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Minister of Fisheries

FINAL ADVICE ON THE RECOMMENDATIONS OF THE JOINT WORKING GROUP ON DEEMED VALUES

Purpose

1. This paper provides you with final advice on the recommendations, presented to the Minister of Fisheries in May 2005, of the Joint Crown and Industry Working Group on Deemed Values. The paper seeks decisions from you on the implementation of those recommendations.

Background

Catch Balancing and Deemed Values

2. One of the core principles of the Quota Management System (QMS) is that the total commercial catch for a fish stock should not exceed the Total Allowable Commercial Catch (TACC). The balancing regime by which catch is balanced against Annual Catch Entitlement (ACE) is critical to achieving this. Catches are not always predictable and, therefore, the balancing system must have some flexibility to deal with the variability which occurs in fishing operations while providing incentives and constraints to limit over-catch.

3. The components of the catch balancing regime are:

- a) Annual deemed values (a civil sanction and the main incentive to cover catch with ACE);
- b) Interim deemed values (a civil sanction that is effectively a within year "reminder" to fishers to obtain ACE);
- c) Differential deemed values (a sliding scale of deemed value rates that provide an increasing disincentive on individual fishers as their individual over-catch increases)¹; and
- d) Permit suspension provisions (incentive to pay deemed values invoices)
- e) Overfishing thresholds (levels of over-catch for each fisher above which they will be banned from fishing for that QMS stock).

4. Deemed values are civil sanctions imposed on fishers by the Crown for failure to balance landed catch of QMS stocks with ACE ownership on a monthly basis. They are intended to provide an incentive to cover all catch with ACE, while allowing some

¹ For each 20% that catch by an individual fisher exceeds their ACE holdings, the deemed value rate increases by 20%. For example, if the standard deemed value rate is \$1 per kilo, then catch in excess of ACE holdings up to 120% attracts the standard rate; between 120% and 140% is charged at \$1.20; between 140% and 160% is charged at \$1.40; and so on up to a maximum of \$2.00 per kilo.

flexibility to ensure that maximum economic gains can be made from the available ACE. This flexibility comes from the ability to purchase ACE to cover catch *after* fishing and allowing for periodic rather than continuous balancing of catch with ACE.

5. Deemed value payments are returned to the fishing permit holder (fisher) if they acquire ACE to cover their over-catch within 15 days of the end of the fishing year.

6. The Fisheries Act 1996 (the Fisheries Act) requires that, when setting deemed values, the Minister of Fisheries must take into account the need to provide an incentive for every commercial fisher to have or acquire sufficient ACE to cover their catch.

Joint Working Group on Deemed Values

7. The Joint Crown/Industry Working Group on Deemed Values (JWG) arose from the considerations of an earlier Joint Crown and Industry Working Group on Under and Over Recovery of Cost Recovery Levies, which reported to the Minister of Fisheries in February 2003.

8. The JWG was comprised of representatives from the fishing industry, the Ministry of Fisheries and the Treasury. The JWG was established in 2004 to discuss whether quota owners should be entitled to a proportion of money paid to the Crown as deemed values. The original terms of reference for the JWG were later expanded to include consideration of the effectiveness of the rest of the deemed values regime.

9. Following completion of their deliberations, the JWG submitted nine recommendations to the Minister of Fisheries in May 2005 (refer S6890). In December 2005 the Minister of Fisheries decided that consultation should be undertaken to seek the views of fisheries stakeholders before any final decisions were taken on the recommendations.

10. A public discussion paper on the nine recommendations of the JWG was released in August 2006.

11. Submissions on the discussion document closed in October 2006 and a summary of submissions has been provided to you (refer S7734). The submissions were mainly from the commercial fishing industry, but one joint submission was also received from non-commercial fishing interests. The submissions reflect a relatively wide range of views on the appropriateness of the recommendations of the JWG.

Recommendations of the Joint Working Group

12. In this section, each of the recommendations are discussed in the following format:

- a) Recommendation;
- b) JWG reasoning for the recommendation, including Ministry comment at the time;
- c) Submissions on the recommendation from stakeholders; and
- d) Ministry comment.

13. The final section of this paper sets out the Ministry's advice on the recommendations arising from the review. In two areas the Ministry's advice departs

from the recommendations of the JWG: (i) repatriation of deemed value revenues to quota owners and (ii) Ministry systems responding to situations where information suggests a reduction in deemed value rates is appropriate.

Recommendation 1: Response to TACC over-catch

Deemed values may provide temporary flexibility in aggregate catch relative to TACCs, but chronic over-catch should trigger one of the management actions below. In cases where catch significantly exceeds available ACE, and this does not appear to be a temporary occurrence, one or more of the following actions should be taken:

- *Increase the deemed value*
- *Increase the TACC of the over-caught stock*
- *Decrease TACCs of stocks responsible for significant incidental catch of the over-caught stock*
- *Implement other management measures to reduce incidental or other over-catch, including gear restrictions and over-fishing thresholds.*

JWG reasoning

14. The JWG report asserts that significant levels of catch in excess of TACCs should not be allowed to persist. If catch exceeds the TACC and is balanced with deemed values, they believe it is appropriate to review the stock status and consider what management action is needed to avoid future over-catch. The JWG believes that a more responsive stance is needed from the Ministry in monitoring over-catch problems and in reviewing both TACCs and deemed value rates.

Submissions

15. The majority of industry submissions supported this recommendation.

16. The major reason advanced by submitters opposing this recommendation relates to a perception that it would be unfair to fishers. Some submitters feel that they cannot be precise about catch mix and therefore believe that some level of over-catch is inevitable. The Ministry recognises that mixed trawl fisheries present particular challenges for catch balancing. However, the expectation is that if fishers have caught, or anticipate catching, more than their ACE holdings for a species they will either obtain more ACE or modify their fishing behaviour – even if this means simply not fully fishing entitlements for one species so as to avoid catching more of the abundant, associated, species.

17. Most industry submissions emphasised the importance of ensuring setting process for assessing the appropriateness of TAC levels is responsive, so as to minimise costs to fishers while providing for full utilisation benefits. The Ministry acknowledges that ensuring TAC levels are appropriate is an important issue.

18. Some industry submitters believe that, because the stock assessment process is often imprecise, TACCs should not be regarded as an absolute limit on fishing effort. The Ministry acknowledges that uncertainty is a hallmark of fisheries management, however that does not mean the TACCs should be disregarded. If fishers believe that the TACC is set too conservatively then the proper place to address this is through the mechanisms to review the TACC (e.g., analysis of available information, or supported by new research), not by deeming catch.

19. The joint submission from non-commercial fishers supported taking action to address over-catch. They submitted that any level of over-catch was significant in

shared fisheries. Non-commercial submitters did not agree deeming was appropriate in shared fisheries as they submit that economic sanctions to constrain commercial catch to TACC have been used for 20 years and that this approach has failed.

Ministry comment

20. The Ministry supports this JWG recommendation that significant TACC over-catch should trigger management action. Deemed values are the primary mechanism for addressing over-catch. However, the Ministry agrees that increasing a deemed value rate is not the only available response to over-catch, and consideration of other management measures, as appropriate, is also needed.

21. The Ministry has already amended its catch balancing guidelines to make the deemed value setting process more responsive to over-catch and allow deemed values to be set on a case by case basis. To support these new guidelines, additional resources will be directed at monitoring over-catch and deemed value payments throughout the year.

22. The emphasis for both the JWG and the Ministry is on case by case consideration of the need for management action for stocks that are being over-caught. Where over-catch is ongoing and deemed value rates are being considered in response, the Ministry will need to take this as a signal to reassess the best available information on the appropriateness of current TAC levels. There is further discussion of TAC adjustment later in this paper. The appropriateness of applying other management mechanisms to the stock, such as over-catch thresholds, and area and method restrictions, will also need to be considered.

