

RESOURCE REVENUE SHARING

PROPERTY RIGHTS AND ECONOMIC INCENTIVES | BY TOM FLANAGAN



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EXECUTIVE SUMMARY

First Nations are now demanding a share of all revenue generated by the exploitation of natural resources in Canada. This share of general resource revenue would be on top of the specific resource revenue that First Nations derive from impact and benefit agreements (IBAs) for projects on Indian reserves or in nearby “traditional territories.”

Though the demand for general sharing of resource revenue has received some support, it faces both legal and economic difficulties. Legally, the claim depends on the theory that First Nations still own subsurface natural resources in Canada because they only surrendered the land “to the depth of a plow” in the treaties. However, that claim is inconsistent with historical evidence. The better view is that the provinces own the natural resources, and the federal Crown owns natural resources in the territories, subject to the terms of modern land-claims agreements.

Economic difficulties also abound. It is unclear what the principle of sharing would be – equality of First Nation governments, population size or need. No proposal has

yet dealt with the difference between renewable and non-renewable resources. Because general resource revenue sharing resembles Equalization, it would replicate that program’s unintended consequences including hypertrophy of the public sector in receiving jurisdictions. Without safeguards, general revenue sharing would also tend to dissipate resource wealth by directing it to current consumption rather than to the creation of other forms of wealth. Most fundamentally, general sharing of natural resource revenue would encourage a form of free riding, in which some First Nations share the wealth created by others without participating in the process of wealth creation.

For these reasons, it is recommended that Canada continue with specific modes of sharing natural resource revenue that generate positive incentives for the production of wealth rather than attempt a further redistribution of resource revenue that would inhibit wealth creation.

INTRODUCTION

Canadian First Nations are demanding a share of government resource revenue as a matter of right. The Federation of Saskatchewan Indian Nations (FSIN) has long taken this position, which was also adopted by the New Democratic Party in the 2011 provincial election, when the party's platform spoke of "Negotiating a possible Resource Revenue Sharing arrangement with First Nations communities."¹ The governing Saskatchewan Party, however, rejected this demand because natural resources belong to all the people of Saskatchewan, and the revenue should be used for purposes that benefit everyone, including First Nations. Premier Brad Wall later said, "Our position will remain unchanged as long as I am premier, as long as this government is in office, that there will be no special deals for any group regardless of that group in terms of natural resource revenue sharing."²

The Saskatchewan Party got the better of the political debate in 2011, winning 64 per cent of the popular vote and 49 of 58 seats. Nonetheless, the demand for resource revenue sharing has now moved to the national stage, with the replacement of Shawn Atleo by Perry Bellegarde as national chief of the Assembly of First Nations (AFN). Bellegarde, a former provincial chief of the FSIN, has long advocated resource revenue sharing, and he emphasized the need for it in his first speech after winning the AFN election: "If our lands and resources are to be developed, it will be done only with our fair share of the royalties, with our ownership of the resources and jobs for our people. It will be done on our terms and our timeline."³ After two children died in a house fire on a Saskatchewan reserve in February 2015, AFN Ontario Regional Chief Stan Beardy commented, "We need to look at our own economic base, a viable economic base. The only way to make that happen is to make sure we have a share of revenues coming from our lands and resources – resource-revenue sharing with the other levels of government."⁴

Resource revenue sharing is now not only the mantra of the AFN, it has received support from a respected scholar writing for the Macdonald-Laurier Institute. According to Ken Coates:

Resource revenue sharing is different than the impact and benefit agreements and collaboration agreements that resource companies have been negotiating with Indigenous communities. Revenue sharing involves money from the provincial and territorial governments and would be on top of any funds secured by the Aboriginal community from their relationships with the companies.⁵

In March 2015, a joint federal government-AFN working group also recommended revenue sharing as part of the way forward, along with Aboriginal participation in the planning and execution of resource projects.⁶ The working group did not take a firm position on how revenue sharing could be carried out, calling rather for consultation: "Resource revenue sharing options and issues need to be explored nationally with the involvement of First Nations, appropriate levels of government, and technical experts."⁷ The First Nations Tax Commission, chaired by Chief Manny Jules, has also entered the debate, suggesting that First Nations could derive resource revenue through taxation:

Royalty sharing with provinces is inadequate. First, many provinces do not want to do it because First Nations are a federal responsibility...

Negotiating revenue arrangements with companies is bad for investment. It is time consuming, uncertain and expensive. It delays projects, adds to their costs and makes them less viable...

