Marine Resource Economics, Volume 11, pp. 129–130
0738-1360/96 $3.00 + .00

Implications of Taxing Quota Value in an Individual Transferable Quota Fishery: Reply

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Grafton is correct in claiming that the subject of resource rentals is "complex." However, he has not successfully argued that the "realities of fisheries management" call for special taxation of the rental value of the fishery.

Consider, for example, Grafton's suggestion that an *ad valorem* tax can reduce the variance faced by fishers and, thus, result in an increase in aggregate rents. If his suggestion is to have merit, fishers must be sufficiently risk averse that the benefits of special taxation off-set the negative consequences. Grafton does not present information indicating that either he or fishery managers know whether fishers are in fact risk averse and, if they are, to what degree. Here, as in much of his previous work, Grafton seems all too willing to assume that the government knows how to set an optimal tax. Moreover, when considering the merits of Grafton's special *ad valorem* tax, one should recognize that fishing firms often are subject to an income tax in one form or another. Thus, variance-reducing taxes are already present in tax codes such as New Zealand's. Accordingly, if Grafton's suggestion is to warrant further consideration, he should demonstrate why the fishing industry, vis à vis other industries also subject to income tax, should be the object of special taxation.

Grafton also suggests that I have exaggerated the incentives for innovation provided by quota ownership when it is unencumbered by special taxation. I do not believe that I have exaggerated the case, but more to the point. Grafton does not deny the positive incentive effects of quota ownership addressed in my paper, nor does his discussion offer additional insights on this issue. Indeed, if anything, Grafton reveals the slim reed supporting his advocacy for rent capture when he suggests that taxation would allow new entrants into the fishery and that these individuals are the fishers most willing to undertake innovation. Of course, I concur that a tax on quota value would lower the market price of quota. According to Grafton, this would make entry more attractive to younger fishers who supposedly are those most open to innovation. In making this argument, not only is Grafton relying on capital market imperfections, but he is asserting that these capital-starved younger entrants will become the industry's innovators. There are many dimensions to innovation, and one that has played a special role in the New Zealand fishery has been the development of new marketing methods for the export market. Here, large vertically integrated firms such Sealords Ltd. have been the leaders, not Grafton's young capital-deprived entrants.

Grafton is also under the impression that taxing rents will somehow make the initial allocation of quota less difficult and can reduce rent-seeking behavior. Clearly, if the government threatens to tax away rents in a fishery, there is less reason for fishers to fight over the initial allocation of quota. But then we are left with the age-old problem of where the political support for an ITQ system would originate. Grafton then discusses rent seeking, but the example he offers does not support

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his argument. According to Grafton, high returns in the Canadian snow crab fishery resulted in rent seeking. However, just because the Canadian government responded to lobbying pressure and issued quota to outside entities, this does not justify taxation. Instead, to reduce this type of rent seeking behavior, private property rights to the fishery should be better defined to prevent the government from simply issuing additional rights. Moreover, if Grafton had his way and the government were in the process of setting a special tax, we should expect to observe considerable rent seeking behavior in the form of lobbying efforts to reduce that tax.

Finally, allow me to briefly comment on Grafton's question "exactly who should benefit from ITQs?" My response is the traditional one: This is the wrong question to ask if you are attempting to understand human behavior and how it is affected by institutional change.