Balancing Local Ownership and Control with Foreign Investment and Foreign Fishing Interests: Transferable Quota Allocation in the Falkland Islands

Michael Harte, Oregon State University, mharte@coas.oregonstate.edu
John Barton, Department of Fisheries, Falkland Islands Government, jbarton@fisheries.gov.mq

Abstract
In August 2005 the Falkland Islands Government passed legislation establishing a transferable rights based management regime for its fisheries resources. The regime is designed to encourage the ownership and control of Falkland Islands fisheries resources by Falkland Islander owned and controlled fishing interests. The allocation of transferable rights has to be sensitive to economic and social considerations specific to the Falkland Islands. These issues include: Existing Falkland Islands investment in fisheries; the high degree of direct foreign investment in Falklands-based fishing enterprises; fiscal dependence on resource rentals paid by foreign vessels licensed to fish in Falkland waters; and community expectation regarding the economic contribution that the owners of valuable fishing rights make to the Islands. To balance local ownership and control with the need for direct foreign investment and the continued involvement of foreign fishing fleets in some fisheries a number of mechanisms are contained in the new legislation. These include: Provisional quota; fully transferable quota; annual catch entitlements; registers of eligibility to own entitlements and quota; and tests of effective control, efficient use and active involvement in a fishery. Now established in law the challenge is to implement the new system efficiently, and to monitor whether the objectives and expectations are delivered as anticipated.

Key Words: Transferable fishing quota; local ownership and control; foreign investment; small Island developing state.

Introduction
In August 2005 the Falkland Islands Government passed legislation establishing a transferable rights based management regime for its fisheries resources. The regime is designed to encourage the long-term ownership and control of rights to Falkland Islands fisheries resources by Falkland Islander owned and controlled fishing companies. The main instrument for achieving this is a comprehensive system of individually transferable fishing rights.

The reasons for the introduction of a rights-based system are predominately economic. The growth of the Falkland Islands economy is significantly affected by the capacity of local fishing companies to take advantage of the globalization of the international seafood market. Participating more fully in the global seafood market means expanding the economic base of the seafood sector by diversifying fishing-related activities undertaken by Falklands-based companies. The system of individually transferable rights is intended to energize a transition from an industry involved in the catching of fish for companies based mainly in Europe, to a Falkland’s...
based seafood industry focused on seafood production marketed to a wide range of international markets. A diversified seafood sector also reduces the Falkland Island Government’s fiscal risk from reliance on fishing license revenues by ensuring that a greater proportion of private and public sector revenue comes from a range of seafood and related economic activity, for example maritime service industries.

A key issue in the design of the system was how to ensure the long-term local ownership and control of fishing rights without unduly disrupting current successful joint venture between local companies and foreign fishing companies. Related to this is the need to maintain ongoing foreign investment in the development of the territories extensive fisheries resources. The Falkland Islands do not have the population base to provide the necessary investment from domestic savings.

OVERVIEW OF THE FISHERIES SECTOR

The Falklands Islands are an Overseas Territory of the United Kingdom and are located in the South Atlantic some 400 miles off the coast of South America between approximately 51 and 53 degrees south (Figure 1). The resident population is 2,500. There is full employment and annual Gross Domestic Product (GDP) is £70 million. The Territory receives no financial or technical development assistance from the United Kingdom, although the UK does maintain a military base in the Islands. It is an open economy with few tariffs or duties and no restrictions on the transfer of capital in or out of the Islands. Real growth in GDP has stalled in large part because of the slow growth of the fisheries sector. There are substantial leakages in the form of wages to overseas crew and transfer of profits by overseas-based companies.

