

SCOMM

#17:7

AN ANALYSIS OF THE LEGISLATIVE OPTIONS UNDER  
CONSIDERATION BY THE LIMITED ENTRY STUDY GROUP

Prepared by: Jack Kreinheder  
Research Economist  
Commercial Fisheries Entry Commission  
December 10, 1979

SUMMARIES:

I. CAPITAL GAINS TAX OPTION

The Capital Gains Tax is intended to provide access to limited entry permits for individuals who are unable to afford a permit at today's high open market prices. This would be accomplished by setting a statutory ceiling on permit prices and taxing any sale price above that level at 100 percent.

ADVANTAGES: Permits would still be freely transferable. Permit holders could select the transferee and no interference with intra-family transfers would occur. Fishermen could still change from one fishery to another without difficulty. Depending on the magnitude of the tax, permit holders who bought their permits would be able to recoup at least part of the purchase price of their permit. State compensation could provide for complete recovery of the purchase price. Administrative costs would be higher than under the present system, but lower than those associated with an apprenticeship program.

DISADVANTAGES: Reduction of permit prices would have a dampening effect on the transfer of permits, since less incentive would exist for a permit holder to sell his permit. Although permits would be more affordable, fewer would be available for purchase, so that access to permits would not necessarily be improved. In order to prevent a black market in entry permits, a strict system of auditing and enforcement would be required, with its associated costs. The determination of statutory permit prices would be complex and subject to controversy. Fishermen who have purchased entry permits could lose much of their permit investment unless compensation were provided by the state, but such compensation could total many millions of dollars.

II. LOAN PROGRAM OPTION

The primary purposes of the proposed changes to the current Commercial Fishing Loan Program are to give preference for such loans to applicants with substantial financial need and dependence on fishing, to provide for hardship in loan repayments, and to encourage the purchase of permits by providing grants for a portion of the loan amount.

ADVANTAGES: This option has the fewest legal and administrative problems and would probably be the most acceptable to present permit holders

The loan program appears to offer the only constitutional means of openly favoring Alaska residents over non-residents, since non-residents can be completely excluded from the program without causing legal problems. It may be possible to further increase resident participation in the limited fisheries by providing preferential loan terms for the purchase of non-resident permits.

DISADVANTAGES: It is unclear whether this option would accomplish its objectives without more specific legislative guidelines for the administration of loans. The majority of fishing loans to low-income persons have been for vessel upgrading rather than for entry into the fisheries. Specific criteria may have to be enacted if such entry is to be given priority in the loan program. Easier access to loan money could bid up permit prices even further if price controls are not enacted. Giving priority to the purchase of entry permits may discourage diversification into bottomfish and other developing fisheries.

### III. APPRENTICESHIP OPTION

The purposes of this option are fully explained in the apprenticeship proposal.

ADVANTAGES: An apprenticeship system would provide fishermen who have limited financial resources with an opportunity to obtain an entry permit at no cost. Access to permits would be based on fishing experience, or dependence, or hardship criteria rather than on the open market bidding process. The system would ensure that a trained and qualified group of persons would be entering the limited fisheries. The system would allow for a natural progression from crewman to skipper.

DISADVANTAGES: There appear to be a number of unresolved legal questions concerning the proposed apprenticeship system. As currently worded, permit holders still have control over entrants to the fisheries, because experience as a crew member is a requisite for admission to the apprenticeship program. Such control was ruled unconstitutional in 1969 by a Federal court. However, the separate apprenticeship supplement may circumvent this problem by basing future admission to the apprenticeship program on dependence or hardship criteria, instead of solely on experience.

No provision has been made for permit holders to switch from one fishery to another without completing another period of apprenticeship, thus locking permit holders into one fishery. An apprenticeship system would be expensive to administer because a continual stream of applicants, which would be much larger than the number of initial applicants for permits under the present program, would have to be evaluated by the Commission. Current permit holders would either lose their purchase investment when they leave the fisheries, or expensive state compensation would be necessary to obtain permits for the system. And finally, most fishermen would probably object to the requirement of taking on a complete stranger in a situation where mutual trust and responsibility are important, not only for business reasons, but for personal safety as well.