A better way to provide certainty for investors and a sustainable and predictable long term revenue stream

would be to replace both these arrangements with a First Nations tax that could be applied by First Nations to resource development in their territories.⁸

Coates claims that sharing resource revenue is "straightforward,"⁹ but in fact, it is anything but that, as was recognized by both the AFN-federal working group and the First Nations Tax Commission. Resource revenue sharing would indeed be particularly attractive if it could replace the repeated negotiations that now lead to IBAs. Reducing transaction costs surrounding natural resource projects would be a victory for everyone. However, that is unlikely to happen because, apart from the First Nations Tax Commission, Aboriginal leaders are demanding resource revenue sharing on top of IBAs rather than as a replacement for them.

Other complexities and difficulties also abound. As explained in the rest of this report, numerous legal and economic issues would have to be addressed before resource revenue sharing could be adopted in any form. The conclusion is that all Canadians, including Aboriginal people, will be better served by localized revenue-sharing agreements tied to specific projects than by a generalized scheme of "sharing the wealth."

SHARING SPECIFIC RESOURCE REVENUE

Before proceeding to an analysis of the concept of general sharing of resource revenue, it is important to list the main ways in which Aboriginal people already receive revenue from the development of natural resources. These are some of the highlights:

- First Nations receive all the royalties from oil and gas discovered and produced on Indian reserves.¹⁰ (The eight Métis settlements in Alberta also have a royalty-sharing scheme with the province.)¹¹
- Modern land-claims agreements in Labrador, northern Quebec, the three territories and British Columbia contain complex schemes of revenue sharing. Typically, the Aboriginal communities own some land outright and have resource rights in more-extensive areas. Although complicated, lengthy and expensive negotiations are often involved in all areas covered by these agreements, no resource development will take place that does not result in a flow of revenue to Aboriginal communities.
- Since 2008, British Columbia has followed a policy of sharing resource revenue from specific projects including mining, forestry and hydroelectric power.¹²
- Today, natural resource projects located near Aboriginal communities are generally accompanied by IBAs that provide for employment and training programs, contracting services to Aboriginal providers and direct payments to the local community. Companies might do this in any case in order to create a local workforce and supply network, but they have also been led in this direction by the Supreme Court's *Haida Nation* and *Mikisew Cree First Nation* decisions, which mandated consultation with Aboriginal communities.¹³
- Both the federal and provincial governments spend heavily on First Nations. From fiscal 1946-1947 to fiscal 2011-2012, combined spending on a per capita basis rose more than twice as much for First Nations people as it did for all Canadians.¹⁴ Health Canada's Non-Insured Health Benefits program, which provides almost 100 per cent coverage for dentistry, pharmaceuticals, vision correction, medical transportation and prosthetic devices, is an advantage enjoyed by few other Canadians.¹⁵ Another First Nations privilege is exemption from personal and property taxation on Indian reserves.¹⁶ Although earmarked transfers from natural resource revenue do not fund these benefits, they could hardly be afforded without the wealth created by Canada's resource-based economy.

What most of these programs have in common is that they are all tied to the development of specific natural resources in specific places. First Nations or Métis communities that happen to be located over or near hydrocarbon reserves, mineral deposits, merchantable timber or rivers with hydro potential can receive substantial benefits through payment of royalties and participating in the economic activity. These payments may impose some costs on government and industry, but they also create positive incentives for Aboriginal communities to participate in resource development on terms that they can negotiate. They are thus win-win because they lead to the creation of new wealth, not just the redistribution of existing wealth. As the Montreal Economic Institute has said about the complex web of agreements among the Cree of northern Quebec, the government of Quebec and resource companies developing mines and hydro power in the region, "This development model, in which *the economic incentives of all of the parties are aligned* [emphasis added], holds much promise for the future."¹⁷

In addition, these programs represent the recognition of property rights. *Black's Law Dictionary* concisely defines a royalty as "a payment reserved by the grantor of a patent, lease of a mine, or similar right, and payable proportionately to the use made of the right by the grantee."¹⁸ The federal Crown owns the land and resources of Indian reserves but collects and retains resource royalties for the benefit of the First Nations people who live on these reserves. Signatories of modern land-claims agreements have a variety of property rights ranging from full ownership in fee simple to specific resource rights, for which they can receive royalties. First Nations in British Columbia have potential claims to Aboriginal title, which is a full ownership right according to the Supreme Court's recent *Tsilhqot'in* decision.¹⁹ In many parts of Canada covered by nineteenth-century treaties, First Nations have a continuing right to hunt and fish on Crown land, regarding which they must be consulted before the provincial Crown exercises its own treaty right to take up this land for other purposes.²⁰ The right to hunt and fish is not full ownership, but it is nonetheless a form of property right. It could be analogized to an easement in Canadian property law except that it is stronger because it is constitutionally protected. The upshot is that Canadian governments and corporations, nudged by important court decisions, have been giving greater recognition than ever before to specific Aboriginal and treaty rights of property.