Recommendation 2: Improving Flexibility for Setting Management Targets

Section 14A and 14B should be revised to provide greater flexibility for setting management targets for bycatch stocks in a multispecies fishery while still taking account of the rights of dissenting parties. The current approval threshold for proposals from quota owners to the Minister to apply 14B should be reduced from the current 95% level. The Ministry will commence a process to determine the appropriate changes to sections 14A and 14B of the Fisheries Act 1996, with the objective of completing that work to provide advice to Government before the end of 2005.

23. Section 14A and 14B provide flexibility for the management of stocks taken primarily as incidental catch. If the TACC of an incidental stock is limiting catch of the TACC of a target stock, then s14A and s14B may be used to increase the incidental stock TACC above the level which would normally be allowed, as long as the long term viability of that incidental stock is ensured. However, this mechanism has not been used since it became operative in 1999.

JWG reasoning

24. Recommendations from quota owners for the use of s14A and 14B must meet specific legislative criteria. The JWG identifies the requirement for 95 per cent quota holder agreement before a proposal can be put to the Minister of Fisheries as a critical condition which may be limiting the use of this provision. They believe that this requirement may not be allowing the greatest value to be obtained from some mixed fisheries, because such complete quota owner agreement is unlikely to be achieved.

Submissions

25. The majority of industry submitters support reducing the approval threshold. Those submitters who oppose the recommendation do not give specific reasons for their opposition but do appear to support the utility of s14A and s14B.

26. This recommendation was not addressed in the submission from non-commercial fishers. Non-commercial fishing interests are protected under s14A(5)(c), which requires that the Minister is satisfied that setting alternative management targets for a stock under s14B will have no detrimental effects on non-commercial fishing interests in that stock.

Ministry comment

27. The Ministry's view is that consideration of the s14A agreement threshold should occur in conjunction with consideration of other collective thresholds in the Fisheries Act. Consideration should include if, and what level of, adjustment should be made to thresholds and whether alignment of thresholds is desirable. Work in this area was scheduled for 2005 but was not progressed because of the emergence of other higher priority issues on the Ministry's work programme.

28. In a review of the appropriate level for the agreement threshold, further work would be required on the implications of reducing the threshold and to what level it should be set. Other issues that would need consideration include the need to develop new mechanisms to address minority quota holder rights if the threshold is reduced. Without new mechanisms there would be a greater burden on the Minister to ensure minority quota owners interests were taken into account when deciding whether to agree to any industry proposal.

29. Reducing the level of the agreement threshold may also raise 1992 Fisheries Deed of Settlement issues. Settlement quota has limited tradability and in most stocks iwi own 10 per cent or less of the quota shares. Therefore, investigation should occur into whether additional mechanisms are needed to protect the interests of iwi quota owners.

30. Policy work to review the quota owner agreement threshold is planned to allow any change to be included in the next Fisheries Act review. At this stage it is unlikely that any legislative change resulting from this will take place before 2009, given the range of other legislation already on the Ministry work programme. Any concrete proposal to change the approval threshold would need to be extensively consulted on in its own right.

Sustainability requirements of s14A

31. The JWG and one submitter also raised concern about the information demands imposed by the requirements of s14A. It is a statutory requirement that the long-term viability of the stock is ensured, and that the costs of the change are outweighed by the benefits. The Minister must also have regard to the need to avoid any significant adverse effects on the aquatic environment.

32. The Ministry believes that these statutory requirements are justified on the basis of ensuring sustainability. Risks to sustainability require management. If there is a clear increase in value to be obtained from reducing a by-catch stock to levels below standard management targets, the beneficiaries of this increase in value should be

prepared to invest some of that value in producing improved information needed to manage the risk to sustainability, if required.

33. However, in some cases, depending on the stock and magnitude of increase to catch levels, extra information may not be required in order for the Ministry to produce an assessment against the statutory criteria. Therefore, management under s14B may not necessarily lead to a requirement for increased information and costs for industry may not increase. The Ministry has not developed any standard as yet as to how to manage the risk of increasing catch levels.

Recommendation 3: Principles for Setting Deemed Value Rates

In general, deemed values should be set at a margin above the ACE value greater than the transactions costs of acquiring ACE. For stocks where over-catch of the TACC is persistent, unless decisions are taken to adjust TACCs (or reduce incidental by-catch by introduction of technical selectivity measures), deemed value rates should be raised until over-catch is eliminated. Where deemed values are set above port prices, compliance activity should be focused to ensure all catch is landed and reported.

For certain high value species such as lobster and paua that are not taken as bycatch in other fisheries, deemed values should continue to be set at 200% of port price. It will be necessary to set deemed values above true ACE values by a larger margin when quota ownership is concentrated so that the net deemed value that would be paid by those quota holders would exceed the value of ACE.

34. The deemed value regime has a single objective: to provide an incentive for individual fishers to balance catch with ACE so that total commercial catch will be constrained within the TACC.

JWG reasoning

35. The JWG recommended that, in order to provide individual incentives to cover catch with ACE, a deemed value should be set above the marginal value of the ACE for the stock plus transaction costs of obtaining ACE. This ACE value is the equilibrium price that would prevail if catch were constrained to the TACC (i.e., if deemed values were not being utilised and the TACC were fully caught). However, since this is a theoretical point and cannot be calculated in practice, the only way to ascertain it is to increase deemed value rates until over-catch ceases.

Submissions

36. Industry submissions were evenly split between supporting and opposing this recommendation. Some of the support, however, was conditional on greater responsiveness by the Ministry to ensure that TACCs are set at an appropriate level.

37. Submitters who opposed this recommendation are concerned about the fairness for fishers, and the economic effects of increased deemed values on fishing operations. They are concerned that increasing deemed value rates will lead to:

- a) Increasing ACE prices;
- b) Fishing trips made uneconomic by lack of ACE;
- c) High deemed values on bycatch stocks; and
- d) Some fishers being forced to stop fishing while others continue to over-catch.

38. However, the JWG, the Ministry and several industry submitters argue that it is entirely acceptable for deemed value and ACE prices to increase in situations where over-catch is occurring. These increasing prices are intended to act as a signal to fishers to reduce effort. Further, low deemed value rates may currently be artificially depressing some ACE prices (and affecting quota value), and these prices would rise if the 'brake' applied by low deemed values is removed.

39. Once over-catch ceases, ACE and deemed values prices should reach equilibrium. However, it is acknowledged that the deemed value adjustment process needs to be sufficiently responsive so that rates are not increased to levels higher than is necessary. (See recommendation 4 for further discussion.)

40. It is an inevitable consequence of the different efficiencies and economic arrangements that exist within the fishing industry that some operators may be forced to stop catching while others continue. However, continuing over-catch by individuals is unacceptable and the management regime should ensure that mechanisms such as differential deemed values and overfishing thresholds are applied.

Ministry comment

41. In general, over-catch should lead to an increase in deemed value rates in the following year. Deemed values are not a mechanism to provide significant flexibility around the TACC; this would be at odds with their purpose of providing an incentive to balance catch with ACE. However, in exceptional cases, where there is good information that over-catch is due to short-term abundance and no other ongoing factors are contributing, deemed values may remain unchanged. Deemed values may also remain unchanged if there is a strong indication from the TAC assessment process that a TACC increase will occur.

42. The Ministry agrees that deemed values for the 'high value single species' category of stocks should continue to be set at a high level (200% of port price). In these fisheries accidental over-catch should not occur because the harvest method used is selective and the fisheries are single species fisheries, meaning they are not taken as incidental bycatch.

43. The JWG report indicates that additional compliance effort may be needed where deemed values are set above port prices. The Ministry already has concerns about the level of catch misreporting and dumping occurring in some fisheries. Increased deemed values and increased differential rates are likely to exacerbate these issues as they add to the cost incentives to undertake those kinds of illegal practices. However, the extent of the effect will need to be determined on a stock by stock basis as deemed value rates are adjusted. Compliance is already focusing effort on monitoring dumping, trucking and other forms of misreporting.