#### IV. AMORTIZATION OPTION

The apparent purposes of the amortization option are to place a time limit on the entry permit and to allow permit holders to recover their investment in either vessel and gear (option A), or in the entry permit (option B), in the event that the apprenticeship option or other transferability system is enacted. The purpose behind the time limit is unclear, since the permit holder would be able to renew his permit indefinitely. A simple use requirement would seem to be more effective. Little justification can be seen for the amortization of vessel and gear, since the individual retains possession of these under any of the proposed transferability options. It is also questionable whether original issues should be allowed to amortize the fair market value of their permits, since they received them for only an administrative fee. In addition, the amortization proposal for entry permits does not seem to be the most equitable method of compensating those permit holders who did buy their permits for their purchase investment.

Rather than allowing a fixed 10 percent write-off each year, it may be more desirable to relate the amount of amortization to the net return on the permit investment at the time the permit reverts to the state, which would be when the permit is no longer fished. Under this type of system, those permit holders whose net fishing earnings during the time of permit ownership equaled or exceeded the purchase price of the permit, plus a "reasonable" return on the investment in permit, vessel, and gear (10-15 percent per year), would be considered to have received "their money's worth" and no amortization would be allowed.

On the other hand, permit holders who had not recovered their permit investment, plus a reasonable return, would be allowed to amortize the difference between this value and the purchase price of their permit, not to exceed the purchase price. A more specific definition of amortization is also needed, so that it is clear whether the former permit holders would qualify for a tax credit, or just a tax deduction from gross income. This requires a policy decision on the degree of compensation to be given to current permit holders. The cost to the state of the amortization option would depend on this decision, and on the earnings of permit holders, the length of permit ownership, and the purchase prices of permits reverting to the state. Amortization would be less expensive than straight compensation for the permit purchase price, because consideration is given to the earnings derived from the permit during the duration of permit ownership. An amortization system would also be more equitable than compensating permit holders for a set percentage of the purchase price, even though the cost to the state may be the same, because the system takes account of each individual's economic situation.

The purpose of the proposed participation or "use it or lose it" requirement is to ensure that entry permits would revert to the state when they are no longer used by the holder. It should be noted that this requirement could be enacted independently of any of the transferability options, but that the effect would be somewhat different. If the participation requirement were enacted without any restriction on permit transferability, it is probable that very few permits would revert to the State, since

fishermen who no longer used their permits would be much better off to sell them. However, speculation would be prevented and more permits would be available for purchase.

If permits were made non-transferable, unused permits would have to be returned to the state, but most fishermen would probably stop renewing their permits anyway when they no longer fished, and permits are already revoked under current law when not renewed for two consecutive years. The effectiveness of the participation requirement is therefore uncertain, but the cost of administration would be low, and the law would ensure that permits were held only by active fishermen.

#### DISCUSSION:

A more detailed analysis of the limited entry legislative options summarized above is provided in the following pages. The comments focus primarily on the economic, social, and administrative implications of the various options and, for the sake of brevity, only the more important problems and impacts are discussed.

#### I. CAPITAL GAINS TAX OPTION

The four most important areas of concern regarding this option are the effect of such a tax on the rate of permit transfers, the compensation question, the setting of permit prices, and enforceability. With regard to the establishment of statutorily fixed permit prices, it would seem desirable to have the permit price in each fishery bear some relationship to the potential economic value of using that permit. For example, a Kodiak purse seine permit should clearly have a higher value than a Kodiak set gill net permit, since a much larger income can be realized in the purse seine fishery.

The problem lies in determining the potential economic value of each fishery and type of permit. The great variability in the yearly salmon runs and in the vessels used in each fishery makes it quite difficult to calculate an average permit value on this basis. It may therefore be necessary to use a less precise, but more workable method of setting permit prices.

One such method would be to use the average permit prices in each fishery over the past year, two years, or several years, and reduce this value by a given amount to arrive at a set of "reasonable" statutory permit prices. The obvious catch in this approach is in the definition of a reasonable permit price. A fisherman who has just spent \$80,000 for a permit would tend to favor a statutory price close to that amount, while a fisherman who was issued a permit for only the application fee might support a lower, or even zero price. Similarly, current permit holders would have an incentive to favor higher permit prices, whereas crew members or others trying to obtain a permit would want permit prices as low as possible. So, a "reasonable" permit price could run from zero to \$80,000 or more, depending on who is defining the term.