Of course, improvements to specific forms of resource revenue sharing may be possible. Below are three that have been suggested:

1. Although First Nations receive all the royalties from oil and gas produced on their reserves, the management regime is paternalistic. Under legislation dating back to 1974,²¹ Indian Oil and Gas Canada deals with the oil companies on behalf of First Nations, and the revenue goes into trust funds administered by the Department of Aboriginal Affairs and Northern Development Canada. In 2005, Parliament passed legislation allowing First Nations to assume control of the oil and gas resources on their reserves and the resulting revenue,²² but as
- of 2014, only one First Nation had opted into the new regime while eight others were reported to be working on it.²³ It takes quite a bit of administrative capacity to opt in, which may be hard for some First Nations to achieve, whereas they already participate in Indian Oil and Gas decision-making through various consultative mechanisms. In addition, by taking over full control themselves, they lose the backstop of the federal government's fiduciary responsibility as defined by the Supreme Court's 1984 *Guerin* decision.²⁴
2. In 2013, the federal government announced that it would join an international reporting regime for payments by resource companies to governments. It also proposed to include payments larger than \$100,000 to Aboriginal governments in the scheme of public reporting.²⁵ The next year, the government announced that the reporting requirement for Aboriginal payments would be postponed until 2016.²⁶ The requirement may never come into effect, depending on the outcome of the federal election scheduled for 2015. Those speaking for First Nations have generally opposed the proposed requirement, claiming that business dealings are normally confidential and that First Nations engaged in business should not be held to different standards. Proponents argue that First Nations usually engage in business through their governments, and governments should be transparent. Even where the First Nation has created another legal entity to do business, it is dealing with land and resources that are the patrimony of the whole community.
3. IBAs, though widely used in natural resource industries for developments on or near First Nations' land, are complicated and often take a long time to negotiate, thus raising transaction costs in terms of lawyers and negotiators as well as the opportunity cost of idle capital. As transaction costs increase, some projects that might have been profitable will be abandoned.²⁷ At least theoretically, it might be more expeditious to replace negotiation with taxation, as suggested by the

First Nations Tax Commission.²⁸ Under appropriate enabling legislation, First Nations' governments, which now have the power to pass by-laws creating systems of property tax, could extend that power to the taxation of resource developments. Such an initiative could be guided by the First Nations Tax Commission, which has been shepherding the development of Aboriginal property taxes since the so-called "Kamloops Amendment" of 1988. This is an interesting idea worthy of further investigation, but it is unlikely to be a panacea. Since 1988, only 139 of Canada's First Nations have adopted property taxation,²⁹ and natural resource taxation would be a more complex proposition than are local property taxes on leaseholders.

The author takes no position on these three proposed reforms, which range from partially implemented, through proposed but deferred, to speculative. Each has many pros and cons and would require a separate investigation to reach a conclusion. The point in mentioning them is rather to illustrate the complexity of existing models of specific resource revenue sharing. The models are complex because First Nations are highly diverse in location, resource endowment, ownership rights and administrative capacity. As well, the implementation of any model inevitably creates vested interests, both Aboriginal and other, that will not want to abandon it. Changes, therefore, will necessarily be small scale and incremental – frustrating, perhaps, to theorists of reform but reflecting the real-world complexity of resource development that has already taken place across Canada.

General resource revenue sharing, in contrast, is at present an abstract idea. It would not be tied to specific projects in specific localities. Although no detailed proposal is available for analysis, it seems that the idea itself, as generally propounded, would entitle all First Nations to a share of the proceeds of all resource-based economic activity anywhere in Canada. This raises formidable legal and economic difficulties, of which the major ones will be examined below.

LEGAL ISSUES – PROPERTY RIGHTS

Existing models of revenue sharing are based on Aboriginal property rights recognized by Canadian courts or other property rights created by modern agreements or nineteenth-century treaties. However, the Numbered Treaties, which covered much of Ontario and the three Prairie Provinces plus northeastern British Columbia, provided for the surrender of Aboriginal ownership of land and resources, which was then known as “Indian title,” to the Crown, as did earlier treaties in Southern Ontario. Below is the relevant language from Treaty 6 (all the Numbered Treaties are similar in this regard):

*The Plain and Wood Cree Tribes of Indians, and all other the Indians inhabiting the district hereinafter described and defined, do hereby cede, release, surrender and yield up to the Government of the Dominion of Canada, for Her Majesty the Queen and Her successors forever, all their rights, titles and privileges, whatsoever, to the lands included within the following limits.... And also, all their rights, titles and privileges whatsoever to all other lands wherever situated in the North-west Territories, or in any other Province or portion of Her Majesty's Dominions, situated and being within the Dominion of Canada.*³⁰

The wording seems to say plainly that the signatories surrendered all property rights except the continuing right to hunt and fish, as described below:

*Her Majesty further agrees with Her said Indians that they, the said Indians, shall have right to pursue their avocations of hunting and fishing throughout the tract surrendered as hereinbefore described, subject to such regulations as may from time to time be made by Her Government of Her Dominion of Canada, and saving and excepting such tracts as may from time to time be required or taken up for settlement, mining, lumbering or other purposes by Her said Government of the Dominion of Canada, or by any of the subjects thereof duly authorized therefor by the said Government.*³¹

Aboriginal leaders have constructed a contrary interpretation of the Numbered Treaties. According to Bellegarde, the land was surrendered only to “the depth of a plow,”³² i.e., for purposes of cultivation. Ken Coates summarizes:

*[First Nations] argue that the land surrenders extended only “to the depth of the plow” and were intended to facilitate or permit agriculture. At the time – from the 1870s to the first decade of the 20th century – there was no serious contemplation of mining activity, they argue, and therefore the sub-surface rights were not included in the treaties.*³³

Coates also correctly notes, “The Government of Canada does not accept this assertion nor has any court yet agreed with the First Nations’ position on this matter.”³⁴

There is great uncertainty concerning the term “traditional territory,” in which these claims are usually couched. Although frequently used, the concept of traditional territory does not have a legal definition. Claims for Aboriginal title refer to traditional territory as that on which the First Nation used to live before the assertion of British sovereignty. That seems simple, but it is not. All pre-contact peoples of North America fed themselves by hunting, fishing and gathering (some also practised agriculture), which meant that their use of land and water fluctuated with the seasons. Tribes also overlapped in their use of land, sometimes peacefully, sometimes with hostility. In parts of Canada, the Métis also overlapped with First Nations in their use of land.

Faced with these issues, the Supreme Court has developed certain tests that must be met before a claim for Aboriginal title is recognized. The *Tsilhqot’in* decision held that occupation must be sufficient, continuous and exclusive.³⁵ Historical evidence is used to determine whether any particular claim meets these standards. The *Tsilhqot’in* First Nation was awarded Aboriginal title to 1,700 square

kilometres, which is only about 2 per cent of what they regard as their traditional territory.³⁶

What does “traditional territory” mean in Ontario and the Prairie Provinces, where the Indians ceded their title to the whole of these areas? “Traditional territory” might have some historical meaning in delineating areas where the First Nations used to live, but what legal meaning does it have today? The logic of the AFN’s position is that all of Ontario and the Prairie Provinces would constitute the traditional territory of some First Nation or other, and since land was only ceded to “the depth of a plow,” the First Nations still own all natural resources everywhere.

The reason that neither the government nor the courts have accepted the “depth of the plow” theory is its historical weakness. Agriculture had little relevance to the northern treaties 8, 9 and 10, and it is not true that the government of Canada had no interest in mining when the treaties were signed. The northern treaties explicitly mention mining, and coal mining began on the Prairies almost immediately after the southern treaties were signed. No treaty refers to “the depth of the plow” nor says that the land is being shared only for the purposes of agriculture. Moreover, one does not have to rely on the treaty texts for historical evidence. Even though the non-literate Indian chiefs and headmen could not leave their own written record, there were other participants in treaty negotiations including the treaty commissioners, interpreters, missionaries, traders and North-West Mounted Police. Many of these people produced written records of the negotiations such as diaries, reports to the government, correspondence, autobiographies and memoirs. Nowhere in this large body of primary sources is there a single reference to “the depth of the plow,” as either an Indian demand or an offer by the Crown’s negotiators.

To the extent that there is any historical evidence in favour of the “depth-of-a-plow” theory, it will be found in oral histories that First Nations researchers started to collect in the 1970s.³⁷ However, this evidence is weak. At the time it was

collected, the Numbered Treaties were almost a century old. The typical statement about a plow’s depth takes the form of someone recollecting stories heard from a parent or grandparent who may have witnessed a treaty negotiation. However, human memory unaided by written records is fallible over this range of time and transmission. Moreover, researchers collected many of the oral histories of the 1970s as part of the Aboriginal political movement that was attempting to build a case for land claims. In the delicate business of oral history, the sympathies of investigators can be easily transmitted to their respondents.³⁸

Oral history has often been used in Aboriginal and treaty litigation where the written record was ambiguous³⁹ or where written records did not exist,⁴⁰ but oral history has not been used to overturn the plain meaning of a written text, especially where that meaning is buttressed by other contemporary written evidence. In short, whatever the political value of the “depth-of-a-plow” theory might be, it is doubtful that it would prevail in court if put to a definitive test.