Recommendation 4: Information and Process for Setting Deemed Values

Information relevant to setting deemed values includes ACE prices, port prices, catch in excess of TACC, and by-catch to target catch ratios. The Ministry should be undertaking regular detailed analysis of these factors to determine appropriate deemed value levels, particularly where over-catch is occurring. Deemed values could be set later in the fishing year so they can reflect information on whether the previous year's deemed value was sufficient to keep catch within the TACC. This might be achieved through allowing any changes to deemed value rates to be made up to the end of the 1st month of the fishing year.

JWG reasoning

44. Deemed value rates are currently set with reference to port price. The JWG recommends that the information used to set deemed values should be broadened. A major new source of information considered relevant to deemed values is ACE prices. Consequently, it is suggested that regular analysis of ACE trading prices and overcatch patterns is needed to help determine the causes of over-catch and to set deemed values at effective levels.

45. The JWG suggests that it may be appropriate to allow deemed value rates to be set up to the end of the first month of the fishing year. This would allow for analysis of data from the whole previous fishing year, which becomes available on the 15 October, to occur.

Submissions

46. The majority of industry submitters support or partially support this recommendation. Opposition or partial support seems to be mainly based on the belief that deemed values should remove economic benefit from catch but not be punitive or leave fishers in a worse financial position. The Ministry reminds fishers that deemed values are a civil sanction. Further, no single deemed value rate can achieve these goals because of the different cost structures within the industry. Also, the shadow value (the economic value of continuing to fish for the target species where an incidental species is constraining catch in the target fishery) must be taken into account when setting deemed value rates for some incidentally caught species.

47. One submitter recommends that triggers should be built into the deemed value setting guidelines to identify opportunities to reduce deemed value rates, where appropriate. The suggested trigger is when catch is at or below the TACC for at least two years, and where there has been no significant use of deemed values.

48. Several industry submitters were concerned with the JWG's proposal that deemed values be allowed to be set during the first month of the fishing year. Submitters were concerned that this would not give them sufficient time to plan their fishing operations.

49. The Ministry disagrees; fishers should not be planning fishing operations based on the cost of over-catch (deemed values). Further, fishers should be able to anticipate whether a deemed value is likely to rise, as this possibility will have been signalled in consultation. The only issue that may be outstanding at the end of the year is what the precise level of the new deemed value rate should be. This issue will only be outstanding for those few stocks where setting a new rate may benefit from a complete set of data from the previous fishing year.

Ministry comment

50. The Ministry agrees that a range of information should be used in determining deemed value rate. Over-catch of the TACC (i.e., available ACE) is the major signal that a deemed value increase should be considered. The primary information source for determining where a deemed value rate should be set is ACE price; this should then be informed and grounded by the other information sources listed by the JWG.

51. However, as set out in recommendation three, the rate indicated by these information sources should not limit where the deemed value is set if over-catch is ongoing. Deemed value rates should be increased until over-catch ceases.

52. The Ministry agrees with the submitted recommendation that the Ministry should ensure opportunities to reduce deemed values are identified. The regime should be responsive to situations where reduction in deemed value rates may be appropriate. Deemed values should not be set higher than is needed to provide sufficient incentives to balance catch with ACE, as this removes the in-season flexibility the system offers fishers in balancing catch against ACE and creates a risk that ACE prices could be pushed up at the end of the fishing year if fishers are facing high deemed value rates.

53. The Ministry considers that enabling analysis of the full previous year's data may be beneficial in some cases. Such a change would require legislative amendment and has been referred into the Fisheries Act review project. It is therefore unlikely to be implemented before 2009.

54. In the interim, more resources are being allocated to monitoring and analysing deemed values and over-catch throughout the year, which is likely to improve the timeliness of analysis and ability to determine trends. Further, the transition into fisheries plans may impact on the internal process for setting deemed values. Therefore, it will be clearer in 2009 whether the extra time is needed to allow for this analysis.

Recommendation 5: Interim Deemed Values

Interim deemed values would be inappropriate under the recommended approach to setting annual deemed values for most stocks. However, until all deemed value rates have been fully adjusted according to the new scheme, interim deemed value rates should be used where necessary to provide a rate commensurate with ACE prices. For any stocks for which deemed values are set well above ACE price, interim deemed values may continue to be appropriate.

55. Interim deemed values are levied on fishers as a monthly charge for any catch not balanced with ACE (or previous interim payments). To date, as a matter of operational policy, the Ministry has set interim rates at 50 per cent of the annual deemed value rate. Fishers must, within 20 days, either balance outstanding catch with ACE or pay interim deemed values. If an interim invoice is not paid the fisher faces permit suspension.

JWG reasoning

56. The JWG recommends that the use of interim deemed values should be phased out for most stocks as the new regime is implemented. Lower interim deemed values relative to ACE price increase the incentives for fishers to delay balancing. This is because low interim deemed values allow fishers to reduce costs, at least until ACE is purchased, or until annual deemed values are paid at the end of the fishing year.

57. However, where a deemed value is set well above ACE price (as in some high value single species fisheries) interim deemed values may continue to be appropriate to provide some flexibility to fishers.

Submissions

58. There was strong support from industry submitters to reduce the use of interim rates, with only one industry submitter opposing this recommendation. The joint submission from non-commercial fishers did not state a position.

Ministry comment

59. The Ministry agrees that interim rates should not provide incentives to avoid acquiring ACE until the end of the year. Delayed balancing has the potential to cause distortions in the ACE market and increases the risk that fishers will be unable to balance their catch with ACE.

60. The Ministry also agrees that use of interim deemed value rates remains appropriate in cases like the 'high value' category of stocks, where the annual rate is set much higher than ACE price. The incentive to balance should remain in this case since the interim rate will be close to the ACE price.

61. The Fisheries Act requires, under section 75, that annual and interim deemed value rates are set for each quota management stock and specifies that annual rates must be greater than interim rates. Therefore, the full implementation of this recommendation, providing the ability to set interim deemed values rates below or at the annual rate, would require legislative amendment.

62. Incentives for fishers to balance more frequently can be improved prior to legislative change by reducing the difference between annual and interim rates. Recently revised catch balancing guidelines provide for interim rates to be set closer to the annual rate in cases where interim rates may be contributing to over-catch.

Recommendation 6: Differential Deemed Values

Differential deemed values can serve as a backstop to protect stocks from over-fishing and as a value indicator to assist the tuning of deemed values to their optimal level. However, differential deemed values can also cause distortions in ACE markets and should not be applied as a general rule. Application of differential deemed values should be reduced to a minimum once the recommended policies for setting annual deemed value levels have proved effective, but differential deemed values should remain in the manager's tool box to be applied in cases where the TACC has been exceeded in the previous year(s).

63. Differential deemed values are intended to provide increasing individual and aggregate disincentives for catch that cannot be covered with ACE. If deemed values do not provide sufficient incentive to keep individual catch within 120% of ACE holdings (or at a lesser percentage of over-catch, if required to ensure appropriate incentives in a particular fishery), then differential deemed values provide a rising price signal as over-catch increases.

JWG reasoning

64. The JWG recommends that the application of differential deemed values should be reduced once the proposed new regime for setting deemed values has been proven effective. However, the JWG recognised that differentials should remain available for use in cases where the TACC was exceeded in the previous year.

65. The JWG reasons that, in general, differential rates may have some perverse effects. The JWG argues that differential deemed values can result in costs for catching

rights that differ across firms, which implies that an efficient allocation of catch has not been achieved. Differentials also may provide incentives for quota owners to hold back ACE until the end of the year when some fishers may be facing differential rates and be willing to pay inflated prices for ACE.

Submissions

66. There was strong support from industry submitters to reduce the use of differential rates, with only one submitter opposing this recommendation. The joint submission from non-commercial fishers did not state a position.

Ministry comment

67. The Ministry agrees that differentials may result in inefficient allocation by reducing liquidity in the ACE market. However, the operation of differentials must be viewed in context of their purpose. Fishers do not face price differentials until they have over-caught on their ACE holdings (usually by more than 20 per cent, but under new Ministry guidelines differentials may begin at lower percentage of over-catch). Therefore, any inefficiency effect is occurring on over-catch. It is appropriate that allocation is managed in this case so that those fishers with greater levels of over-catch will reduce their over-catch – by either obtaining more ACE or ceasing to fish. That is the function of differentials, to provide a rising price signal as over-catch increases and thereby limit over-catch.