An additional factor which must be considered is the compensation question. The legal implications of reducing or eliminating the value

of entry permits are still not completely clear, but there seems to be a general feeling among the Committee members that from an equity or fairness standpoint, compensation for permit expenditures should at least be considered. I am under the further impression that most Committee members feel that if a compensation program were to be adopted, the program should reimburse permit holders for the amount each holder paid for his permit(s), or a percentage of that value, rather than for the amount which could have been received for the permit on the open market. The apparent consensus is that the state has no obligation, legal or ethical, to compensate those permit holders who were originally issued their permits for free, even though a higher value could have been received for the permits if the value were not reduced by legislative action.

The compensation issue is closely related to the capital gains tax option, as well as to any option which would limit transferability of entry permits. Decisions about compensation would have a major impact on the setting of permit prices under the capital gains tax option, and vice versa. The fundamental purpose behind this option, as I understand it, is to allow easier access to entry permits for those fishermen who would like to run their own boats but are unable to afford a permit at today's prices. At first glance, it might appear that this purpose would best be served by the setting of permit prices at very low levels, so that almost anyone with enough initiative could afford an entry permit.

But although such a plan may make permits more affordable, it would also reduce the number of permits available for sale, unless complete compensation were provided. One of the most basic principles of economics is that of supply and demand relationships, and the implication of this principle for this case is that if permit prices are statutorily reduced, fewer permits will be offered for sale, other things being equal. Considering the extreme case, if the legislature declared that permits could not be sold at all but must be transferred for free, the number of permits transferred would be much lower than current levels. Since no economic gain could be realized from permit transfers, permit holders would have no incentive to pass on their permit, even if they were no longer fishing. A "use it or lose it" requirement could free up some permits, but the number would be small in relation to the demand for permits.

It should be mentioned that permit transfers would not cease entirely if the value of the permit were eliminated. Based on the Entry Commission's permit transfer survey, it is estimated that 25 to 33 percent of transfers to date have not involved money in the transaction, and an additional percentage have been substantially below market value. The majority of these transfers were probably to relatives or close crew members and would continue with reduced or eliminated permit values, but such transfers would not increase access to entry permits in comparison to the present situation.

If entry permit values were statutorily reduced, rather than eliminated, the drop in permit transfers would be less severe, with the decrease in

transfers expected to correspond roughly to the degree by which values were reduced. If permit prices are lowered by only 10% of their open market value, the impact of this action on the number of transfers would be fairly minor, but the improvement in access to permits by low-income fishermen would also be small. Unless a compensation program is implemented, there will always be this trade-off between permits available for transfer and permit affordability.

The effects of a compensation plan in conjunction with the capital gains tax option are fairly predictable, and depend primarily on the extent of compensation offered and the amount by which permit prices are reduced. If compensation is limited to the amount paid for a particular permit, there is still likely to be a marked decrease in permit transfers associated with a major statutory reduction in permit prices. Those original permit issues who might sell their permits in coming years would have less incentive to do so if permit prices were limited by statute, since they paid nothing for their permits and would not be eligible for compensation under such a plan. Those most likely to sell their permits would be fishermen who purchased permits just before the legislation limiting prices was enacted, because they could receive nearly full value for their permits.

It is possible that a compensation program could increase the number of permits for sale in some fisheries above that of an open market situation. This could occur if a series of poor harvests and/or low fish prices reduced the profitability of a particular fishery. In this situation, permit prices would probably drop, but if permit holders were entitled to recover their purchase price, they could avoid the loss caused by lower prices and more permits would be for sale than if an open market existed.

Except for the situation just discussed, it is uncertain whether a capital gains tax system will actually improve access to entry permits, even if compensation is provided. Although permits may be more affordable, the possible reduction in permit transfers could outweigh the benefit of lower permit prices. The only compensation plan that would appear likely to maintain current transfer rates would be one which duplicated the open market situation; permit holders would have to be compensated for the difference between the statutory price and the fair market value of their permit. This is an expensive proposition, even if no further inflation in permit values occurs. I have calculated the total average market value of all permanent entry permits (including herring) to be over \$360 million as of June, 1979.\* This is a conservative estimate and the total value has probably increased by now. Given the magnitude of this total value, it is doubtful that the legislature would adopt a fair market value compensation plan.