The basic plan of the Canadian constitution is that the public lands and minerals situated within the provinces belong to the provinces.⁴¹ In 1888, the Judicial Committee of the Privy Council ruled in the *St. Catherines Milling* case that lands and resources acquired through the Numbered Treaties belonged to the provinces, even though the federal Crown had negotiated the treaties.⁴² The ownership of land and natural resources was extended from the original provinces of Ontario, Quebec, New Brunswick and Nova Scotia to other provinces as they were admitted to Confederation. The only exceptions were Manitoba, Saskatchewan and Alberta. Manitoba was so sparsely settled when it became a province in 1870 that the federal government decided to retain control of public lands and natural resources in order to control immigration and the construction of railways during the subsequent era of nation-building. The same treatment was extended to Saskatchewan and Alberta when they were admitted to Confederation in 1905. Control of public lands and natural resources was not extended to

the Prairie Provinces until the Natural Resource Transfer Agreements of 1930.⁴³

"First Nations argue," according to Coates, " – as yet without agreement from the courts – that this transfer occurred without their permission and without consultation. The resource transfer, in their estimation, should have accommodated Aboriginal interests and should have provided for a significant return to the First Nations in the treaty territories."⁴⁴ It is true that there was no consultation with native people when the Natural Resource Transfer Agreements were negotiated, but that would seem to make no legal difference. The *Constitution Act, 1982*, which in s. 35 gave constitutional status to "the existing aboriginal and treaty rights of the aboriginal peoples of Canada," also listed the Natural Resource Transfer Agreements as part of the written constitution of Canada.⁴⁵ It is a settled tenet of constitutional law that one part of the constitution cannot be used to overturn another part; all must be read together.⁴⁶

In short, Ontario, Manitoba, Saskatchewan and Alberta own their public lands and natural resources without Aboriginal encumbrance on the title, save for continuing rights to hunt and fish on Crown lands as mentioned in the Numbered Treaties. In light of the Supreme Court's recent jurisprudence, the same cannot be said of most parts of British Columbia, where Aboriginal title was never surrendered by treaty.⁴⁷ It is also possible that future judicial decisions may cast a cloud over provincial resource control in southern Quebec and the Atlantic provinces, where there were treaties of peace and friendship but not land-surrender agreements. Nevertheless, in Ontario and the Prairie Provinces, the provinces own the property rights.⁴⁸

There is, therefore, no convincing legal argument that First Nations have a legal or constitutional right to a share of resource revenue in Ontario and the Prairie Provinces. No authority, not even the federal Parliament, can impose a national scheme of resource revenue sharing because Parliament cannot legislatively override provincial constitutional rights.⁴⁹ Resource-owning provinces will have to agree to whatever might be done in this field. Yet,

that is not to say that the federal government would have no role. Ottawa could provide leadership in negotiations, and it could offer financial compensation to provinces that wished to engage in resource revenue sharing with First Nations.⁵⁰

An additional complication is the possible claim of Métis and non-status Indians to be participants in natural resource revenue sharing. The Supreme Court of Canada confirmed that, under certain circumstances, contemporary Métis people might have an Aboriginal right to hunt and fish.⁵¹ However, the jurisprudence of Métis rights is underdeveloped in comparison with that of First Nations,⁵² and it is not clear whether the courts will eventually find that the Métis have a share of Aboriginal title (i.e., ownership) in land in addition to hunting and fishing rights. As a political matter, it would be hard to ignore the Métis if some general scheme of resource revenue sharing is to be adopted. In the 2011 census, Statistics Canada enumerated 851,560 First Nations people as against 451,795 Métis.⁵³ The First Nations are more numerous, but the Métis are numerous enough to be considered, and their status as an Aboriginal people under s. 35 of the *Constitution Act, 1982* is not in doubt. Including the Métis in revenue sharing would either increase the cost of the program or diminish the amount available to First Nations, depending on what approach was adopted.

ECONOMIC ISSUES – INCENTIVES

In addition to arguments about property rights, proponents of resource revenue sharing also rely on redistributive arguments, as shown in the title of Coates's paper "Sharing the Wealth." Yet, from the standpoint of a market economy, wealth is not something that exists in order to be shared. Wealth has to be created through human ingenuity, and those who contribute to its creation – resource owners, inventors, investors, workers – are rewarded in proportion to the market value of their contribution.

The misunderstanding of natural resources as pre-existing wealth is common in much popular discourse as well as in the statements of Aboriginal leaders. For example, Attawapiskat Chief Theresa Spence famously said, "precious diamonds from my land grace the fingers and necklaces of Hollywood celebrities."⁵⁴ But diamonds can be sold for high prices in Hollywood only because geologists find them deep underground; mining engineers figure out how to bring them to the surface; miners carry out the extraction; gem cutters make them beautiful to the human eye; marketers sell them around the world; and investors finance the whole process. The native people around James Bay also have a stake because the mining process disrupts the land on which they have hunting rights under Treaty 9. In a market economy, value or wealth is created when all these participants come together to co-operate in production and to receive appropriate rewards as decided by voluntary exchange.

