



Dr. Tim Raybould

**The Economics of First Nations Governance
Investment Capital, Money and Wealth Accumulation**

NCFNG
NATIONAL CENTRE
FOR FIRST NATIONS
GOVERNANCE



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DES PREMIÈRES NATIONS

Research Paper for the
National Centre for
First Nations Governance

2006

**the
K a L o N a
group**

**THE ECONOMICS OF FIRST
NATIONS GOVERNANCE:
Investment Capital, Money and
Wealth Accumulation**

Dr. Tim Raybould

**Prepared for the
National Centre for First Nations Governance**

**2006
(revised)**

3640 Paynter Road, Westbank, BC, V4T 1R1
Ph. (250) 768-1359 Fax (250) 768-1329 timraybould@shaw.ca

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Introduction

There has been much said and written about the underdevelopment of Indian reserves in Canada, the lack of wealth in First Nations' communities and the concomitant poverty of most First Nations' people.¹ While Canada sits at seven on the United Nations Human Development Scale this would dramatically drop to 48 out of some 174 countries if Canada's performance was judged solely on the economic and social well-being of First Nations' people.² Canada's First Nations remain part of the 'Fourth World', after the term coined in the late 1970s by the former National Chief of the Assembly of First Nations, George Manuel; indigenous nations living in Third World conditions locked within modern nation states.³

Poverty is still the norm for most of Canada's First Nations, despite ongoing efforts over many years to stimulate reserve economies, including significant investment by governments trying to 'prime the economic pump'. There are, however, some good examples where the pattern has been changed and communities are breaking the chains of poverty.⁴ There are lessons to be learned from both within Canada and outside as to what can be done to alleviate poverty and stimulate economic growth.

In order to understand what is being done it is necessary to appreciate the general nature of capital and place this squarely within the history of the administration of First Nations in Canada and the politics of modernisation. This is examined in Part One of this paper with two caveats. Firstly, this Part essentially concerns governance and economic development on-reserve and does not address the related but different questions of economic development off-reserve within broader traditional territories. Secondly, while the principles apply to any First Nation, the practical application of these findings to all First Nations, will, of course, be limited by the economic potential of a First Nation's reserve lands. Inevitably, potential varies from location to location due to a variety of circumstances.

Because prosperity and wealth inevitably follow the creation of capital, an equally important task then becomes managing the wealth and administering it wisely. This is addressed in Part Two.

The insights in this Paper are the author's own. Some of the perspectives offered in this paper have been more fully set out elsewhere, in greater length and detail, and in a more academic manner. Some readers may take issue with the underlying capitalist thesis and while I acknowledge the ongoing political and economic debate there is simply insufficient space to address it in any depth. My objective here has been to simplify and briefly set out for a broad audience some of the issues that surround the importance of capital, and secondly what, if politically supported and reflecting the vision of First Nations, can be done to realise the capital on-reserve and encourage greater investment and thereby generate wealth. Only by doing this, where the opportunities exist, will the practical means be created to alleviate the endemic poverty that still exists today among so many First Nations in Canada.

PART ONE

The Nature of Capital

The Stages of Economic Growth: Reaching Maturity

Political scientists, social theorists and economists, amongst other scholars, have tended to view society as being in a continuous process of ‘development’ or ‘evolution’.⁵ For example, it is possible to track the stages or transformation through time from band or tribal society, through agrarian society to the period of industrialisation and the modern nation state and, more recently, to post-industrial society and globalisation. A common theme is that society is continually evolving, ever increasing output by harnessing the resources available to it (natural and man-made) to create a better quality of life for its citizens; ever ‘upwards and onwards’, as it were. Whether this is good or not is, of course, as much debated as the theories of social evolution themselves; witness in recent years the popular resistance to mass globalisation and free trade.

Regardless of one’s political views, the reality today is that at the beginning of the twenty-first century, capitalism has become the economic system that drives the global economy. Almost without exception, all nations seek to develop their economies on a market-based system. At its core, this is about the creation of capital and its strategic investment to stimulate growth and thereby create wealth. First Nations are also a part of this global economy.

One, though, has to ask why Canada’s First Nations’ economies are so underdeveloped and the people poor, despite the fact that they are situated within one of the world’s most successful modern capitalist economies? Why are they not benefiting equally from the success of that economy?