A compensation program which reimbursed permit holders for the difference between the amount paid for a permit and the statutory price, or some fraction of that difference, would be much less expensive but could still run into many millions of dollars, and would still have the dampening effect on permit transfers discussed above. I have estimated the total value expended for entry permits since 1975 (not including multiple purchases of the same permit) to be approximately \$38 million.\*

\*Based on the Commercial Fisheries Entry Commission Permit Transfer Survey.

Thus if permits were completely devalued and a decision were made to reimburse permit holders for the purchase price of their permits, a state expenditure in the neighborhood of \$40 million would be required. If permit prices were fixed at 50 percent of their 1979 averages, roughly \$15 million would be necessary to make up the difference between the purchase prices and the statutorily set permit values. The alternative amortization approach discussed later would reduce the compensation cost significantly, but at least several million dollars could be required to compensate permit holders for a 50 percent price reduction. The Interim Committee must consider whether this funding could be more effective in achieving its goals if used for one of the other options, such as the loan program. The question which was raised about the resident/non-resident effects of the capital gains tax option is a very salient one, but it will be discussed below in the section on the loan program option.

The section on implementation options for the capital gains tax seems fairly complete, with the exception of a method for verifying the value of vessels, gear, or other equipment included in the permit sale. It may be desirable to add a section requiring that current certified appraisals or surveys be required of vessels, gear, etc., which are combined with the permit in the transaction. Such appraisals should also be required of any in-kind compensation which is used to purchase the permit.

Permit holders will have an obvious incentive to circumvent any price control system. The proposal, if strictly enforced, appears to be workable (though I still question its cost effectiveness), but I have little experience in the price control area. Considering the high values at stake here, the Committee may want to hire an economist and/or lawyer familiar with price control methodology to draft the enabling legislation if this option is pursued.

In reading through Commission files, I came across a transcript of a discussion with Dr. James Crutchfield of the University of Washington, one of the leading economists in the fisheries area and also a former price control economist. Dr. Crutchfield was adamantly opposed in the transcript to any method of controlling entry permit prices. He did not go into much detail about the reasoning behind his view, but his comments indicate that there may be more severe problems regarding enforceability than are readily apparent. He stated that he "could think of a dozen ways to avoid (price controls) without even trying." Crutchfield suggested higher landing taxes and/or permit fees as better ways to keep permit prices to reasonable levels. Fisherman resistance would be the principal problem with Crutchfield's suggestion.

## II. LOAN PROGRAM OPTION

The proposed changes to the Commercial Fishing Loan Program appear to be one of the more feasible and effective options under consideration. It has been asked whether statutorily set permit prices would make permits more available to Alaska residents than non-residents. It is possible that some advantage would be given to Alaskans by fixed prices, but the loan program appears to give Alaskans a much greater advantage, since non-residents can legally be excluded from eligibility for state

loans. Statutorily reduced permit prices would put entry permits within the reach of more Alaskans, but would also do the same for lower-income non-residents, and it is therefore unlikely that Alaska residents would be given greater access to entry permits than non-residents.

Of all the options under consideration, expansion of the loan program is likely to encounter the least resistance from present entry permit holders. The program offers the potential for low-income fishermen to obtain permits, without affecting the ability of permit holders to transfer their permits as they wish and to recover their purchase price. The state appears to have considerable legal freedom in the structure of its loan programs, thus allowing the modification of the current fishing loan program to meet specific needs.

However, it appears that the present loan program has not met the needs of low income fishermen desiring to purchase entry permits. Preliminary research has indicated that 75 percent of the commercial fishing loans have been to individuals with a net worth of over \$100,000. Although a sizable number of loans have been made to rural and lower-income fishermen, almost all of these loans have been for the purpose of upgrading vessels, rather than the purchase of entry permits. The proposed loan option provides that "priority shall be given to those applicants who demonstrate substantial financial need, and who substantially depend upon fishing as a source of livelihood." This wording may not be strong enough. If the Committee resolves that more emphasis should be given in the loan program to the acquisition of entry permits, as opposed to vessel improvement, specific legislative standards to this effect may be required.

One possible addition to the loan program option would be a section providing that fishermen acquiring entry permits previously held by non-residents would receive more favorable terms on their loans. This could be accomplished through lower interest rates, partial grants, or other provisions. The obvious intent of such a policy would be to increase resident participation in the limited fisheries. The additional cost to the state of preferential loan terms for the purchase of non-resident permits can be justified because the benefits to the state and its residents are substantially greater than the benefits resulting from the purchase of resident permits.