![Map of the Falkland Islands](image)

**Figure 1. Map of the Falkland Islands**

Fisheries are the largest contributors to the Falkland Islands economy generating approximately 42% of GDP. The main catch in tonnage and value is squid (Figure 2). Two species are caught, *Illex (Illex argentinus)* squid by a jigger fleet from East Asian countries and *Loligo* squid (*Loligo gahi*) by Falkland Islands registered vessels owned by joint ventures between Falkland Island and Spanish companies. Catches of all species of squid and finfish have ranged from a high of 377,038 tonnes to a low of 100,979 tonnes per annum over the last decade. During this period catches averaged
around 220,000 tonnes. The low total catch of 100,979 tonnes in 2002 was due to the failure of the Illex fishery. The fishery has again failed in 2004 and 2005. These recent low years appear to be the result of a combination of unfavorable oceanographic conditions and excessive fishing effort throughout the Southwest Atlantic. This has led to poor squid recruitment and the few squid recruited in those years did not enter the Falklands Islands waters.

Figure 2. Total catch in Falkland Islands waters 2003 (metric tonnes)

The total ex-vessel value of fishing and related maritime activity in an average fishing year is estimated to be between £200 and £250 million. The biggest source of Government revenue (approximately 50%) is the sale of licenses to mainly foreign vessels from the Far East and Spain. The share of fishing income generated by joint venture companies, owned by partners from the Falkland Islands and foreign, mainly Spanish partners has increased over recent years.

There are currently nine local companies owned by Falkland Islanders with a share of more than 25 percent in one or more vessels. Their share amounts to between 15 and 20 percent of fishing revenues. Local companies are vertically integrated into the processing and marketing operations of their joint venture partners. Local investment is predominantly a share in the fishing vessel. No significant onshore processing or cold storage of offshore catches occurs in the Falkland Islands. Transhipment of catch occurs at sea in sheltered coastal waters or in South American ports.

THE EVOLUTION OF FALKLAND ISLANDS FISHERIES POLICY

Prior to 1987 the Falkland Islands had no control of fisheries resources beyond its 12 nautical mile territorial sea. In 198r the Falklands Interim Conservation and Management Zone (FICZ), extending 150 nautical miles a central point, was created to regulate the activities of foreign fishing vessels and to raise license revenue for the Falkland Islands Government. The creation of the Falkland Islands Outer Conservation Zone (FOCZ) in December 1990 extended Falkland Islands fisheries management jurisdiction to 200 nautical miles.

An economic development policy for fisheries was set in the Falkland Islands Development Strategy produced in August 1988 (Prynn 1988). This advocated a cautious approach to investments in the fishery until the viability was proven. Subsequent fisheries policy statements, culminating in the 1997 policy (FIG 1997), promoted greater involvement by the private sector in fishing activities. The
evolution of fisheries policy in the Falkland Islands from 1988 to 1997 is set out in Table One.

Although successful for over 15 years, by 2001 it had become apparent that the policy approach to fisheries management required a fundamental change. Without change it was felt that in the short term Falkland Islands fishing companies would find it increasingly difficult to generate the cash flows and capital required to maintain a viable presence in Falkland Islands fisheries. In the medium to long-term it was expected that the Falkland Islands economy would be incapable of capturing a significant share of the total economic activity generated by its fisheries resources. Also Government revenues, in the absence of other sources of income such as oil revenues, would decline in real terms, as revenue from fisheries license fees remained static or fell (Figure 3). Note that the rapid drop in license income in 2004 and 2005 is due to the decline in the Illex squid fishery and license income is expected to return to £16 million in nominal income for 2006 and 2007.

![Figure 3. Fisheries License Revenue 1988-2005](image)

Between 2001 and 2005 a lengthy process of policy development, public consultation and legislative drafting was undertaken. In late 2005 a new Fisheries Ordinance implementing system of tradable fisheries rights was passed into Falkland Islands law.

**COMPONENTS OF THE NEW RIGHTS BASED MANAGEMENT REGIME**

The new fisheries rights-based management regime confers both entitlements and obligations on the holders of fishing rights. The nature of entitlements and obligations depend on the class of rights held. The three classes of right are individual transferable quota, provisional quota, and catch entitlements.