Many aboriginal and non-aboriginal politicians contend that the answer is simple: there is a critical need for more economic development on-reserve. This economic development is the key to unlocking the problem of improving the standard of living and quality of life

for aboriginal people. Even the Privy Council Office website propounds that economic development is “the precursor to all other forms of development –social, cultural and political and is necessary to achieving other development objectives.”⁶

The question is therefore why is it taking so long and why is it so often failing? Despite the repeated stated objectives of aboriginal leaders and federal officials, and a current annual investment of over \$600 million a year in economic development initiatives on-reserve through eleven federal departments and agencies, success still seems beyond our grasp. As the Auditor General of Canada wrote in her 2003 report on economic development of First Nation communities, there are still many barriers to be overcome before they can “take control of their economic development”.⁷ The same question has been asked of the poor nations of the world where similar efforts by the western liberal democracies to stimulate Third World economies in South America, Africa and Asia have generally failed to improve the quality of life of their citizens.

Before attempting to answer this question in the context of First Nations in Canada we need to step back and remind ourselves of where First Nations have come from and where they are going within their own world view; or stated another way, the juxtaposition of ‘traditional’ and ‘modern’ economies.

Understanding Aboriginal Economies: The Debate

Not all First Nation leaders agree that the solution to aboriginal poverty is through embracing western economic development and stimulating market forces on-reserve. Notwithstanding the reality of global capitalism and the pervasiveness of the capitalist system in the lives of aboriginal people within Canada today, there are leaders who advocate as strongly as those who advocate economic development that First Nations should focus on their traditional ways of life and rely on their traditional economies, which they contend, should be supported politically, legally and financially by the federal government.

Tribal economies, as part of the social fabric of distinct communities, existed for thousands of years outside modern capitalist notions of orthodox economics.⁸ Today, though influenced by modern capitalism, aspects of traditional aboriginal economies continue to exist within Canada. Anthropological literature is full of accounts of traditional society and makes a reasoned and strong case for its continued existence and place in the modern economy.⁹ The Royal Commission on Aboriginal Peoples gave serious attention to this debate and how traditional aboriginal economies in Canada need to be considered and accommodated.

Whether traditional tribal economies can be accommodated within the modern capitalist state is a question that will probably not be answered until well into the future when it is not only answered for indigenous peoples within modern capitalist states but for all cultures and peoples of the world, as capitalism advances. It is, nevertheless, important to raise such issues because in developing their economies aboriginal people have to ask some fundamental questions about their vision for their society and their contemporary existence as part of Canada and as part of the global economy.

These choices will inevitably drive both political decision-making and policy development. Some of the changes discussed in this Paper will not, of course, be universally embraced by all First Nations' leaders and such discussions will continue to be controversial. However, the discussion has to be entered into.

The Nature of Capital: The Lifeblood of a Modern Economy

In order to understand how modern capitalist economies work it is necessary to appreciate the concept of 'capital', because in a market economy the creation and use of capital stimulates economic growth.

Capital is a concept used by economists to describe value given to assets. It is the process by which assets (actual tangible things like buildings, machinery and inventory) can be turned into value and consequently can be used to invest and produce more capital. It is

the key to the market economy and now the lifeblood of modern capitalism spanning global society.

In classical economic theory, ‘investment’ or ‘capital accumulation’ is the act of producing increased capital. In order to invest, goods must be produced which are not immediately consumed, but instead are used to produce other goods as part of the economic process. Investment is like saving, although they are not the same. When we ‘save’ we are not spending all of our income on current goods or services. When we ‘invest’, on the other hand, we spend on specific types of ‘capital goods’.

Western nations have been very good at producing capital and using it to grow their modern industrial economies. In contrast, the poorer nations have typically not been able to produce capital to the same extent. While there are, of course, many reasons cited for Third World poverty, such as ‘modern’ corporate colonialism and numerous critiques of the benefits of global capitalism, the inability of a nation to produce capital does explain, in large part, why it is poor. In an analysis of why Third World countries have had difficulty in releasing the capital ‘locked’ in the assets of their nations there are some striking parallels to the legal, political and economic plight of First Nations in Canada and their own colonial past.

Releasing the Capital: Making Assets Work

The Peruvian economist, Hernando de Soto, in his seminal work on the ‘Mystery of Capital’ asks a blunt question, “Why do Third World countries fail to produce capital as we do in the West, no matter how eagerly their people manage all the other activities that characterize a capitalist economy.”¹⁰

The same can be asked of First Nations. Why, despite the eagerness of so many First Nation leaders and federal politicians to create modern economies on-reserve, has it been so difficult to create capital on-reserve and encourage investment? Answering this question is critical as First Nations currently move to re-establish self-government in the modern era and develop the policies that will guide their law-making and, ultimately, influence the direction their economies will take.