68. The inflation of ACE prices at the end of the season due to monopoly effects, as raised by the JWG, only occurs when fishers are 20% or more overcaught (or a lesser percentage of over-catch, if required to ensure appropriate incentives in a particular fishery). The Ministry believes that the most likely reason for fishers to be in this position is because of heavy reliance on interim deemed values to reduce costs. By reducing the use of interims (or increasing the interim rates) the advantage to fishers of relying on interims to balance rather than more frequent ACE purchase is reduced or eliminated. Furthermore, we expect the potential for end of season ACE price inflation attributable to monopoly effects to be mitigated to some extent by arbitrage between fishers and ACE owners.

69. If the recommended changes to the catch balancing regime work as the JWG anticipate, then differential rates should not impact on the vast majority of fishers as they will balance their catch with ACE.

70. The Ministry agrees that the differentials should be retained until changes to deemed value/catch balancing policy have proven effective. However, even in a situation where over-catch is minimised, differentials would continue to perform important functions. They provide a backstop to annual rates in cases where the regime has not captured a change in circumstances. Differentials also protect stocks from incidences of severe overfishing by fishers with low fishing costs.

71. The Ministry's view is that differentials should continue to be applied. The Ministry has amended its catch balancing guidelines so that differential deemed values will not be automatically applied to a stock. A case-by-case approach will be taken and differentials may be applied if individual over-catch is a problem. The guidelines also allow for the level and rate of increase of differentials to be varied on a case-by-case basis.

Recommendation 7: Redistribution of Deemed Value Revenue

Redistribution in Commercial Only Stocks –

Deemed values for catch in excess of the TACC or agreed and binding lesser catch limits in proportion to quota ownership

JWG reasoning

72. The JWG presents a number of reasons why redistribution of deemed value revenue to quota owners should be considered.

73. The interests of fishers, who require ACE or pay deemed values to balance catch, are distinguishable in principle from the interests of quota owners, who hold a long-term interest in harvest returns from the stock.² Fishers catching without ACE can damage quota owners' interests.

74. Where catch for a stock exceeds the TACC and deemed values are paid to the Crown, this has a negative impact on the interests of the quota owners. Payment of deemed values may reduce quota owner's ACE revenue because deemed value rates can potentially undercut the ACE price that would have prevailed if catch were limited to the TACC. Over the longer term, the value of ACE may also be reduced. Overcatch of the stock will reduce the stock size, which increases cost per unit of catch and therefore decreases the price fishers are willing to pay for ACE.

75. Further, catch above the TACC, covered by deemed values, may reduce the quantity of future ACE issued to quota owners by either causing future reductions in the TACC or displacing TACC increases that would have been possible.

76. Payment of deemed values is a legal substitute for ACE cover of catch. Where persistent over-catch of a TACC is tolerated by the system, with accompanying deemed value payments, this can be viewed as the Government "selling an alternative" to ACE. If the deemed catch is actually sustainable the TACC should be increased, with the resulting ACE issued to quota owners. In some stocks Government has not taken effective action to prevent ongoing over-catch (or to adjust the TACC if appropriate) and therefore prevent ongoing losses to quota owners. At the same time Government retains the deemed value revenue in these stocks.

77. For these key reasons, the JWG recommended that deemed value revenue collected by the Crown for such over-catch should, at least in part, be redistributed to quota owners. The JWG recommended that such redistribution only occur for deemed values paid on catch above the TACC (or a lesser binding agreed catch limit). This would ensure incentives for quota owners to make ACE available to fishers are maintained.

Submissions

78. Submissions from industry showed cautious support for redistribution. The majority of industry submitters who supported redistribution gave either conditional

² In practice the bulk of deemed value payments are made by quota owning companies, but even in that case, the economic interests of the company as quota share owner may be considered separately from their annual harvesting interests as a fisher.

support or supported while emphasising the need for caution in designing a system for redistribution.

79. Submitters expressed concern about difficulties (which are discussed above) for fishers if:

- a) ACE was not made available by quota owners,
- b) Inappropriately set TACCs are not addressed, or
- c) If the ability of quota owners to manipulate the ACE market is not dealt with.

80. One submitter also recognised the need for caution given that deemed values fulfil other purposes than protecting property rights, such as sustainability.

81. Submitters disagreed on whether redistribution should only be on catch in excess of the TACC or for all deemed value revenue, and on whether redistribution should be restricted to those quota share owners whose ACE had been utilised. Several submitters believed that some or all the revenue should be used to improve management of the stocks, with one suggesting stakeholder organisations should undertake this management.

Ministry Comment

82. In considering this question, the JWG focused on the issue of the property rights of quota owners. This is an important consideration. If deemed values are set too low, fishers may have incentives to pay deemed values instead of covering the catch with ACE. This decreases the value of ACE and hence the value of quota shares. If catch is in excess of the TACC, the resource base can be damaged, further reducing the value of quota shares. These and other issues outlined by the JWG signal the importance of setting deemed values at adequate levels.

83. Some industry parties are concerned that the Ministry has incentives to set deemed values that do not adequately defend the TACCs. If deemed values are set too low, the Crown can receive revenue for catch in excess of TACCs. They consider that repatriation of deemed value revenue removes this incentive by ensuring that the Crown does not benefit from inadequate deemed values. The Ministry does not accept that revenue accruing to the consolidated fund has influence on the level at which deemed value rates are set. Deemed value revenue is non-departmental revenue and the Ministry, which advises on setting deemed value rates, does not benefit from deemed value revenues.

84. Redistribution must be considered from the perspective of the wider fisheries management regime and in particular its effects on the integrity of catch balancing regime.

85. Deemed values play an important role in ensuring the sustainability of stocks by providing the main incentive for fishers to balance catch with ACE and therefore keep total commercial catch constrained to the available ACE. The JWG and several submitters recognised the role that deemed values play in ensuring sustainability.

86. Redistribution may reduce incentives for quota owners to take responsibility for how their ACE is fished. Quota owners have a responsibility to take those steps

available to them to protect their interests, such as holding fishers who fish to their ACE more accountable for fishing within the management regime. However, because redistribution would allow quota owners to receive a return from fishing in excess of the TACC, it reduces quota holder's interests in ensuring the TACC is defended. Therefore, the likelihood that quota owners' actions would collectively lead to restraint of catch to the TACC is reduced.

87. Quota owners have positive incentives to ensure the integrity of the TACC and protect the value of quota shares. But in mixed species fisheries realising the economic benefit for some stocks is significantly constrained by the availability of ACE for other stocks in the same fishery. This creates economic incentives for fishers to exceed the available ACE for the stock that is constrained, particularly if it is low value or a minor catch component. The positive incentives that quota owners might have would be weakened by repatriation.

88. Other serious effects of redistribution of deemed value revenues on the operation of the catch-balancing regime are discussed in the section on recommendation 8.

89. Further, the issue of ongoing revenue collection from high deemed value payments may be largely historical. The issues leading to the JWG recommendation for redistribution arose because of persistent over-catch in some stocks accompanied by ongoing deemed value payments. The Ministry is now committed to significantly reducing over-catch of the TACC by taking a range of measures along the lines of those recommended by the JWG. The expectation is that the modified rules for dealing with over-catch and deemed values will largely solve the problem of persistent over-catch. Therefore, the damage to quota owner's interests and the revenues created by deemed values on over-catch of the TACC should also reduce accordingly.

90. As a result of further consideration since the JWG report of the advantages and disadvantages of repatriation, the Ministry has come to the view that on balance repatriation should not be considered.