This understanding of how wealth is created furnishes a basis for judging proposals for resource revenue sharing and the incentives that those proposals would generate. Existing forms of specific revenue sharing produce incentives for native people to become involved in wealth creation. First Nations and Métis communities receive royalties only if resources are actually discovered, produced and sold. Individual members of these communities find employment

and contracting opportunities only if the project becomes a reality. As in private-sector labour relations, parties may bargain hard to maximize their share of the proceeds, but they understand that they will get no share at all unless the project can proceed.

But what can be said about proposals for general revenue sharing? What type of incentives would they create? In the absence of detailed proposals, it is difficult to be sure, but certain features seem intrinsic to general revenue sharing. By its very nature, general resource revenue sharing has to involve a large jurisdiction within which revenue will be pooled for distribution. Aboriginal advocates sometimes suggest that this jurisdiction could be the whole of Canada, but that is unlikely to happen, because of provincial ownership of natural resources. A much more likely outcome would be a set of different provincial revenue-sharing plans.

Provinces are not nearly as large as Canada, but they are still large entities, except in Atlantic Canada. Alberta, for example, encompasses three treaty areas and 45 First Nations living on 140 reserves,⁵⁵ plus eight provincially recognized Métis settlements. These communities vary widely in their circumstances. Some, such as the Samson First Nation, have very large trust funds based on decades-long production of oil and gas.⁵⁶ Others, such as the Tsuu T'ina Nation,⁵⁷ are rapidly becoming prosperous because they run casinos near large cities, exploiting their location much as other First Nations exploit oil and gas. And still other First Nations are very poor, having, at least for now, no obvious advantages in terms of location or natural resources.

What, then, would be the principle of sharing? Would it be the equality of First Nations – each to receive an equal share of whatever is to be divided? Or would it be the equality of Aboriginal persons so that First Nations would

receive revenue in proportion to their population? Or would it be need so that poor First Nations would receive all or most of the distribution? Or some politically negotiated compromise based on all these principles?

Each principle faces obvious objections. If need is the only criterion, First Nations that have taken the initiative to create wealth for themselves and their members are penalized if some of their wealth is redistributed to others. But if need is ignored, First Nations that are already wealthy receive additional revenue. If population size is ignored, small First Nations receive as much as large ones, even though the latter face an obviously greater demand for public services to their members. But treating First Nations as equal units recognizes the fact that each has its own government that must be financially supported.

When principles of distribution come into conflict, compromise solutions sometimes emerge. The Canadian tax code is full of such compromises, e.g., higher rates of tax on higher incomes (need) but only on top of a universal deductible amount (individual equality). Presumably, a compromise formula for general resource revenue sharing could be negotiated to balance the claims of First Nations as governmental units, their population size and their need against the claims of provinces as resource owners. Like all such formulas, it might be intellectually incoherent, because each principle can be defended in morally absolute terms, but acceptable political compromises do not have to be intellectually consistent.

But what about incentives for wealth creation? Any general scheme of resource revenue sharing will create incentives for free riding. Most economic development projects create at least temporary nuisances of noise, dirt, odour and visual degradation as buildings are erected and infrastructure is added. This is particularly true of natural resource projects, some of which, such as forest clear-cutting, open-pit mining and hydroelectric power generation, may have effects that last for decades or centuries. Other things being equal, most of us would rather have the revenue without the environmental

disruption and loss of amenities. The same logic would apply to First Nations that were guaranteed a share of resource revenue generated throughout the province even if they chose not to develop the economy on and around their own reserves. Specific resource revenue sharing generates incentives to create wealth, but general resource revenue sharing generates incentives to enjoy wealth created by others. It is the familiar n-person Prisoner's Dilemma: If everyone reasons in the same self-interested way, nothing will be developed. Of course, Prisoner's Dilemma is just a mathematical model, and in the real world, some players usually co-operate even if ruthless self-interest predicts non-cooperation.⁵⁸ However, if some First Nations opt out of local economic development because they get money from natural resource projects elsewhere, their members will be deprived of opportunities for individual advancement through employment and contracting.

Another complication is that resource revenue would almost certainly be shared among First Nations' governments rather than First Nations people. (It is possible to conceive of the distribution of resource revenue to individuals, as is done in Alaska,⁵⁹ but such a scheme is not being demanded in Canada and is unlikely to happen here.) Sharing of provincial resource revenue with First Nations' governments would be somewhat like Canada's Equalization program, in which the federal government distributes money to provincial governments according to a complex formula that attempts to measure provincial ability to raise revenue through taxation.

The original purpose of Equalization according to the inventor of the concept, economist and Nobel Laureate James Buchanan, was to give regional governments the fiscal ability to provide comparable public services so that residents would not have an artificial inducement to emigrate.⁶⁰ This reasoning is reflected in s. 36(2) of the *Constitution Act, 1982*:

Parliament and the government of Canada are committed to the principle of making equalization payments to ensure

that provincial governments have sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation.