De Soto's conclusions are really very simple although, admittedly, not so easy to implement¹¹.

He concludes that for the poor countries of the world the reason for lack of capital is that the assets in these countries are held in defective form. This is not because of cultural or national differences, but because of the legal systems that underpin the very fabric of economic activity. For example, he demonstrates how houses in the Third World are built on land where ownership rights are not adequately recorded, where unincorporated businesses exist with undefined liability, and where industries are located where financiers and investors can not see them. De Soto concludes that because these rights to assets are not adequately documented, they cannot be readily turned into capital. Unlike in Canada or any other 'First World' country, they cannot be traded outside of narrow local circles where people know and trust each other; they cannot be used as collateral for loans, and they cannot be used as a share against an investment. Economic development opportunities are, therefore, lost.

De Soto contrasts this to the situation in the West, where every parcel of land, every building, every piece of equipment or store of inventories is represented in a property document that is a visible sign of a vast, hidden process that connects all these assets to the rest of the economy as if by an 'Invisible Hand'. By this process, he says, the West has injected life into assets, makes them generate capital, which in turn fuels economic growth. While capitalist nations have different laws to accomplish this documentation, they all do it.

In the West we now take the mechanisms that translate assets into capital so completely for granted that we have lost all awareness of their existence. In Canada, of course, these mechanisms that create capital do exist off-reserve. However, on-reserve they don't, or where they do, they are not so effective or in some cases downright defective. This is because of the separate legal reality of reserve lands administered by the federal government under the *Indian Act* which is, more often than not, in conflict with local or indigenous systems of administration, as well as those within the rest of Canada.

The *Indian Act* was imposed in 1876 as a means to administer land reserved for Indians as set out in treaties. It made Indians ‘wards of the state’ and essentially removed the ability to create capital on-reserve. While ‘protecting’ the remaining tribal lands from encroachment by in-coming settlers, it also took reserve lands out of the market and replaced whatever economy existed before with a system of wardship that has, over the years, lead to what many consider an unhealthy degree of dependency on the federal state.

For example, until the 1950s, there was no efficient way to record private property on-reserve and the system today is far from perfect. While systems to record rights in property developed in the rest of Canada they were ignored on-reserve. In fact, astonishingly, there is still no proper system of land registration in existence for all reserves in Canada. Another example of the problems with the reserve system has been the inability to easily secure land interests for financing, given the *Indian Act* restrictions on the seizure of certain types of interests and where the creation of interest requires the approval of federal bureaucrats with little or no local knowledge. The deficient legal system means doing business is much harder and, even where possible, the cost of doing that business is often much higher and takes much longer than off-reserve.

In the poor countries of the world ‘informal’ mechanisms to record property have developed over time in response to the state’s ability to coordinate and establish national and coherent systems of enforceable property rights. What de Soto calls ‘extralegal responses’. At the end of the day, people in the Third World are as every bit as industrious as people in the West, as are First Nations’ people. When forced to work outside of the state system they do find other ways to do business. Often the state’s system does not recognize local property rights and is too cumbersome or bureaucratic to effectively release the capital in assets, even when it tries. Often it is only available to the ‘elites’ and those with access to the bureaucracy and the ‘law’.

Today, on many reserves traditional systems of property holding sit alongside non-traditional. Some First Nations may follow parts of the *Indian Act* system, while others do not. Consequently there exists a myriad of land tenures on-reserve, from *Indian Act*

instruments such as Certificates of Possession, to 'buckshee' leases to traditional land holdings held by families and clans. Locally, people know who uses what land and how you get access to it. What is needed now is for First Nation communities to go through the process of creating their own law, from the ground up, to unlock the capital so that all these systems somehow tie together in a way that is easily discernable to third parties.

In the West this process of capitalization took place gradually over centuries. The process itself was largely unrecorded and not very well understood or appreciated. Nevertheless, it is the process that has created capital. First Nations need to do this if they want to create capital on-reserve.

Freeing the locked capital in assets is not simply a matter of adopting another nation's laws. In fact, poor nations of the world have sometimes adopted the laws of Western nations without regard to local custom or recognizing informal rights to assets. This does not work. The solution is more complicated and requires understanding what is actually happening on the ground and codifying these rights to assets.