Shared Stocks

The proportion of deemed values for catch in excess of the TACC equal to the TACC/TAC ratio should be returned to commercial quota holders. The remaining portion of the deemed values on catches above available ACE should be tagged for provision of research and services for the stock that improve management of recreational and customary fisheries, and might be considered for such activities that contribute to the reduction of commercial over-catch.

JWG reasoning

91. The JWG had difficulty agreeing on redistribution in fisheries that are significantly shared with non-commercial fishers. It was recognised that over-catch by the commercial sector does have a detrimental effect on non-commercial as well as commercial interests in the stock. Also recognised were issues with the management of non-commercial fisheries in terms of knowledge of the total take of stocks and effectiveness of the regime.

92. Therefore, the JWG recommended that a proportion (equal to the proportion of the TAC not allocated to the TACC) of deemed value revenue would be retained by the Crown for improving management of customary and recreational fisheries, thereby addressing both issues. Redistribution directly to non-commercial fishers was seen as impractical due to the dispersed nature of rights and their lack of quantification at the individual level.

Submissions

93. The joint submission from non-commercial fishers opposes redistribution in those fisheries in which they have an interest. Non-commercial fishers submit that commercial catch above the TACC in shared fisheries, or fisheries important in the food chain of shared fish, adversely affects the interests of other sectors.

94. In these shared stocks non-commercial fishers submit that the TACC should be the maximum level for commercial catch that can be taken. Otherwise, management objectives of Ministerial decisions are undermined, unsustainable burdens are placed on fish stocks, the value of quota holdings is undermined, other users' aspirations and interests are overridden, and public confidence in the QMS reduced.

95. Non-commercial fishers submit that the rental or return to quota owners should be confined to fish taken within the TACC. The QMS gave quota owners certain rights and these rights give commercial fishers a responsibility to constrain total commercial catch to TACC. Non-commercial fishers submit that refunding deemed values above the TACC reduces the incentives for quota owners to work collectively to constrain total commercial catch and may create incentives to do the opposite.

96. Non-commercial fishers submitted two alternative arrangements to current use of deemed values to address over-catch that do not rely upon economic sanctions to constrain commercial catch to TACC. They believe either alternative would ensure that commercial over-catch was accounted for in the long run commercial allocation and not by adversely affecting other sectors or the sustainability considerations for the stock.

- a) The first proposal, which non-commercial fishers consider would be the most effective measure, would be to reduce the TACC the following year by the amount of any commercial over-catch; and
- b) If proposal a) is resisted, then the second proposal is that the TACC should be split into a reduced TACC and a "deeming allowance" which would add together to equal the 'old' TACC. The deeming allowance could then be increased and decreased depending on levels of over-catch in the previous year. Under this scenario non-commercial fishers consider that the deemed value revenues should be returned to the quota owners up to the level of the previous TACC. Quota owners would have no entitlement to compensation because the ACE/quota reduction would be implemented to constrain commercial fishers to their sustainable entitlement – the 'old' TACC.

97. All industry submitters only partially supported the JWG recommendation for redistribution of deemed values in shared stocks. Submitters expressed concern that:

- a) Information on non-commercial catch needed to be improved;
- b) The non-commercial allocation should be more accurately set and catch better constrained within it; and

- c) Quota owners would not be compensated for over-catch of non-commercial allocations.

Ministry Comment

98. The Ministry is sympathetic to the concerns put forward by non-commercial fishers and strongly supports the objective of keeping commercial catch within TACC. However, the Ministry believes that commercial over-catch can be addressed using the current tools. Changes to the deemed value regime and modifications the Ministry processes to set priorities for stock assessment review, as described in the sections on recommendations 1 to 6, should allow the catch balancing regime to operate far more effectively to reduce over-catch.

99. The proposals outlined by non-commercial fishers have some significant drawbacks. The most important drawback would be the risk, especially in mixed fisheries, of a feedback loop of over-catch leading to reduced ACE and then greater volumes of over-catch. While fishers should stay within allocations, this mechanism could lead to or exacerbate TACC imbalances and associated difficulties. The better way to reduce over-catch is by increasing the deemed value rates.

100. Many of the issues raised by the joint submission from non-commercial fishers, such as how commercial over-catch is accounted for when TACCs and recreational catch limits are adjusted, relate to perceived unfairness in the allocation process between sectors. The 'Shared Fisheries' project is currently endeavouring to address these issues. The Ministry also notes that while deemed catch is not accounted for in the commercial allocation, it is taken into account in the stock assessment process.

Recommendation 8 – Perverse Effects and Risks to Catch Balancing Regime from Redistribution of Deemed Value Revenue

If the deemed value regime is failing to constrain catches within the TACC and other management actions are not available to effectively address this problem, the Minister should set over-fishing thresholds for the stocks concerned to prevent fishing without ACE. Where deemed values are set higher than the port price for a stock, compliance attention should be focused on the fishing of that stock to ensure that significant discarding of by-catch is detected and prosecuted.

101. The purpose of deemed values is to provide an incentive for fishers to balance catch with ACE. However, redistribution would damage this incentive for quota owners who are also fishers, by returning to them some of any deemed value payments they make for over-catch.

102. A large proportion of fishing in New Zealand is carried out by integrated companies that both fish and own quota, and the quota for some stocks is concentrated in the hands of a few owners.

JWG reasoning

103. The JWG acknowledges that redistribution may weaken or eliminate incentives for fishers who are also quota owners to cover catch with ACE and therefore keep aggregate catches within the TACC. Quota owners would effectively gain a rebate on deemed value payments when they overfish because a portion of their deemed value payment is returned to them through redistribution.

104. The effective deemed value rate, the deemed value rate after rebate, will only act as a sufficient deterrent to over-catch by larger quota holding fishers if it is greater than the economic value gained by that quota owning fisher from catch. The JWG proposes that, to address this risk, the deemed value rate should be increased enough to counteract the rebate for the largest quota holder of the stock.

105. The JWG also recommends that measures are taken to address compliance risks where deemed values are set higher than port price (i.e., where payment of deemed values will cost fishers more than the gross revenue on landed fish). Measures that should be considered include strategic placement of observers and compliance investigations such as catch profiling.

Submissions

106. Half of industry submitters support this recommendation. The majority of the remaining industry submitters had no stated position. Several submitters cited the need to be careful about manipulation of the system or collusion by quota owners. However, submissions differed over whether these risks could be adequately managed.

Ministry comment

107. The Ministry agrees with the JWG that redistribution would damage incentives for fishers who are also quota owners to balance catch against ACE. However, the Ministry believes that the proposed solution, to increase deemed value rates to mitigate against loss of incentives for large quota owners, removes some of the benefits of the deemed value mechanism for other fishers.

108. Many stocks have high or relatively high levels of quota aggregation. For example, one company owns 86% of the quota shares for trevally in quota management area 3, and the same company owns more than 20% of the quota shares for some 40 stocks. Another company owns 61% of the quota shares for snapper in quota management area 8, and that company also owns more than 20% of the quota shares for 121 stocks and more than 35% of the quota shares for 49 stocks.

109. To account for the discounting affect of revenue redistribution, the proportion of the stock held by the largest quota holder would need to be determined for each stock and a premium added to the deemed value accordingly. So, for example, for a stock with 20% aggregation a \$1 deemed value becomes \$1.25 (since the 20% owner gets a $1.25 \times 0.2 = 0.25$ rebate). As quota aggregation increases the level of deemed value needed to counteract the discount effect increases sharply (see table below). For a stock like SNA8 with 61% aggregation the deemed value would need to be set at 250% of what it would be without redistribution.

Max holding	DV rate (\$1 base)
20%	1.25
40%	1.67
50%	2.00
60%	2.50
70%	3.33
80%	5.00
90%	10.00

110. The deemed value regime currently allows fishers some flexibility for legitimate catch balancing to:

- a) Allow periodic balancing;
- b) Deal with mixed catch in year; and
- c) Allow landing of accidental end of year catch over runs that cannot be covered with ACE.

111. By increasing deemed values rates as described above, this legitimate flexibility would be removed for the majority of fishers, since they would be facing a highly inflated deemed value price. Flexibility would be retained only for the largest quota owners through the rebate they receive from redistribution.

