to other fisheries.

### **Review of Fishery Policy Objectives**

4.10 In discussing the EET (discussion involving a group of MLAs and officers in late September 2010) , the subject of a wider review of fisheries policy arose together with assessing whether the high level aspirations of the ITQ system were being achieved. The EET should be a relatively mechanical process, whereas there was some feeling that a wider look at the development and direction of fisheries sector would be useful. There are some caveats in this. In the pre-ITQ system; fisheries policy was largely synonymous with licensing policy. It was the system which was used to assess whether a licence was awarded or not. That no longer applies in the

new world of ITQs. In the discussion it was also noted that as ITQ have been granted on a medium to long-term basis that the scope for policy influence is limited unless it deals with an aspect where influence is clearly permissible under the ordinance.

**4.11** In broad terms it was felt that a review should look into the following issues:

- a) How the fisheries sector is developing in the new ITQ environment. Whether; FI companies are developing as anticipated, whether they see opportunities for growth. Whether; FI companies are becoming more involved in fishing and seafood production. Has the ITQ system created the environment in which companies can progress?
- b) A number of aspirations were set out for the new fisheries policy and the new fisheries law and ITQ system. The review should seek to measure whether there is movement on these aspirations and to what extent they are being achieved. The objectives included:
  - Economic efficiency and flexibility
  - Security of access to resources
  - Diversification and value added processes
  - Investment in research and development
  - Increased international competitiveness
  - Greater tax return
- c) To evaluate how well companies are doing with the complementary tests to the EET of 'effective control' and 'active involvement' (also set out in the ordinance).
- d) To establish whether there are any policy, regulatory, structural or other developments that would facilitate the growth of the fisheries sector. Such developments might require FIG action, in other cases it might be a case of the industry agreeing a common direction and acting in a cohesive way. One caveat on this is that it risks replicating the process which has just been gone through with the EDS. However, it is relevant to any wider review of fisheries policy and progress.

**4.12** It is anticipated that the task could be undertaken by the Policy Unit. The process would most likely require some combination of interview, questionnaire, together with data collected from companies and other sources. All companies holding quota (ITQ and provisional quota) should be involved. The review could provide a benchmark for the early years of the ITQ system.

**4.13** The project will need some careful presentation to the fishing industry, otherwise they may view it with some suspicion. However, the fundamentals are:

- The introduction of the ITQ system was a massive change. Whilst it is relatively early it is worth taking stock; how is it working, is it delivering the aspirations anticipated?

- The intent of the new system was to provide a rational economic environment for companies to operate in compared to the ‘carrot and stick’ approach of the old licensing/ fishery policy system. Is this working, is it sufficient, or do there need to be policy initiatives or action plans, either FIG led, industry (FIFCA) led, or involving all parties?

Leaving the sector to find its own direction in response to the prevailing economic environment may suffice and it is largely the intent of the ITQ system. However, there might also be a view that there is some vacuum on overall policy development, particularly on big issue items which affect the whole sector. The free market approach may well work at the individual company level, but some overarching policy development may be necessary for the sector as a whole (but see earlier reference to EDS).

- 4.14** The timescale for such a review is likely to be c. one year. It will take significant time to assemble a questionnaire, undertake interviews, collect data, and analyse and compile results. A realistic delivery date might be June 2012.

## **5.0 Financial Implications**

**5.1** The main resource required is the input of officer time. The outputs and benefits are unquantifiable. However, the fishery remains the largest sector of the economy so the application of the EET and the wider review should be worthwhile. There will also be resource implications for fishing companies who will need to compile and provide data in specified formats.

## **6.0 Legal Implications**

There are no legal implications

## **7.0 Human Resources Implications**

No additional resources required although the wider review does depend on the Policy Unit having the capacity to undertake the work.