A good place to start for First Nations might be housing. In North America the home is the single biggest source of investment capital for new business start up and a huge economic driver. All First Nations have houses on their reserves and everyone knows who lives where, and generally where the boundaries are. Because in many cases these houses are not registered outside of local systems they have no economic 'value'. They are assets but not yet capital. No member can use them in the way all other Canadian can use their homes as capital. It would be a good first step to bring this about on-reserve.

Developing the Appropriate Legal Structure: Supporting First Nations' Capital Investment

The process of making that which is extralegal, the local responses to the *Indian Act* and the myriad of customary practices of property rights on-reserve, needs to be developed from the ground up, community by community. This does not mean simply adopting provincial systems of land tenure that may not recognize cultural and legal differences,

and therefore not necessarily accommodate existing interests in land (and may even create competing ones), which would, at the end of the day, not be accepted by the people and, consequently, impossible to enforce.

This process has already started in Canada. For example, for the thirty-six communities that have opted to come under the *First Nations Land Management Act* 1999, the sections of the *Indian Act* that deal with land are replaced by provisions that recognize First Nations ability to manage their own lands and create interests in those lands.¹² In practice, the process involves First Nations developing their own land codes and essentially making legal the extralegal property interests in their communities in order to facilitate economic development; in other words, to transform assets into capital. The land codes being developed typically codify both private and communal interests in land.¹³

The property interests once created can be registered in a central land registry maintained by Canada under a federal regulation that gives priority to interests so recorded. Third parties, including the banks and other lending institutions, can understand the system from the codes and be assured interests in land are registered nationally. An important aspect of this model is that a national on-reserve registry system will tie the myriad of local property interests together under one enforceable system to create legal certainty. This is important because First Nations are typically very small and some of the institutions of government that support the creation of capital cannot be practically or successfully built at the local level. There is, therefore, a role for regional and national institutions.

The Role of Institutions: Attracting Investment and Encouraging Economic Growth

There is a role for national First Nation institutions that support local economies and investment on-reserve. This is in recognition that not all regulatory functions of the capitalist system are most appropriately conducted at the local level. The land registry is one example. Another is long-term public debt financing.

Through the *First Nations Fiscal and Statistical Management Act*, passed in 2005, First Nations that opt to come under this Act agree to be bound by the oversight role of national institutions for the purposes of i) ensuring national standards in implementing systems of property taxation and financial management and ii) collectively issuing debentures to raise cash for on-reserve infrastructure projects such as sewer and water systems to attract economic development.¹⁴ By working together, these First Nations seek to reduce their administrative and legal costs, create economies of scale and generally improve the collective credit of all the participants. This will, it is anticipated, facilitate increased investment and reduce the cost of borrowing and, for some First Nations, make long-term debt financing possible when previously this was not the case.

The role of First Nation and Federal Policy Makers: Providing Leadership and Vision.

If First Nation leaders support the freeing up of capital in appropriate legal forms as developed by the First Nations themselves, then there must be legislative change. This has already started with the passage of the *First Nations Land Management Act*, 1999; the *First Nations Commercial and Industrial Development Act*, and the *First Nations Fiscal and Statistical Management Act*, 2005. There are also a handful of community specific-acts dealing with local self-government such as the *Westbank First Nation Self-Government Act*, 2004, and the *Sechelt Indian Band Self-Government Act*, 1986, or where self-government forms part of a modern land claim, such as in the Tlicho (2003) and Nisga'a (2000) arrangements.¹⁵ All these initiatives address, to some degree, the fundamental property rights and the questions raised by de Soto and provide tools for First Nations to develop laws that turn assets into capital where this is the policy objective.¹⁶

This work needs to continue. If a policy objective of self-government, whether comprehensive or sectoral, is to facilitate economic growth, then the legislation needs to be held up to the basic capitalist test of “Does the new law assist First Nations in turning assets into capital?”

Politicians, both federal and First Nation, need to show strong leadership and imaginative resolve. It is the government's responsibility to work with First Nation leaders with a clear vision of what is being attempted. This is fundamental for the achievement of economic success.