112. Increasing deemed value rates to take into account redistribution to large quota owners reduces the efficiency of the regime. A greater penalty is charged than is needed, for the majority of fishers, to achieve the objective of balancing catch with ACE. Further, higher deemed values increase the temptation for fishers to dump, which is a serious offence, and the resulting loss of information may also reduce the effectiveness of the fisheries management regime.

113. Increasing deemed values in proportion to aggregation of quota holdings relies upon the Ministry being able to determine what level of quota aggregation exists in a stock in order to set the correct deemed value rate. It is not an easy task at present to disentangle cross-ownership of companies to determine the real beneficiaries of activity or regulatory change. Redistribution would make this even more difficult as it sets up new incentives to reduce concentrations of quota under any one company so that true aggregation is disguised. If aggregation cannot be determined accurately then deemed values may not be increased enough to counteract the rebate from redistribution and some of the rebate will be retained.

114. Other complexities of implementing redistribution include:

- a) Dealing with the potential for bycatch/target rent transfer, whereby bycatch quota owners could restrict available ACE, thereby increasing the price of their ACE (because demand is driven by the target species) in the knowledge they will also receive a return on over-catch as fishers harvest the more valuable target stock; and
- b) Whether redistribution should only be on utilised ACE to provide greater incentives to make ACE available or, if not, the appropriateness of ACE carry-forward if quota owners had already gained return on that ACE through redistribution.

Recommendation 9 – Retrospective Application of Repatriation

Option1:

If recommendation 7 of this report concerning the repatriation of part of deemed value revenue is accepted by the Government, that policy should be applied in respect of the revenues for the fishing year ending 30 September 2005. Legislation necessary to give effect to that recommendation is unlikely to be in place before 2006. To avoid distorting the incentives provided by deemed values in the current fishing year, the deemed values paid in the 2004-05 year should be used to offset generic cost-recovery levies for the 2005-06 fishing year rather than be returned to quota owners for the relevant stocks.

Option 2:

If recommendation 7 of this report concerning the repatriation of part of the deemed value revenue is accepted by the Government, that policy should be applied in respect of the revenues collected under the new integrated policy regime. The decisions required to proceed with the policies, including repatriation, could be made before the commencement of the 2005-06 fishing year. If this occurs, but a legislative opportunity to authorise repatriation is not available until a later stage, the other aspects of the revised policy should be applied, and Cabinet approval sought for application of the repatriation policy to all revenues generated under the new policy settings.

JWG Reasoning

115. The JWG was unable to present a consensus view on the retrospective application of repatriated funds.

116. Government officials, while supporting repatriation of revenues under a revised policy, viewed the current recommendations as an integrated package of policy settings with corresponding co-dependencies. In terms of the policy package there is no rationale for applying just one aspect retrospectively. The policy package is intended to bring about behavioural changes, the most important of which is to encourage fishers to harvest within the TACC. If these measures are effective, less over-catch will occur and the flow of revenues should be reduced. Thus the revenue from past years is not related to the recommended new regime.

117. Industry acknowledged that the scope of this review has expanded and the resulting broader range of recommendations for change to the deemed value regime is a valuable achievement. However, industry was frustrated by the time taken to address the fate of deemed value revenues and favours the return of revenues collected during the delayed timeframe.

Submissions

118. Most industry submissions supported option 1. One submitter noted the historical context for the JWG, where it was to start in 2003 and would have allowed changes to take effect from the beginning of the October 2003/04 fishing year. In addition, the review terms of reference provided for consideration of "applying the outcomes of the review as if the review had been completed by 1 Oct 2004", which the submitter believes potentially allowed for 2003/04 revenue to be brought to account. The submitter estimates that approximately \$16 million of deemed values would have been available to redistribute to quota owners, had that policy been in place over the last two fishing years.

119. Another submitter noted that redistribution would need to occur directly to iwi where allocation of relevant stocks had occurred. Two submissions from the commercial fishing industry supported option 1, provided a fair regime was implemented. Two submissions from the commercial fishing industry opposed option 1. No position was expressed in two submissions from the commercial fishing industry. The submission from the non-commercial fishing industry contained no position.

Ministry comment

120. The Ministry considers that there are no reasons for applying one aspect of the overall package of reforms retrospectively. The reforms are intended to bring about changes in behaviour so that catches in the future are within the TACC. Revenue from previous years is not related to the operation of the new framework.

Ministry Summary of Redistribution Issue

121. Redistribution does not address the problem of over-catch. It does provide some compensation for one set of interests that are damaged by over-catch – those of quota owners. However, other interests are also damaged through over-catch of the TACC, including those of non-commercial fishers and the society-wide interest in sustainable fisheries.

122. Deemed values are a legal substitute for ACE. The Government should take action to address over-catch so as not to undermine quota rights or the fisheries management system. The Ministry, through revised catch balancing guidelines, has already committed to taking the management action needed to address over-catch along the lines of that recommended by the JWG. As over-catch is reduced, deemed value revenue will shrink. Therefore, the proper recipient for large streams of deemed value revenue is likely to be an historical issue.

123. Further, redistribution is likely to have detrimental effects on the operation of the catch balancing regime. Redistribution may create perverse incentives for quota owners to act inconsistently with the management of commercial fishing within TACCs. As discussed above, this may risk sustainability and damage the interests of non-commercial fishers in shared fisheries.

124. If redistribution were implemented, then maintaining incentives on fishers who are also quota owners would lead a reduction in flexibility, for the majority of fishers, currently provided by deemed values for in-season balancing and accidental end of year overruns. The efficiency of the deemed value mechanism would also be reduced by imposing a higher cost on industry than is needed to provide the proper incentives for the majority of fishers. These effects mean that some key functions of the deemed value system would be largely sacrificed.

125. For these reasons, the Ministry believes that redistribution of deemed value revenue to quota owners should not be implemented.

Other Issues arising from the Review

Management actions in response to over-catch

126. Over-catch should elicit consideration of a deemed value increase and other management measures to halt over-catch. The Ministry has already taken action to improve the responsiveness and consistency of the deemed value adjustment process. However, this still leaves legitimate concerns from the JWG and industry submitters about the responsiveness of TAC adjustment that need to be addressed

127. TAC assessment has emerged as an important issue to industry, both during the JWG and in submissions. Industry has emphasised that adjusting deemed values is not always going to be the appropriate response to address over-catch and, alongside consideration of other management actions, there is a need for a more responsive process for assessing (and, where necessary, adjusting) TACs.

128. The joint submission from non-commercial fishers states that any proposal to increase TACCs to cover chronic deeming is unacceptable in shared fisheries, particularly for those stocks that are rebuilding, or under a proportional allocation

system. The Ministry notes that this is not what is being contemplated and that TACs will continue to be set according to the best available information and TACC allocation decisions will continue to be taken where an increase or decrease occurs.

129. If a TAC is set too conservatively then deemed value payments or restricted catches represent a loss of value to extractive users, which could be avoided if the TAC was reassessed.

130. Therefore, it is important to address the responsiveness of stock and TAC assessment mechanisms to over-catch, both to reduce costs on industry of deemed value payments, where catch is sustainable, and to reassure industry about the functioning of the management regime and robustness of TACs in the face of increasing deemed value rates.

131. If ongoing over-catch is occurring and information suggests that some or all of that over-catch might be sustainable then a process to assess the appropriateness of the TAC level for the stock should be initiated. This will require some modification of Ministry processes to ensure that those processes take into account, and give appropriate priority to, the signal provided by over-catch and deemed value payments.

132. In the Fisheries Services Plan for 2007-08 a new research project has been developed to examine each year the available information on two middle depth stocks, which have not been analysed for some time. This analysis will seek to use existing information to determine whether management actions such as a TAC adjustment are warranted. This year southern warehou (SWA) stock/s and another species, that has yet to be determined, will be examined. Other species that are likely to be examined through this process in the future include ghost shark (GSH) and gemfish (SKI).