Individual transferable quota (ITQ) can be owned by companies with Falkland Island status holders as shareholders and is tradable and of 25 years duration. ITQ can be expressed either as a proportional share of a total allowable catch (TAC) or as a proportional share of total allowable effort (TAE). ITQ is effort-based in the first instance because the current management system is effort-based, making implementation easier. An effort-based system will have lower administration and enforcement costs than a catch-based system. This is especially relevant to the
<table>
<thead>
<tr>
<th>Year</th>
<th>Policy Evolution</th>
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<tbody>
<tr>
<td>1989</td>
<td>Foreign fishing companies are encouraged to work with Falkland companies. Provided for an increase in Falklands involvement.</td>
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<td>1990</td>
<td>Gave “strong emphasis” to the development of Falkland Islands participation in the fishery. Priority considered for Falklands registered fishing vessels. Priority for Falklands companies chartering fishing vessels. Prospect of long-term licenses for Loligo introduced.</td>
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<td>1991</td>
<td>Priority considered in license allocations for vessels owned or chartered by companies in which there is genuine investment by Falkland Islands residents, and where the company is registered and managed in the Falkland islands and subject to Falklands tax. Additional priority for Falklands registered vessels.</td>
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<td>1992</td>
<td>“Principal” aim of licensing policy to give emphasis to participation by FI residents in fishing activities within the FICZ. Long-term all species licenses introduced with priority in allocations to be considered according to the following scheme:  - Companies registered in the Falklands with whole or majority of voting share capital owned by persons ordinarily resident in the Falklands, wishing to fish using a vessel wholly owned by the company who would own the catch.  - Joint ventures between companies and overseas companies with a ‘significant’ proportion of voting shares in the company owned by persons ordinarily resident in the Falklands. Profits divided according to shareholding. Paid up capital of at least GBP 100000. Limit on management expenses.  - Charter arrangements where the vessel is chartered to a Falklands company or a joint venture. The local company to receive not less than 10% of the catch.  - Companies establishing fishing related operations in which not less than 5 persons are fully employed.  - Companies demonstrating a long-term commitment, which entailed long-term economic benefits.  - The intent of the long-term multi-species license was to give significant encouragement to the growth of a local fishing industry.  - The scheme was to include verification of plans.  - Different approaches for different license types. First specific encouragement for Falklands involvement in the Illex fishery including long-term licenses.</td>
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<td>1994</td>
<td>Allocation of long-term multi-species (or multi-license type) licenses. First introduction of points system including definitions and criteria of Parent companies, Falklands residents, and applicant companies. The points system focused growth of the Falklands fisheries sector and rewarded investment in fixed assets intended to support the fishing industry. It rewarded previous involvement in the fishery and promoted ownership of catch and ownership of vessels. The initial points system also gave more points for involvement in Illex than Loligo. A parent company had to have at least 51% of shares owned by Falklands residents.</td>
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<td>1995</td>
<td>Basic policy remained the same as 1994. In the points system some criteria were stretched in order to make it more difficult to obtain maximum points. Definition of management was expanded.</td>
</tr>
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<td>1997</td>
<td>Further update of the points system. Indication that expiring long-term licenses could be considered for renewal for a further 5 years, where; the applicant has implemented their original plans, the parent company has invested more than GBP 200000 in the purchase of a vessel funded from shareholders funds or post tax profits, the investment should have been made by May 1996. 10% of Illex licenses could be available on similar criteria to those applied to Loligo. The parent company had to be 100% owned by Falklands residents although a dispensation was given for existing companies. Falklands residents must own at least 25.1% of the shares of the Applicant Company. Day to day management must be carried out in the Falklands. Priority was given to vessels wholly owned and operated by a Falklands parent company. The points system was ‘stretched’ again with a significant number of points being available according to the level of investment in fishing vessels. Previous involvement continued to be rewarded.</td>
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in the Falkland Islands where the major fisheries are offshore and dominated by foreign registered vessels and there is limited local capacity to implement catch-based compliance systems.