Canadian equalization operates across provinces at the federal level, but could an equivalent program for dozens or hundreds of First Nations within a province operate in the same way? It is well documented that government-to-government transfers in the name of Equalization encourage the growth of the public sector and diminish the private sector in the receiving jurisdictions. Thus, provinces that receive equalization payments sometimes offer more lavishly funded public services than do provinces that receive nothing (e.g., cheap daycare and cheap university tuition in Quebec and support of numerous small universities in the Maritime provinces). Equalization payments also lead to higher remuneration of public servants, sometimes contributing to labour shortages in the private sector. To support their enlarged public sector, receiving provinces end up imposing higher levels of taxation than do provinces that do not receive payments, thus disappointing one of the hopes of equalization (“... at reasonably comparable levels of taxation”).⁶¹

There is still another issue on which Equalization offers a warning: the difference between renewable and non-renewable resources, e.g., surface water and trees versus hydrocarbons and minerals. Hydroelectric generation is largely kept out of the Equalization formula because provincial Crown corporations that do not pay royalties or taxes carry out most of it. The benefits to the province may come in the form of lower prices for electricity or in shareholder returns to the provincial government, which do not show up in provincial fiscal capacity as calculated by the Equalization formula. The payments that Quebec and Manitoba derive from Equalization would be considerably lower if their large hydro sectors were privately owned and paid royalties and taxes to the province, because their fiscal capacity as calculated by the Equalization formula would be higher.⁶²

The point here is that the difference between renewable and non-renewable resources is potentially important in any system of revenue sharing. No one knows how it would play out in resource revenue sharing with First Nations because there is no detailed proposal on the table to analyze, and the issue has not been addressed in any of the published reports on revenue sharing. However, statements from First Nations leaders refer to all resource revenue without distinction between renewable and non-renewable, and First Nations in the past have often fought to obtain revenue from hydro and forestry projects. Of course, this can also be accomplished in other ways, such as assuming a share of ownership.⁶³ Proposals for resource revenue sharing need to address this issue before they can lead to serious policy initiatives.

Another issue also arises in relation to non-renewable resources. The conventional economic view is that non-renewable resources are physical assets that should be converted into other assets as they are produced. The new assets could take the form of financial investments (e.g., a trust fund), infrastructure (e.g., roads and airports) or human capital (higher levels of health and education that increase productivity). In a perfect world, governmental owners of natural resources would spend taxes levied on resource companies to help fund current operations, but they would invest royalty income to improve future productivity. Riffing off Adam Smith’s famous metaphor of the invisible hand, if the baker sells his bread, he earns income to meet the daily needs of himself and his family, but if he sells his oven, he is selling a capital asset, and he should replace it with another oven if he wants to remain a baker or invest it elsewhere if he wants to enter another line of work.⁶⁴

This was the logic behind the establishment of the Alberta Heritage Savings Trust Fund and similar funds in Canada and other countries. However, Canada in general and Alberta in particular have a poor record of actually converting non-renewable resources into other capital assets. The Alberta

Heritage Savings Trust Fund had assets of approximately \$17.5-billion in 2015, which may seem impressive but is only a fraction of what it would be if it had been allowed to follow its original mission. The Fund was established in 1976, but regular deposits ceased in 1984, and most of the Fund's earnings are channelled into the annual operating budget.⁶⁵

Another problem is that investments in infrastructure and human capital, though very important for future productivity, can easily become a disguise for current consumption. Politicians often use infrastructure investments for local pork-barrel projects and to "create jobs" rather than to meet genuine long-term needs for improved transportation and communication. Human capital investments are also quite slippery, as unionized employees often capture the putative benefits of greater expenditure on health, education and welfare. Thus, investment in hard financial assets is probably the best measure of how effectively a government converts its natural resource endowments into other forms of wealth.

Equalization exacerbates the tendency to use royalties for current consumption to the extent that the formula's calculation of fiscal capacity factors in royalties from non-renewable resources. To offer Equalization payments to the recipient provinces, the federal government has to increase its tax revenue (by about \$16.7-billion in fiscal 2014-15),⁶⁶ thus directly taking that much away from individuals and corporations and indirectly reducing the revenue of provincial governments, which might occupy at least part of that tax space if the federal government were not filling it. General resource revenue sharing with First Nations would have a similar effect if there were no restrictions on the use of the transfers. Specifically, a share of royalty income from provinces such as Alberta and Saskatchewan, which are already saving much less than economists recommend, would be transferred to First Nations within those provinces. If there were no restrictions on expenditure, First Nations might use the transfers to fund current governmental operations or distribute the proceeds directly to members. If there is to be revenue sharing, there should be provisions

to limit dissipation of wealth, e.g., a requirement that at least some of the revenue go into First Nations' investment trust funds. Given their poor performances, Canadian provincial governments are not in a strong position to demand such safeguards, but enlightened First Nations leaders may step forward to make the same point.