133. However, we must acknowledge that, unless the system has failed badly, most TACs for overcaught stocks will already be set according to an assessment of the best available information. TACs cannot be adjusted, in most situations, merely because over-catch is occurring. Therefore it is likely that in many cases new information will be needed to allow the TAC to be meaningfully reassessed.

134. The assessment of information on the appropriateness of TAC levels may result in identification of a need to generate further information through directed research effort, which may take some time and have cost recovery implications. Gathering new information is often costly and if this extra cost is not justified by returns on a stock, or associated stocks, then high levels of uncertainty and hence carefully set TACs will be largely unavoidable.

Utilisation of Deemed Value revenue

135. Currently deemed value revenue goes into the consolidated Crown account. If redistribution to quota owners were not to be implemented, you have asked the Ministry to consider alternative uses of deemed value revenue.

136. The Crown is benefiting from a large revenue stream (approximately \$10 million per year) as a result of over-catch and payment of deemed values by the fishing industry. The revenue from deemed values is value that is being lost from the fishery. Furthermore, the purpose of the deemed values is to provide sanction and therefore a disincentive to overcatch. Deemed value revenues are not monies that the Crown has

any expectation of receiving. Therefore, it would seem reasonable to return at least some of that value to the fishery.

137. In terms of the operation of the fisheries management regime, there are two types of deemed value revenue:

- a) *Deemed values from catch under the TACC (undercatch)*. Deemed values paid on undercatch are paid on catch that could have been covered by ACE and is within the limits of sustainability as determined by the management regime. For the last three fishing years this type of deemed value has accounted for approximately 20 percent of deemed value invoices.
- b) *Deemed values from catch above the TACC (over-catch)*. Deemed values paid on over-catch are paid on catch outside the commercial allocation and, if, as is likely, the TAC is set appropriately, on catch which is not sustainable. For the last three fishing years this type of deemed value has accounted for approximately 80 percent of deemed value invoices.

138. Utilisation of these different types of revenue will create differing incentives.

139. The Ministry considers that deemed values from undercatch should continue being directed into the consolidated fund, as recommended by the JWG. If the distribution or use of this revenue provides benefits to quota owners or fishers it may damage incentives for quota owners to make ACE available to fishers, since they may gain some return on unutilised ACE, and damage incentives for fishers to balance catch with ACE, since they may gain some return on deemed value payments.

140. Deemed values from over-catch of the TACC could be utilised in several different areas, to provide some value back to fisheries in the following ways:

- a) Analysis and research for the fishery in which over-catch is occurring and deemed values are being paid to allow for review of the appropriateness of the TAC, or better and more targeted management of over-catch;
- b) Compliance services for the fishery in which over-catch is occurring and deemed values are being paid (such as observer coverage and targeted compliance investigation, including profiling); and
- c) Sector good fund for fishing industry (uses may include environmental certification, training and development).

A *Analysis and research*

141. Funding could be used for analysis of existing information in relation to the appropriateness of the TAC of the over-caught stock and associated stocks. Analysis may indicate the need for further stock assessment research to improve the robustness of the TAC. This addresses the need to review TACs, as identified by the JWG and discussed above, to ensure sanctions are being applied on the basis of a robust TACC. Further, in a few cases, utilisation may not be fully provided for because available information on stocks is not sufficient to provide for meaningful TAC assessment.

142. Funding could also be used for in-depth socio-economic analysis of fishing behaviour and fisheries economics to determine the source of over-catch. This would allow for better, more targeted management of over-catch (such as better implementation of differential rates, use of overfishing thresholds and provision of information to fishers to help them modify fishing behaviour). It would seem reasonable

to use at least some of the deemed value revenue to address over-catch, given that over-catch is detrimental to the interests of stakeholders and creates risks for sustainability.

143. Funding from deemed values would ensure that overcaught stocks that do not meet Ministry resource prioritisation thresholds still receive services, better enabling the over-catch to be appropriately addressed. This would avoid the situation, warned against by the JWG, of the Ministry increasing deemed values without taking other management actions to address over-catch as may be needed.

144. Funding analysis and research for the fishery in which over-catch is occurring would provide benefit to quota owners and fishers by reducing costs imposed by over-catch and from greater integrity of TACCs. Quota owners would gain further indirect benefit through the at least partially offset of potential future cost recovery levies. This may be seen as partial redress for the damage to quota owners' interests of catch covered by deemed values.

145. However, as with redistribution of deemed value revenue to quota owners, its use of deemed value revenues for research and analysis also creates some risk of damaging incentives on quota owners to take steps to reduce catch in excess of TACCs. The level of risk is much lower than for redistribution since the benefit that quota owners may receive from catch above TACC is indirect and relatively small. Risk to incentives for quota owners is more likely to be an issue in low value by-catch stocks, where there are lower economic incentives to maintain stock levels.

B Compliance Services

146. Funding could be used to provide compliance services, such as observer coverage and targeted compliance investigation, including profiling, for the fishery in which over-catch is occurring. This addresses the likely consequences of increasing deemed values (they will be increased if over-catch is occurring), which will increase incentives to discard or misreport. However, funding would not provide a solution over time to those likely consequences because if a deemed values increase leads to increased misreporting and dumping then funding from deemed value revenue will decrease.

147. Funding compliance services from deemed value revenue may present some challenges for compliance management, as it may be difficult to gear compliance resources up and down in response to the variable funding streams (unlike research funding where contracting is a more viable option to deal with funding variability). However, planning across the Ministry should be attuned to so that compliance services are responsive to the likely consequences of the increases in deemed value rates.

148. Extra policing of fishers' behaviour will have some benefit to quota owners' interests where illegal fishing is occurring. As above, it also provides some indirect benefit to quota owners because funding of compliance services will at least partially offset cost recovery levies. These benefits to quota owners may be seen as partial redress for damage to their interests from over-catch covered by deemed values, but also may create some minor risk to incentives on quota owners to take steps to reduce catch in excess of TACCs.

C Sector good fund

149. Funding could be put into a sector good fund for the fishing industry for purposes such as environmental certification, training and development initiatives and research and development in areas such as product development and fishing selectivity techniques.

150. Putting deemed value revenue into a sector good fund does not address the problem of over-catch, except perhaps if spent on improving fishing selectivity techniques. As it is not directly address the problem over overcatch, the rationale for redirection of the revenue is lower. However, assuming the fund is successful in increasing profitability for the fishing industry, a sector good fund does mean that the value of that revenue is not 'lost' from the sector.

151. Use of revenue for 'sector good' benefits the whole commercial fishing sector, or if the activity would have happened anyway, it benefits those who would have borne the cost (quota owners in the case of certification, fishers/fishing companies in the case of training and development).

152. If used on all stocks or those with the most potential for increased profit, it may create a situation where deemed value revenue from over-catch of a by-catch stock is funding benefit to the target stock that is driving the over-catch of the by-catch stock.

153. If spending were targeted to the stock that the deemed values were paid on, then any increased profitability of that stock would necessitate stronger deemed value increases to offset increased catch value. This creates a risk that incentives on quota holder to defend TACC may be damaged, especially in stocks where there are good prospects for increased value or stocks where quota holder cooperation or access to capital is poor.

154. The revenue for funding sector good activities would not be proportional to the need. This is unlike using the funding for addressing over-catch in the stock deemed values are being paid on (where deemed value revenues and over-catch would increase and decrease together).

Comment and Next Steps

155. All of the above areas could present a risk of conflict of interest for the Ministry, which sets deemed value rates as well as the management measures within fisheries, but would benefit from increased revenue if these were not effective in minimising over-catch of the TACC. If the money were appropriated directly to the Ministry for use, then fiscal discipline is reduced unless strict mechanisms can be set up to ensure accountability and cost effective expenditure.

156. Quota owners are likely to be concerned with deemed value revenues benefiting other industry participants. They will argue that it is their property rights that have been damaged by catch in excess of TACCs and other participants are not entitled to revenue generated by such damage.