Provisional quota (PQ) is owned by companies where the shareholding held by Falkland Island status holders is less than the threshold required to hold ITQ. The Fisheries Ordinance sets out the criteria that have to be met in order for a company to gain a listing on the eligibility register and thereby be eligible to hold PQ. The creation of PQ as a class of fishery right is largely a transitional arrangement which facilitates the implementation of the new management regime. PQ is non-tradable and has a life of 5 years. PQ can be transferred to ITQ at any time should the company holding the PQ become eligible to hold ITQ.

Annual or seasonal catch entitlements (CE) are owned by companies in which Falkland Island status holders have at least a 25.1% shareholding, is tradable and is of a maximum of one year duration. Both ITQ and PQ generate CE at the beginning of the fishing season or year. CE generated by ITQ is fully tradable to eligible companies but CE generated by PQ cannot be traded. CE, rather than ITQ, or as now the fishing license, becomes the day-to-day currency of the rights-based regime. Fishing vessels will still be required to have a fishing license that will be granted if the vessels operators have sufficient CE to cover their fishing campaign in Falkland Islands waters. The fishing license is retained in the new management system to regulate fishing activity with respect to gear type and sizes and mitigation measures to limit the impact of fishing on dependent and associated fish stocks, marine mammals, seabirds and the marine environment.

LOCAL OWNERSHIP & FOREIGN INVESTMENT

In many small territories the issue of foreign ownership and control of natural resources is politically sensitive. Part of this sensitivity is a legacy of the colonial system where in some cases resources were exploited for the benefit of absentee land owners with little benefit accruing to the local population. At the same time, limited experience with industrial fisheries and limited capital means that foreign investment plays a major role in the development of fisheries in small territories. In the case of the Falkland Islands, not only do joint ventures with foreign companies form the backbone of the domestic fishing sector, sales of fishing licenses to foreign flagged vessels, often only loosely connected to local companies through agency agreements, make up half of annual government revenue.

Another dimension that has political significance in small, fishery dependent states is how much faith officials and politicians are willing to put in the operation of the market to ensure fisheries resources are used in a way that maximizes the welfare of the community. Any apprehension is often warranted given thin markets arising from a limited number of eligible owners of rights and the significant amount of capital required to obtain rights, and the stickiness in markets caused by long-term joint venture arrangements. Addressing these concerns presents a major policy challenge.

Such concerns were at the heart of protracted debates during the development of the new policy. The agreed solutions had to be both politically acceptable, conform with international agreements and be workable for both administrators and fishing companies. Consensus was finally reached when it was agreed that only companies
that are 100% owned by shareholders with Falkland Islands Status could own ITQ. This addresses local concerns that non-Falkland Islanders could come to live in the Islands in order to obtain fishing rights. Falkland Island Status is normally awarded after a period of seven years as a full time resident in the Islands. Significant political and public concern about granting perpetual rights resulted in rights being granted for 25 years. This time period was a compromise between those who called for the certainty of permanent rights and those who did not wish to see “public” rights given away permanently.

Limiting the ownership of ITQ rights to status holders should see Falkland Islands partners in any joint venture in a much stronger bargaining position. Under previous arrangements vessels were effectively foreign owned and crewed and catches were integrated into the marketing operations of the foreign partners. Although Falkland Island companies may have had up to a 50 percent ownership in a vessel, their bargaining power was severely reduced because of the need to renew one year or five-year licenses. Renewal depends on owning a part share of a vessel that has a track record in local fisheries and hence on the continued presence and cooperation of the foreign partner. Under the new arrangement it is the foreign partner who will need the continued support of the local partner to guarantee access to the fishery.

Catch entitlements have a dual purpose. First, they provide for joint venture arrangements between foreign fishing companies and Falkland Island owned companies. Second, CE creates more robust markets for rights trading. Unlike ITQ, joint venture companies can own catch entitlements even if Falkland Island status holders have a minority shareholding. The threshold for local ownership may be set at different level in different fisheries. This allows existing joint ventures to continue with minimal disruption and gives the security of short-term access to fisheries to foreign investors. It is also expected that Falkland Islands companies will be more willing to trade short duration CEs rather than ITQ because this trade does not affect a company’s long-term access to the fishery. The use of CE should see a faster rationalization of the fishing fleet and effort than would have been the case if ITQs alone were implemented.