Other Factors that Contribute to Economic Growth: The Crucial Questions to Ask

In Canada, private-sector investment accounts for up to 95% of the investment in the economy, with only 5% coming from government sources.¹⁷ On-reserves the figures are the other way around. So, assuming that the legal structure is put in place to support the creation and ownership of capital on-reserve, then what can First Nations do to attract more private as well as public investment and promote economic growth? In addition to unlocking capital what are some of the other factors that contribute to economic growth and how can First Nations encourage more private investment on-reserve? These questions have been looked at recently in the policy development behind the *First Nations Fiscal and Statistical Management Act* in trying to address what is needed to create investor confidence.¹⁸

Capital is by its very nature mobile and will go where the best return can be found for the risks involved. First and foremost, the capitalist must have a reason to invest or locate within a particular area; there needs to be some competitive advantage. This can include gaining access to natural resources such as oil, gas, timber, gravel etc. Or it could be because of a competitive advantage for access to markets or technology. It could be because there is a skilled labour force. Assuming there is a competitive advantage to locating in a particular area, the next question will be, what are the risks and are there alternatives? "Can I go somewhere else, maybe to the next jurisdiction over?"

In this way, governments typically try to develop policies that maximize the use of capital and encourage private-sector investment within their jurisdictions. In fact they compete for the same capital and at all levels; internationally, regionally and locally. Jurisdictions that better satisfy the needs of the investor attract more capital; the capital at work in those jurisdictions increases in value. Depending upon the economic policy of a

government, capital will either flow in or flow out. The market will decide. No central planner can.

Good governance is, therefore, one of the keys to market confidence and investor satisfaction. While good law is a necessary precursor to turning assets into capital, good governance is needed to make it work. Governments do more than record property rights. In complex nation states different levels of government have the responsibility for managing institutions that support capitalism. When investors have choices where to locate they will consider whether the jurisdiction in which they may invest is stable. For example, they may ask: “Does the government respond quickly and efficiently?” With respect to local government, “Are the planning and approval processes for land development clear and fair?” “Are there the necessary institutions (locally, regionally, nationally) to support my investment activity?” “Are they independent and transparent in their operations?” “What are the tax policies of the governments I have to deal with?” “If I am successful in my venture will I be able to keep my profits?” “If I have a dispute with whom I am doing business or, indeed, for that matter with the government(s), are there clear avenues for recourse? Is there a dispute resolution mechanism (i.e. access to independent courts)?” Finally, “Are the governments I deal with accountable and transparent?” “Can I find out reliable statistical information on their finances and their decision-making processes?”

In addition to good governance, investors will have to be satisfied that the physical infrastructure needed to support their investment is readily available in the now, not the hereafter. “Are the lands serviced?” “Are there transportation networks so that I can get my products out or my customers in?” If I am interested in land development, “Are sewer and water and other services available?”

‘Human Capital’ is, of course, as vital as physical capital, so an investor well might ask “What is the availability of a labour force?” “How well trained is it?” “What educational facilities exist nearby?”

A related issue concerns gender equality and the place of women within the economy. In traditional aboriginal economies the role of women within a domestic mode of production and hunter gatherer economy was central and integral to the success of that economy. Industrialization changed the role of women. Globally, the treatment of women given the current cultural norms of a society, will, arguably, affect a nation's ability to participate as effectively in a market economy. A nation that does not recognize the potential contribution of all its citizens, regardless of gender, will be operating in a market economy with potentially only 50% of its human capital being used. First Nations, like all nations, should ensure that their policies promote gender equality and the full participation of women in all aspects of their economies.

There are, of course, many other specific factors than those considered here, that different industries will consider and ask questions about when making investment choices. The point here is that First Nations, even with capital freed up, need to be aware that the policies they develop that impact on investment decisions will have a direct bearing on whether capital is utilized to its fullest potential. This is a very core concept. The questions need to be answered to the satisfaction of the investor or the investor may go elsewhere.

Transparent and fair jurisdictions known for clear processes, independent institutions, and timely decision making with the necessary physical infrastructure in place will have a very distinct advantage in attracting investment over jurisdictions that do not.

So how do investors know if they should invest without doing a lot of independent research? One way is to rely on independent analysis and published statistics. An important way today how markets understand risk is through credit ratings. Governments (national and sub-national) and companies are all rated and scored in the capitalist society. This is invaluable information for investors.

In Canada, Dominion Bond Rating Service in Toronto provides independent rating services. These ratings assist investors in assessing the quality of their investments and help confirm or challenge conclusions based on their own research and experience.

Moody's Investors Services and Standard & Poor's provide similar services in the USA. Investors closely watch ratings. A change in rating can have a direct impact on the flow of capital. In assessing risk, the rating agencies use a number of methodologies and consider factors similar to the ones described above.

The services of rating agencies can also be used by First Nation governments and First Nation people when making their own investment decisions with the wealth created from economic activity on-reserve, to which we now turn our attention.