157. Deemed value revenues are currently treated as non-departmental revenue. Revenues received are placed in a trust account and, 15 days after the end of the fishing year, becomes Crown revenue.

158. The Ministry has identified three approaches to provide for the above uses of deemed value revenues:

- a) Earmarking a relevant portion of the Crown revenue for particular Vote: Fisheries activity. This would involve appropriation to Vote: Fisheries for use by the Ministry as a departmental expense. However, Treasury do not support this approach. The appropriation of Crown revenue for new activities needs to go through the new initiative bid process each year. Any deviation from this path subverts the normal new government expenditure prioritisation process as well as raising Ministry conflict of interest issues (discussed above);
- b) Providing the Minister of Fisheries with the ability make a decision to retain some or all of the balance of the deemed value trust account to purchase specific Ministry services (e.g., research, compliance). The relevant monies, instead of becoming Crown revenues, would be non-Crown revenue and an appropriation to Vote: Fisheries for use by the Ministry as a departmental expense. The exercise of the Minister's discretion to utilise the monies in the deemed value trust account would be subject to process and rules agreed by Cabinet. However, Treasury do not support this approach. It creates Ministry conflict of interest issues (discussed above) and involves money going to the Ministry in a manner inconsistent with normal new government expenditure prioritisation process; and
- c) Providing the Minister of Fisheries with the ability make a decision to retain some or all of the balance of the deemed value trust account to transfer to one or more industry commercial stakeholder organisations for a specific purpose. The relevant monies, instead of becoming Crown revenues, would be non-Crown revenue and an appropriation to Vote: Fisheries as a non-departmental expense. The Ministry would likely have some role in administration of the transfer and monitoring its use. The exercise of the Minister's discretion to utilise the monies in the deemed value trust account would be subject to process and rules agreed by Cabinet. As this approach does not involve earmarking the use of Crown revenue, does not directly involve Ministry activities, and treats the money as "industry money", Treasury prefers this approach.

159. If you wish to take the above proposals further, Ministry officials will prepare further advice, in consultation with Treasury, setting out in detail the rationale, purposes and enabling mechanisms for the use of deemed value revenues.

160. Given the impacts on the interests of the industry and the operation of incentives in the catch balancing regime, stakeholders should be provided with the opportunity to provide views on the possible use of deemed value revenue. This further work could be addressed separately to making decisions implementing the other recommendations from the JWG.

Financial Implications

161. Currently the Crown receives around \$10 million per year from fishers' payment of deemed values. The implementation of the recommended improvements in the operation of TACC and deemed value mechanisms should lead to a reduction in deemed value revenue. Crown revenue is therefore expected to fall as the recommendations in this paper are implemented. If a portion of deemed value is to be returned to the sector, as discussed in the previous section, then the amount of Crown revenue will fall further still.

Implementation Review and Communication

Implementation Review

162. The JWG review has suggested a number of useful improvements in the implementation of the catch-balancing regime as well as several legislative amendments. The Ministry considers a medium-term assessment of the implementation of the review recommendations would be appropriate to ensure that it is being reflected in the management of fisheries. Once implemented, an important indicator of the success of the changes will be the likely downward trend in total deemed value revenues collected. Officials propose that the Ministry conducts the review in 2012.

Communication

163. In accordance with the terms of reference for the review, the Ministry has recently advised industry two of the Ministry's recommendations differ from those of the JWG. The recommendations in this regard are on the repatriation of deemed value revenues and on establishing process to reduce deemed value rates (when necessary).

164. Industry members of the JWG have for some time been awaiting the outcome of the stakeholder consultation and Government decisions on the JWG recommendations. Industry JWG members have been informed of the likely Ministry recommendations and have indicated they wish to meet with you to discuss the recommendations. When you have made your decisions, the Ministry will prepare draft correspondence for your signature informing industry JWG members. Once this correspondence has been sent to industry JWG members, the Ministry will inform other stakeholders who made submissions in the public consultation.

Consultation

165. The Treasury have reviewed and provided comment on the contents of this paper.

Recommendations

166. It is recommended that you:

- a. **Note** that the Ministry has already taken steps to implement parts of the recommendations of the JWG through its revised catch balancing guidelines;

Recommendation 1

- b. **Agree** that the Ministry should be committed to taking action where over-catch of the TACC is occurring and that case by case consideration will be given to the most appropriate management actions, including:
 - i. Deemed value increase and differential deemed value adjustments,
 - ii. Reassessment of best information relating to appropriateness of TACCs,
 - iii. Other management measures such as overfishing thresholds;

Recommendation 2

- c. **Agree** that a review of the s14A agreement threshold, in conjunction with consideration of other collective thresholds in the Fisheries Act, should be included in the work programme for the planned Fisheries Act review, as resources allow;

Recommendation 3

- d. **Note** that the Ministry's revised catch balancing guidelines have already made the operational changes required to implement "recommendation 3: the principles for setting deemed values";
- e. **Agree** that, in general, over-catch should lead to an increase in deemed value rates in the following year so that they provide sufficient incentive to fishers to balance catch with ACE
- f. **Note** that the need for any extra compliance effort will be determined on a stock by stock basis as increased deemed values and differentials are applied;

Recommendation 4

- g. **Note** that the Ministry will amend its catch balancing guidelines to ensure that they are responsive to situations where a reduction in deemed values may be appropriate;
- h. **Agree** that the proposal to allow deemed values to be set in the first month of the fishing year should be included in the work programme for the planned Fisheries Act review;

Recommendation 5

- i. **Agree** that interim deemed values rates should not be substantially lower than annual deemed values rates, unless annual deemed value rates are set well above ACE prices;
- j. **Agree** that the proposal to remove restriction on the relationship between interim and annual deemed value rate be included in the planned Fisheries Act review;
- k. **Note** that, in the meantime, the Ministry's revised catch balancing guidelines recommend that interim rates be set at a level closer to the annual rate in cases where interim rates may be contributing to over-catch;

Recommendation 6

- l. **Agree** that the use of differential deemed value rates will be retained to provide protection from overfishing in cases where annual deemed value rates have not captured a change in circumstances, or from occasional severe overfishing by fishers with low fishing costs;

Recommendation 7-9

- m. **Note** that redistribution would damage the incentives of the catch balancing regime and should not be implemented;
- n. **Agree** that deemed value revenue not be redistributed directly to quota owners;

TACC setting

- o. **Note** that some modification of Ministry prioritisation process is likely to be needed so that the TAC reassessment and stock research prioritisation processes appropriately recognise the signal of high deemed value payments;

Use of Deemed Value Revenues

- p. **Note** that deemed value revenue, collected on catch above the TACCs, could be used in three ways to benefit the sector:
 - i. Research services in fisheries that, due to over-catch, are generating the deemed value revenues;
 - ii. Compliance services in fisheries that, due to over-catch, are generating the deemed value revenues;
 - iii. Funding to support specific activities that benefit the fishing industry;
- q. **Note** that each of the above activities would need to be supported by processes that ensure cost effectiveness and accountability;

EITHER

- i. **Agree** to direct the Ministry to prepare further advice, in consultation with Treasury and fisheries stakeholders, on the rationale, purposes and use of deemed value revenues (on catch above TACCs) for one or more of the purposes set out in recommendation p;

OR

- ii. Agree that deemed value revenues continue to go into Crown revenue (*status quo*);

Implementation

- r. **Agree** that in 2012 the Ministry should review the operation of the deemed value and catch balancing regime, the implementation of these recommendations, and the amounts of deemed values collected; and
- s. **Note** that industry members of the JWG wish to meet with you to discuss the issue of repatriation of deemed value revenues to quota owners;
- t. **Agree** that, subsequent to your decisions, the Ministry prepare for your signature draft letters to the JWG, and subsequently to other fisheries stakeholders, informing them of your final decisions.

Mark Edwards
for Chief Executive
Ministry of Fisheries

AGREED / NOT AGREED / AGREED AS AMENDED

Hon Jim Anderton
Minister of Fisheries

/ / 2007