**STATUTORY ABILITY TO REQUIRE RIGHTS TO BE MANAGED FOR THE BENEFIT OF THE FALKLAND ISLANDS**

Throughout the policy development process and also expressed in debate during the passage of the Fisheries Ordinance a strongly held view was expressed that fishing rights impose on their holders an obligation to effectively and efficiently manage the right for the benefit of the Falkland Islands. To ensure this obligation is met, it was felt that Government must have the statutory ability to enforce it (Falkland Islands Government 2003).

The three key components of effective and efficient management enshrined in legislation are effective control, active involvement, and efficient use. These were subject to much debate since they were introduced in the original fisheries policy consultation paper. For economic and political reasons it is of paramount importance that the Falkland Islands is in effective control of its own fisheries resources. Active involvement and efficient use received wide support because there is a strong inclination to prevent people from brokering the rights they own for immediate
monetary gain, rather than using the ownership of rights to be the basis of investment and growth of their seafood businesses.

After much work, review and consultation it was decided that no quantitative tests for the principles could be created that were simple to apply and/or did not unnecessarily restrict the business decisions of fishing companies. There was also concern that if applied in a formulaic way, without regard to the circumstances of the fishing company concerned, the Director of Fisheries could be judicially reviewed thus undermining the principles.

The new Fisheries Ordinance therefore contains a statutory process that gives the Director of Fisheries the ability to intervene if he or she reasonably believes that a company is not complying with the principles. The key to intervention is that the Director of Fisheries acts reasonably and fairly in making his or her intervention. The intervention process has been designed to ensure this.

Central to the process is the creation of eligibility registers to hold ITQ, PQ and CE. Companies who are not on a register cannot acquire rights. A company already on an eligibility register that is found have become ineligible has a time-limited opportunity to become eligible again, dispose of its rights or appeal to an independent Disputes Commission.

For example, to be on the ITQ register the Director of Fisheries must be satisfied that the company is or in the case of a new company will be in effective control of the rights it holds, actively involved in the seafood business and making efficient use of the rights.

Effective control is a broad concept that goes beyond just foreign influence on a fishing company and can relate to other aspects of fisheries policy such as aggregation limits on rights holdings and to criminal enforcement. Unless the contrary is proven Company A will be deemed to be subject to the effective control of Company B if Company A is:

- Accustomed to following the instructions of Company B; or
- Accustomed to acting in the a manner of consistent with advancing the interests of Company B; or
- Company B holds:
  - The right to exercise control or control the exercise of 25% or more of the voting power at any meeting of the company; or
  - 25% or more of any class of shares in a company.

Active involvement requires the Director of Fisheries to be satisfied that the company, or in the case of a holding company, associated companies are involved in the catching, processing, wholesaling, retailing, and/or marketing of seafood and the level of involvement is commensurate with the type and quantity of rights held.

A company that holds equivalent rights to 10,000 tonnes of fish would be in potential breach of active involvement provisions if it only caught 2,000 tonnes and the rest was sold to other unrelated companies as catch entitlement. In this situation the Director of Fisheries would still have to establish the reasons why the 8,000 tonnes was sold as catch entitlement. For example, a company may have had a one-off offer.
of a price that meant it was more profitable to sell the catch entitlement than fish it. The profits from the sale were then reinvested in another part of its seafood business. Having reviewed the circumstances of the sale, the Director of Fisheries might decide to take no action on the grounds that this is a normal and reasonable commercial practice. If on the other hand the company sold all catch entitlements to unrelated companies three years in a row and paid all profits out as dividends to shareholders, the Director of Fisheries might reasonably investigate whether the company continued to be actively involved in the fishery.

