



GOVERNMENT FINANCIAL TRANSFERS TO THE FISHING INDUSTRY:

The Economic Effects

The view of the European Association of Fisheries Economists

Government support to any industry may be given for a number of reasons; to overcome unduly high start-up costs or unfair competition, to encourage restructuring and safety improvements, to help overcome exceptional costs, to create or maintain employment, and to foster regional economies, *inter alia*.

The fishing industry in Europe has received financial transfers from various levels of administration for all of these reasons in recent years but the results have not been entirely as intended. The absence of a market price mechanism to allocate fishing entitlements among fishing enterprises means that excess capacity and over-fishing have developed, wasting valuable capital and reducing potential output.

When government provides financial support to an industry there will normally be two consequences broadly described as an income effect and a substitution effect.

The income effect is that there will be an increase in output in the short run, because financial support adds to the amount of income enterprises have available for investment. (It is highly unlikely that the financial transfer from government would entirely displace what the investors would have spent without it.) However, the short run increase in

output leads to a long run reduction, because the fish stock is a self-renewing resource. Hence the long run income effect tends to aggravate overcapacity, increase over-fishing and ultimately reduce output.

Producing output - landings - in the fishing industry requires the use of a range of inputs such as vessels of various classes, crews, fuel, gear of different forms, electronics, insurance and so forth. The amounts of each of these used by a fishing enterprise will vary to suit its operations and circumstances. However, within its budget the enterprise can often vary the mix chosen because many of these inputs can be substituted for each other. For example, the investor will try to work out whether it is more economical to use a large powerful vessel with a small crew or lots of small dories and many fishermen. In a highly industrialised economy one would expect to see a capital-intensive fleet, while in areas where labour is plentiful and cheap a labour-intensive operation can be expected. The mix of inputs chosen depends on their relative unit costs.

Government financial transfers to industry cannot replicate this mix because it varies with every enterprise, and in general the support will be only for one or two inputs. The effect is to lower the relative cost of the subsidised input and encourage its substitution for unsupported inputs.

Each of these effects produces difficulties for the fishing industry. The income effect encourages extra investment but most EU fisheries already have serious over-capacity. The incentive to break quota regulations or similar constraints is increased because the returns are greater in the short run than for an unsupported level of investment and capacity is higher. The impact is likely to be greater pressure on the fish stocks.

The substitution effect impinges on fishing effort. There will be a substitution of supported inputs for the others. Regulations fixing fishing effort, however, assume that the mix of inputs is fixed, whereas in fact substitution may be used to circumvent a Regulation, which is why fishing effort controls have proved difficult to apply effectively in the long run. Government financial transfers make this circumvention even more

worthwhile. The income effect of subsidies also increases the incentive to break output controls by landing illegal quantities.

European Union financial transfers to the fishing industry have been available for new harbours and auction markets, for new vessels, and for decommissioning excess capacity. Some of these reduce the cost of capital encouraging increased capacity, an income effect, but run contrary to the purpose of the funds for decommissioning.

Similarly, the EU has attempted to run a policy of preserving jobs in the peripheral areas of Europe where most of the fishing industry is located. Yet the funding available under the Financial Instrument for Fisheries Guidance reduces the cost of capital encouraging capital stuffing at the expense of labour, a substitution effect.

It is not always the case that government financial transfers create capital stuffing. Where say, subsidies to labour (such as through lower social security taxes compared to other industries) lower its cost then the substitution effect will act against capital.

Does this mean that there should be no government financial transfers to the fishing industry? The answer is generally that there should not be, but there is little doubt that there are areas where the industry and the community could benefit. However, great care is needed. For example, properly constructed support for decommissioning within the right management system will produce benefits without there being any losers, but in an inappropriate system the support would at best have a neutral effect. At worst it could actually add to the problem of overcapacity if the transfers were to be allowed to find their way into investment in new vessels. This demonstrates that it is vital to set coherent policy objectives. The impact of the chosen instruments must be thought through meticulously to ensure that they support the policy and do not run into the problems of the present measures which often run counter to it.

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March 2002

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