PART TWO

Wealth Accumulation and Money Management

After the Capital Flows: The Need to Manage Wealth

Part Two builds on the lessons learned in Part One. As Part One has discussed, when assets on-reserve are turned into capital, new wealth should be created which, in turn, can be invested and can stimulate the economy. Wealth accumulation should, theoretically, follow; both for the First Nation and for its individual members. This will create the welcome problem of having to make investment decisions about how to allocate the new wealth. Part Two provides some helpful pointers for First Nations and their individual members with respect to wealth accumulation and money management. The decisions individuals make with respect to how they use their own money, and how governments use the public purse, are important to maximizing both personal and public wealth, now and in the future, in the short-term and the long-term.

For First Nations, the communal aspect of capital is very important; more so than perhaps off-reserve. This is because much of the wealth from capital created on-reserves will be held collectively by the First Nation governments for the good of their communities as a whole, and not by individuals.

The purpose of encouraging economic development on reserve is to create jobs and stimulate the 'micro' economy and thereby generate wealth for the First Nation; wealth that presumably will be reinvested to generate more wealth and accumulate new assets. The returns on investments can be used for improving the quality of life of members in many ways, including investment in community businesses, the delivery of enhanced programs and services or, even in the form of distribution dividends to the members.

Where a First Nation is involved directly in economic development through conducting business activities, or receives taxes or income from claims settlement, or receives compensation for the loss of its assets (typically land and resources), there will be money

to invest. For communities of whatever size to make the most of their income there must be a comprehensive strategy for wealth creation and its retention.

The investment strategies that individuals or First Nation governments might follow to maximize wealth accumulation will, of course, depend on the investment objectives chosen and the ability to tolerate risk. The strategy will therefore differ from individual to individual and from First Nation government to First Nation government, and often indeed within First Nation governments.

In all cases there should be a financial plan, carefully thought out and professionally constructed.

The Need for Financial Planning: For Both Governments and Individuals

All governments and individuals who have funds to invest should have a financial plan and an investment strategy. In developing a plan, it is prudent to use impartial, professional financial advisors who are specialists in money management and who can provide sound advice.

The strategy a First Nation government might follow will depend on its needs, its stage of economic development, and the type of funds available to be invested. Inevitably, not all investment decisions made by a First Nation government will follow the same investment approach. This is because First Nations typically have different funds for different purposes.

In considering investments made by First Nations it is important to understand the distinction between ‘capital investment’ (for instance, the investment in a First Nation-owned business) and ‘savings’ (the non-capital investment of trust funds, land claims settlement monies or operating monies not immediately needed to provide programs and services). It is therefore essential to be very aware that there will be different considerations in making investment decisions depending on the sources and types of funds.

For some First Nations the type of capital investment the community can make (the use of its collective capital) will require consultation with, and sometimes the approval of, its members.

For other funds, there may be restrictions in a First Nation's law or in agreements with other governments as to how the monies can be invested. As a general rule of thumb, small sub-national governments are considered what is described as being 'risk adverse'. In the case of most Canadian municipalities, there are strict controls on investment; both with respect to capital investment in business ventures, as well as investing restricted funds and operating revenues that are not immediately needed.

In deciding what governments should be investing in, there is one school of thought that says while governments are needed to create the legal environment conducive to investment, governments themselves should not be capitalists as they are not good at business. As the old adage goes, "the only business of government should be government." This, of course, poses some challenges for First Nations when the First Nation government for the benefit of its citizens often holds the community's capital. This is even more a reason why an appreciation of investment risk, the need for sound financial advice, and a solid financial plan are so important for First Nation governments. This is particularly so, because elected officials (in their role similar to that of a trustee) are bound by a duty of care when making investment decisions.

Factors That Contribute to Wealth Accumulation and its Preservation: Time, Quality, Diversification

There are many theories and approaches to investing and many books published on wealth creation and management; some are useful, some less useful, all depending on one's personal approach. There are, however, some basic principles to investing that every individual and every politician should be aware of.

When investing, there are three universal considerations; *time*, *quality* and *diversification*. These are the key considerations to take into account when developing a financial plan and an investment strategy, and to building a strong investment portfolio. Whether the

funds to be invested are managed by the individual investor, (with or without the advice of a financial planner), or by professional fund managers, trustees or government employees, the considerations are always the same.