The requirement for efficient use of rights is intended to encourage companies to make the best economic use of their rights. This means the actual or expected economic return to the holder is commensurate with the value of the rights held and not inconsistent with the returns received by holders of similar rights over a reasonable period of ownership. For example, if a company held CE equivalent to 10,000 tonnes of loligo and these entitlements are trading for £100 a tonne, a company could make £1000,000 by selling the catch entitlements or make more than this by fishing the rights. But, if in the same season a company reported a return of only £10 a tonne, the Director of Fisheries would want to know why the return was only 10% of what the market judged to be a reasonable return.

Efficient use is a more difficult principle to apply in practice because business growth is a dynamic process responding to factors external to a company such as prices in markets and to internal factors such as investment strategies and asset acquisitions. Therefore at any point in time some companies will be more profitable than others but this will change through time as internal and external economic factors evolve. The individual and collective economic performance of companies will show great variation in returns, and hence any test based solely on average industry performance will need to take this into account.

No seafood company will have exactly the same portfolio of fishing rights or choose to use those rights in exactly the same way. For example, some companies may choose to buy catch entitlement to Illex squid and use its own trawlers to harvest a fish stock for the Southern European market. Another company may own Illex ITQ but choose to charter Asian-based jiggers to sell to the Japanese market. Portfolio diversity and fishing operation diversity should become greater not less through time. Revenue from trading of rights, as well as from harvesting, will complicate the measurement of economic returns. As a legitimate part of a company’s asset portfolio it would be difficult to argue that revenue from rights trading or any other asset sale should be excluded from the evaluation of a company’s economic performance.

Nevertheless, a provision requiring the efficient use of rights is retained in the Fisheries Ordinance because it provides the ability for the Director of Fisheries to target seafood companies that have a repeated pattern of poor financial performance relative to the rest of the sector. If after taking into account factors relevant to the specific business and fishery, the Director Fisheries is not satisfied that the company is making efficient use of its rights, the company can be removed from the eligibility register and therefore be forced to sell its rights to more profitable companies.

Structured as described in this section the principles of effective control, active involvement and efficient use should not interfere with the day-to-day operations of
seafood companies. Their presence in legislation, together with the power of the Director of Fisheries to intervene if he or she is not satisfied that the principles are being upheld, should be sufficient to remind seafood companies of the obligation to use fishing rights in the best economic interests of the Islands.

In practice, the removal of a company from the eligibility register will generally be a last resort for the more extreme cases of poor company management of rights. This would mean the tradability of rights has failed to see another more successful company buy a failing operator out and dialogue between the Director of Fisheries and the company under investigation has failed to bring about a change in company operations.

CONCLUSION
The Falkland Islands rights based management regime will be progressively implemented from the 1st of July 2006. The expectation is that all fisheries will be managed under the new regime by January 2007. There is evidence that local companies are restructuring and/or are putting in place measures to ensure their shareholding can not become non-compliant and hence fail to meet the new regime’s requirements on rights ownership in the future.

If successful the Falklands fisheries sector will again become a prime driver of economic growth. First, fishing companies have increased security of access to the fisheries resources and increased flexibility in the way they decide to structure activities to take advantage of global business opportunities. Second, diversification should occur in the industry as companies, no longer required to invest in vessels, look to invest in value-added activities such as processing and marketing. Third, seafood companies should invest more in research and development because long-term rights mean that they will benefit from investments that have longer pay-off periods. Fourth, international competitiveness should increase as poorly performing companies sell rights to better performing companies. Fifth, as the profitability of the domestic seafood sector increases, government income from personal and corporation tax and resource rents should increase.

Even if only in part successful, the new rights-based management system provides a model for small coastal states or small industrial fisheries currently dependent on foreign fishing fleets. Rights-based systems promoting local ownership and control have been considered too complex to implement and administer for small territories and states. Following the Falklands model many states and territories should be able enjoy inherent advantages of local rights-based management over dependency on foreign investment and the loss of control of fisheries resources to foreign interests.

REFERENCES