The acquisition of a non-resident permit by an Alaskan fisherman means that a larger percentage of the income generated by the use of that permit is likely to be spent in Alaska, thus providing more income for other Alaskans (this is known as the multiplier effect). In addition, the crew members are more likely to be Alaska residents, further adding to the benefits derived from the use of an entry permit by an Alaskan fisherman.

The probable effect of the preferential loan terms on the market for entry permits would be that non-residents would have an added incentive to sell their permits to Alaskans, since those resident fishermen qualifying for loans could afford to pay more for a non-resident permit than a resident one because of the better loan terms. The resident permit holders, on the other hand, should have less incentive to sell their permits, because fishermen obtaining loans would rather purchase a non-

resident permit and would pay less for a permit from an Alaska resident. The market for entry permits is complex and there are other factors at work, but in general, these are the results that could be expected from the implementation of preferential loan terms for purchasing non-resident entry permits. It should be noted that the preceding discussion would not apply if permit prices were also statutorily fixed, since fishermen would not be allowed to pay more for one permit than another (within the same fishery). However, if it were constitutional, legislation could be enacted which would provide a supplementary payment to non-residents selling their permits to Alaskans. These supplementary payments would have the same effect, and would take the place of the preferential loan terms.

The loan program is not, it should be stressed, an easy answer to the current problems of the limited entry program. The high cost of entry permits would require substantial expenditures by the state if the loan program is to be the primary vehicle for improving access to entry permits. As a case in point, an estimated 109 permits were purchased in the Bristol Bay drift gill net fishery during the first nine months of this year. Financing of these permit purchases through the Commercial Fishing Loan Program would require an estimated \$5.9 million in this one fishery alone.\*

It is true that funds expended for the loan program are eventually returned to the state, with interest, but the low interest rates on fishing loans represent a major opportunity cost to the state, because the state foregoes the much higher return that could be realized from alternative investments in bonds, etc.

An additional problem is that extensive use of state loans for permit purchases could contribute to further inflation in permit prices if price controls are not enacted. Loan recipients would be able to pay more for permits than if they had not received state financing, and this would have a tendency to push permit prices higher. The extent of this impact would depend primarily on the number of loans issued and the degree to which the loan terms increased the purchasing power of resident permit buyers. Further increases in permit prices would reduce the effectiveness of the loan program by making permits less affordable, so this possible impact should be given careful consideration.

The effect of the proposed loan program option on the development of bottomfish, herring, and other fisheries must also be assessed. While it may be desirable to encourage resident entry into the limited fisheries, an emphasis on this aspect of the loan program could discourage diversification into developing and non-limited fisheries. The limited salmon and herring fisheries are, for the most part, a fully exploited resource, in contrast to other fishery resources which are just beginning to be commercially harvested in Alaska. A careful balance must therefore be struck between the use of loan funds for the purchase of entry permits and the use of funds for developing fisheries.

### III. APPRENTICESHIP OPTION

The basic idea behind an apprenticeship system is an attractive one: Entry permits would be issued to those individuals who had demonstrated

\*Based on the CFEC Permit Transfer Survey.

their competence in and commitment to fishing by serving as a crew member on a vessel for a given number of years. This system would continue the natural progression from crewman to skipper that generally characterized the fishing industry prior to limited entry. An apprenticeship program would also ensure that persons obtaining entry permits were experienced fishermen and were able to use those permits in an efficient and safe manner.

Although the idea is a sound one, legal, economic, and administrative complications make it difficult to transform the idea into a workable apprenticeship program. The first stumbling block is a 1969 Federal court decision which overturned an apprenticeship program enacted by the Alaska legislature in 1968. The basis of the decision was that the program allowed fishermen to choose the apprentices involved, and that this act violated the Fourteenth Amendment of the U.S. Constitution. The decision stated in part: "Under the scheme, entry into the salmon fishing industry is controlled not by the state but by local fishermen in each area...whose own benefit would ordinarily not be served by assisting potential competition to qualify."

The first requirement of any apprenticeship program is therefore that the state, and not the fishermen, must determine the participants in the program. This requirement creates a substantial administrative burden, but also creates a more serious problem within the fishing industry by disrupting the conventional hiring practices employed in the fisheries. The idea of having to accept a complete stranger of unknown ability for a crewman is not likely to go over well with the majority of permit holders, particularly those that usually employ family members as crew.