Time: Wealth is accumulated over time. Most people and, indeed, many governments have far too short time horizons for their investments. Many people do not make money from their investments because their time horizons were too short. They sell too soon. In government, where political terms are typically 2-5 years but where investment horizons need to be much longer, it is not always politically desirable to make long-term investments. Where there are excess revenues or funds that could be invested, it is all too easy to plough the money back into the ‘always-needed’ programs and services. This vote-getting strategy should be avoided if at all possible.

When planning for the investment of trust funds and settlement monies, the guidelines for the investment of the funds in the financial plan should include a well thought-out statement about time horizons. The types of investment allowed in these funds should typically be held over the long-term and for the life of the investment. This is one of the keys to the way the well-run pension funds work and it should be no different for First Nations ‘legacy’ funds. For individuals, a good rule of thumb, (notwithstanding the possible need to access one’s money sooner), is that at a minimum, a person should not invest in anything that he or she would not be prepared to hold for at least ten years.

Quality: When buying investments (e.g. shares in a company, the debt of a company or a government - bonds), or simply depositing money into a savings account or buying government savings vehicles (i.e. Treasury Bills) quality always matters. Determining quality is not often easy for the individual, which is why, as discussed in Part One, investors and their advisors rely on credit rating agencies to assess quality and risk, along with the legions of analysts employed by financial institutions and investment companies.

If wealth accumulation over time is the goal and risk tolerance low, then when buying securities (e.g. shares and bonds) they should typically be what is called ‘investment

grade', that is rated by the rating agencies in the highest categories (i.e. typically 'A' or higher). Pension funds can typically buy this grade. These are sometime colloquially referred to as 'blue chip' investments. As a strategy, it might also be good to make investments which pay dividends, which usually means the companies have good cash flows. A financial plan might, for example, state that not less than 50% of the securities in its portfolio provide dividends. This forces the fund managers to purchase quality companies, with good cash flows.

Diversification: It is important to spread and reduce risk through diversification, which refers to buying investments from different asset classes, and then having a variety of investments within each class. There are three major asset classes: i) cash and cash equivalents; ii) fixed income (bonds and other products that have defined income) and iii) equities (shares in companies). Financial advisors may well debate what appropriate asset class mixes at any given times should be and how they vary for different types of investors (usually based on age and investment horizons). At the end of the day the key point is to be diversified, which extends to deciding how many different investments within a class a portfolio should ideally have.

With a diversified portfolio, an investor is less exposed to market fluctuations between asset classes as well as between investments within an asset class. As a general rule of thumb, governments should probably not put more than 5% of their investment into one asset. This percentage could be higher for individuals. The simple reason is that when it is your own money you tend to be more careful in your decisions. You are more risk sensitive. Governments do not 'own' the money directly. As an official of a government or a politician, handling 'other people's money', it is easier to take risks as we know governments have; nevertheless they should always be aware of the possible downside and exercise sensible due diligence on behalf of those to whom they owe a fiduciary duty.

Taxation and Fiscal Relations: Towards a First Nations' Perspective

Every discussion of wealth creation and the use of capital must also include a discussion of taxation. Taxes may well be used to redistribute wealth and ensure that there is

reinvestment in the economy. They are also used to provide basic infrastructure (roads, hospitals, sewers etc.) as well as benefits for those who need to be looked after (the ‘safety-net’). Creating and supporting the institutions of good governance have also to be funded, including the government itself.

There have, historically, been forms of wealth redistribution in most, if not all societies, as a means by which peoples who rely on the labour of others support one another. In the capitalist liberal democracies, the amount of taxes collected by government is often a matter of considerable political debate. Are governments collecting too much tax? Should they let the money stay in the economy and allow ‘the market system’ to make the investment choices? While individuals and companies complain of too much taxation, the truth is, the very institutions that the taxes support do provide the certainty that helps makes the complainers’ economic activities profitable.

The issue of taxation of First Nation peoples and for First Nations generally is inevitably complicated because it is tied to the whole question of dismantling the *Indian Act* and moving to self-government. While it is beyond the scope of this present Paper to discuss this issue in detail suffice to say there are several points that need to be made with respect to First Nation investing and wealth accumulation.

Notwithstanding the public policy rationale for taxation set out above, legally avoiding taxes in capitalist societies is one of the quickest ways to accumulate wealth. Investors will consider how to legitimately minimize the amount of taxes paid on their investment income. Invariably the tax policies that governments make will very much impact investment choices. For instance, taxes on dividends in Canada are lower than taxes on interest income, so this has the effect of stimulating investment in equities (shares) that pay dividends.