CONCLUSION

Although general natural resource revenue sharing with First Nations has been presented as an inevitable idea whose time has come, there are formidable obstacles. Let us summarize the legal difficulties first.

Aboriginal land and resource ownership rights are highly diverse across Canada. The federal Crown owns resource rights on Indian reserves but dedicates all oil and gas royalties to the people who live on those reserves. First Nations in the three territories, Labrador, northern Quebec and parts of British Columbia have constitutionally protected resource rights pursuant to modern land-claims agreements. Aboriginal title has not been extinguished in most of British Columbia but neither has it been geographically defined and recognized, except in the recent *Tsilhqot'in* decision. In the absence of delineation, First Nations have a right to be consulted about resource development on lands subject to claim of Aboriginal title. Provincial governments own natural resources in Ontario and the three Prairie Provinces, while First Nations have certain harvesting rights on Crown lands in these provinces subject to the Numbered Treaties, and they have a right to be consulted before the Crown takes up lands and diminishes these rights. The situation is uncertain in southern Quebec and the Maritime provinces, which were originally settled under French sovereignty, because France neither recognized Aboriginal title nor negotiated any land-surrender treaties. The Supreme Court may eventually hold that Aboriginal title still exists in these provinces, as it does in British Columbia, but it has not done so yet.

Given this welter of overlapping property rights, ranging from well established through contested to conjectural, it is utopian to think of developing a uniform national approach. Existing approaches to resource revenue sharing with First Nations are admittedly complex and always in flux, but that is because the underlying structure of property rights is also complex and fluctuating.

Important economic issues must also be faced. Some of these problems are technical in nature and could perhaps be solved through negotiation.

1. How would resource revenue be divided among First Nations? By treating each First Nations as an equal unit, by making payments proportional to the population size of each First Nation, by assessing the need of First Nations according to their current standard of living, by governmental revenue or by some other metric? Or by some negotiated compromise among these principles?
2. How would a scheme of resource revenue sharing treat renewable and non-renewable resources? This would be a hot issue in provinces such as Quebec and Manitoba that are major producers of hydroelectricity. Thus far, proposals for general revenue sharing have not touched upon this question.
3. Could payments be structured to prevent dissipation of resource rents in spending on current consumption? Proposals thus far have not adequately focused on the need to convert natural resources as physical assets into financial assets that can be invested for the future.

The greatest difficulty for a general scheme of sharing resource revenue with First Nations is more intractable, however. This is the question of incentives for further economic development on the part of First Nations. Current revenue sharing programs are admittedly complicated and often expensive to negotiate, but they do create positive incentives for action. First Nations negotiate over resources on their reserves or in their "traditional territories." The latter term has never been clearly defined, but in current practise, it refers to locations reasonably close to where a First Nation is located. Under localized revenue sharing, First Nations can aim for certain revenue from resource development knowing

that they will also have to accept concomitant nuisances and impact upon the environment. They get the benefits and they bear the costs, thus making rational decisions possible.

This union of cost and benefit would be sundered in a general scheme of resource revenue sharing that stretches across a jurisdiction as large as Canada or even one of the large provinces. First Nations would obtain financial benefits from far-away resource developments that impose no cost on them, while they would bear the full cost of nearby developments whose benefits would be pooled for distribution. The resultant incentives are a recipe for free riding, which, if it became widespread, would diminish the overall pace of resource development while also reducing collateral opportunities such as jobs and contracts for individual members of First Nations. As a government-to-government transfer, general resource revenue sharing would also tend to replicate some of the negative effects of Equalization, such as enlargement of the First Nation's public sector. General resource revenue sharing, in sum, is not a good idea.

This does not mean abandoning First Nations that do not have immediate opportunities for natural resource development. Many such First Nations have the advantage of being situated near urban areas, which offers a double benefit. Their members can find jobs in the general Canadian economy without having to move far from home, and the land on which their reserves are located will be valuable for commercial purposes such as casinos, shopping centres, business parks and residential developments. Other non-urban First Nations without natural resources may be located on coastlines, near lakes or mountains or close to other recreational areas, allowing them to develop fishing and hunting lodges, ski hills, golf courses and holiday housing. Still others may be able to acquire land in urban areas, as is happening through treaty entitlement programs in Saskatchewan and Manitoba.

For these types of situations, the goal of public policy should be to encourage the economic growth of First

Nations through better physical infrastructure (road and utility connections), legal infrastructure (ownership and land-management regimes) and education and job training. Concentration upon natural resource development is appropriate for many First Nations but will not be helpful to those located far from any resource and/or not possessing any clear ownership or easement rights to resources. In the latter case, fixation upon resource revenue is more likely to impede development by creating perverse incentives accompanied by political squabbling over irreconcilable principles of "sharing the wealth."

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