In addition, the 1969 court decision gives the impression that it may be unconstitutional to use fishing experience in any standards of qualification for an apprenticeship program. The legal problems involved have not been sufficiently clarified, but it appears that using crewman experience as a prerequisite for admission to the program would create the same situation addressed in the 1969 decision, just one step removed. In other words, the fishermen would not be choosing the apprentices, but would still be choosing individuals who in the future would qualify for the program on the basis of their previous experience as a crew member. To avoid this legal problem, a separate set of eligibility requirements have been developed to supplement the apprenticeship option. Under this plan, crewmember experience accrued prior to the enactment of the program would still be used as a determinant of apprenticeship eligibility, but the experience requirements would be supplemented with economic hardship criteria that did not rely on fishing experience. It appears that this modification would circumvent the constitutional difficulties discussed above, but not without altering the future distribution of entry permits and the corresponding equity of the apprenticeship program.

The alternative economic hardship and dependence criteria which have been developed are intended to provide a means by which greater consideration can be given to hardship on the community level, rather than just the individual level. This issue is explored in detail in Dr. Rogers' paper. It is important to note that the alternative hardship criteria are intended to supplement, not replace, the criteria by which

individual hardship and dependence are evaluated. Fishing involvement, in terms of both participation and fishing income, was the major factor used in the ranking of applicants during the initial issuance of entry permits. While it may be desirable to supplement criteria based on fishing involvement with more broadly based criteria which consider the community situation, it is questionable whether such criteria alone would result in the most equitable distribution of entry permits under an apprenticeship program or any other system of permit transfer. The resolution of the legal issues surrounding the use of crewman experience as a basis for apprenticeship eligibility is therefore one of the most important tasks remaining if the apprenticeship option is to be pursued.

There are a number of other problems with the apprenticeship option. One of these is that the number of new entrants to the limited fisheries under an apprenticeship system would probably be much lower than current levels unless complete compensation for the fair market value of permits were provided to permit holders who returned their permits to the state. This issue is explored more thoroughly in the discussion of the capital gains tax option, but the basic difficulty is that without the profit incentive for transferring a permit, far fewer permits will be returned to the state than are presently transferred to other individuals. Thus, the state may be forced to buy permits if sufficient permits are to be available for the apprenticeship program.

A second problem is that it would be impossible for permit holders to switch to another limited fishery without serving another period of apprenticeship. And if a provision were drafted which would allow trades between permit holders, only permits from low income fisheries would ever return to the state, since fishermen holding permits for high value fisheries who wished to leave fishing would find many persons wanting to trade a permit of lesser value. An incentive would be created for the development of a black market in permit trades.

An apprenticeship program would also eliminate intra-family transfers unless some sort of "qualified transferee" list is created, from which permit holders are free to choose when they desire to transfer their permit. Over 25 percent of permit transfers to date have been estimated to be between family members, so substantial weight should be given to the continuance of this pattern in any alternative system of permit transfer.

Besides the possible compensation costs discussed earlier, an apprenticeship program would have considerable administrative costs. The number of applicants and potential qualifiers would be many times larger than the number of applicants during the issuance of the original entry permits, for there are many more crewmen than there were gear license holders during the original eligibility period. In addition, the application process for an apprenticeship program would not be a one-time affair, but would continue indefinitely into the future as more persons qualified and more permits became available. The Commercial Fisheries Entry Commission or other administering agency would require a significant permanent increase in staff and funding.

#### IV. AMORTIZATION OPTION

The amortization option is apparently intended to establish a time

limit on entry permits. It would also provide an alternative method of compensation for current permit holders in the event that an apprenticeship program or other system of transferability is enacted and permit holders can no longer sell their permits. However, in its present form the purposes of the option are too vague and it does not appear to be the best answer to the compensation problem. After the discussion of the amortization option as drafted, a different amortization approach which may be a more effective method of compensation will be presented for consideration.

The logic behind option A is difficult to follow. This option would allow the amortization of vessels and gear at 10 percent per year, after which the entry permit would revert to the state, unless renewed by the original permit holder, who would have to demonstrate consistent use of the permit. In the first place, it is unclear why permit holders should be compensated, through amortization, for vessels and gear, since the individual would retain possession of these under any option and is free to sell them at any price and to any individual he chooses. Perhaps it is thought that because a permit holder could no longer sell his boat and permit together under this option, his boat and gear would be of lesser value without a permit included. But in both 1978 and 1979, only an estimated 13 percent\* of permit transfers included vessels and/or gear in the transaction, so the cessation of combined transfers should not cause significant hardship.

With regard to the time limit inherent in both option A and B, it would seem that a simple participation or use requirement would be more effective. Since the permit holder is given the right to renew his permit at the end of the amortization period, the time limit is really superfluous. The only time when permits would revert to the state would be when permits were no longer used, regardless of the time limit. Dropping the time limit and substituting the use requirement would result in permits reverting to the state as soon as they were no longer fished, rather than at the end of the time limit.

Option B is a more reasonable approach to the compensation question than option A, because it addresses the value of the permit, which is the item being devalued, rather than the vessel and gear. However, it is questionable whether permit holders who were originally issued their permits by the state should be allowed to amortize the fair market value of their permits, since they received them for only an administrative fee. Compensation of this type would appear to be a windfall gain and difficult to justify. One argument for such compensation is that some permit holders are counting on the value of their permits as a retirement nest egg. If this is a major problem, some type of special exception should be made for these persons, instead of giving compensation to all of the original issuees regardless of financial standing.

Neither of the amortization options presented appear to be the most equitable and cost effective method of compensating those permit holders who did buy their permits for their purchase investment. Both of the proposed options would establish a fixed 10 percent per year amortization schedule, so that the amount of amortization would depend solely on the

\*Based on the CFEC Permit Transfer Survey.

purchase price of the vessel and gear (option A), or of the permit (option B). Such a system takes no account of the length of time which a permit has been held or of the earnings derived from the use of the permit. Instead of allowing a fixed 10 percent write-off each year, it would be more desirable to relate the amortization schedule to the net return on the permit investment at the time when the permit is no longer fished and reverts to the state.

Incorporating the return which a permit holder has realized on his investment into the amortization option would provide a more equitable system of compensation, because consideration would be given to each fisherman's individual economic position, rather than relying on an arbitrary formula or schedule. Under this type of system, those permit holders whose net fishing earnings during the time of permit ownership equaled or exceeded the purchase price of the permit, plus a "reasonable" return on the investment in permit, vessel, and gear (10-15 percent per year), would be allowed no amortization or other compensation, since they had received "their money's worth" from the use of the entry permit.

On the other hand, permit holders who had not recovered their permit investment, plus a reasonable return, would be allowed to amortize the difference between this value and the purchase price of their permit, with the amortization amount not to exceed the permit purchase price. For example, take the case of a fisherman who had bought a permit for \$50,000, a boat and gear for another \$50,000, and fished for three years. If a "reasonable" rate of return were determined to be 10 percent, then a reasonable net fishing income for the example fisherman for the three years would be \$80,000 (permit price of \$50,000 + return on investment of \$30,000 ( $\$100,000 \times 10\% \times 3 \text{ years}$ )).

Therefore, if the fisherman made \$80,000 or more during the three years he fished his permit, he would receive no compensation when his permit reverted to the state. A net fishing income of less than \$80,000 would make the fisherman eligible to amortize the difference between his income and \$80,000, not to exceed \$50,000. If his earnings were \$50,000, the fisherman could amortize \$30,000 over a specified period of time.

Three major problems can be foreseen with this alternative approach to compensation. The first is that it is necessary to determine a "reasonable" rate of return. This determination would take into account current market rates of interest, the high degree of risk in fishing, and historical earnings in the limited fisheries. Although difficult, this obstacle does not appear to be insurmountable.

The second problem is that a permit holder is not just an investor, but is also the skipper of the fishing operation. It is therefore necessary to account for the portion of the permit holders' income which is earned from skippering the vessel, apart from the return on his investment. I am not familiar enough with fishermen's bookkeeping practices to know just how this would be done, but it should be feasible.

The third need is to define the meaning of amortization more precisely, so that it is clear whether the former permit holders would qualify for a tax credit, or just a tax deduction from gross income. This requires a policy decision on the degree of compensation to be given to current

permit holders, since a tax credit would entitle the former permit holders to save the entire amount of amortization, while a tax deduction would only save them a fraction of the amortization amount. The cost to the state for a tax credit would of course be much greater, but it would still be less than compensating fishermen for the entire purchase price of their permits.