Good financial planners will consider the tax implications of their investment recommendations based on an individual’s tax circumstances. First Nation investors also require similar comprehensive tax planning, particularly given some of the unique tax advantages available to them when investing on-reserve, and the important exemption of

such income from provincial and federal taxes. From a First Nation's government perspective, at least today, these advantages should, as individuals become wealthier, mean more investment by First Nations' people on-reserve because of the advantageous tax benefits.

When governments make income on their investments, as a general rule they do not pay taxes to one another, or tax themselves. This is generally the case for First Nation governments, although it is not always clear under the current legal structures; particularly where a First Nation is conducting business through a corporation. What is even less clear is how the Federal government might treat new wealth in terms of offsets to federal transfers to First Nations to provide agreed-upon programs and services. This is an important issue for First Nations to consider and brings us squarely to the basic question of the fiscal relationship between First Nations and the Crown, and what impact it might have on First Nations' wealth creation.

It is very important to recognize that the collective capital of the reserves (and indeed claims settlements where applicable) is not to be used to pay for government services and programs. It could become all too easy for the capital to be used to meet current obligations that for the rest of society are paid from the collection of taxes and other revenues. If this happens, it could very quickly short-circuit investment, wealth creation and its retention. This could be financially devastating in communities where the wealth is held collectively by the First Nation government and is not in the hands of individuals. This is a crucial point for public policy makers to always remember when developing tax and fiscal relations policy with respect to First Nation governments.

It cannot be overemphasised that the fiscal relationship that is developing between First Nations and the Crown must take into account the need to grow First Nation economies and to generate new wealth. Own-source revenue from capitalist enterprises should not be applied to the costs of governance or for the delivery of agreed-to programs and services until, at the very least, the First Nation has achieved levels of wealth adequate to provide for growth and for improved standards of health, education, training, employment and income for its members. The terms of any reductions in the amount of

funding provided by the Crown to a First Nation as a result of a First Nation's own-source revenue (whether from capitalist enterprises or government revenues –taxes, fees, and other charges) must be equitable.

Responsible Government: Creating a Legal Framework

As can be seen from the points discussed in this Part, parallel with the understandable satisfaction with wealth accumulation on-reserve, there will also exist a vital responsibility for both individuals and leaders of First Nation governments. There is always this over-riding responsibility to observe the best money-management practices possible.

The rules may be set out in policy or law of the First Nation with investment plans to fill in the gaps. Some communities may choose to set out the rules for public investing in a financial management law or code; perhaps even in a community Constitution. The rules can put limits of the types of investments, taking into consideration the different sources of funds or income and the purposes for which they are intended.

Without an appropriate legal framework for community financial management the result could lead to potential mismanagement and the squandering or loss of the Nation's or individual's assets. This would be very unfortunate, having finally established legal systems releasing the locked up capital on-reserve.

Conclusion

Investors on-reserve have to face institutional and deeply-rooted historical obstacles to economic development; absence of secure property rights (communal or private); time-consuming, red-tape burdens; a lack of local control of economic destiny. All these obstacles result in great difficulty in releasing and attracting capital. These are, indeed, obstacles that similar commercial and industrial development in the non-aboriginal sector of the Canadian economy would never have to face or, indeed, expect to face.

Without taking anything away from the number of undoubted and very praiseworthy First Nations commercial and entrepreneurial success stories, such successes are, at the end of the day, quite relative. Overcoming what one can even describe as often horrendous institutional obstacles was part of many of these success stories in the first place, as much as the subsequent commercial success of the residential subdivision, condominium development, shopping centre, winery or cultural attraction itself.

However, what is needed is a 'level playing field' where such Aboriginal developments can take place in a legal, institutional and business environment comparable to what exists in the non-aboriginal sector.

Put bluntly, First Nations, because of the historical burden that has been placed on them since the *Indian Act* and the inability to turn assets into capital, have had to overcome extremely burdensome obstacles to reach even the 'level playing field' on which to try and start their commercial enterprises that non-aboriginal businessmen and women, entrepreneurs and industrialists take for granted.

So, coming up with solutions to generate widely hoped for economic growth, to resolve so much deep-rooted aboriginal poverty are profound challenges to be addressed, often in competing visions of First Nations' modernisation. While this work has begun for approximately 100 to 150 of Canada's First Nations through the legislative initiatives discussed briefly in this Paper, for many First Nations it has not. For those that have

begun the journey, in some cases the process is incomplete, addressing only part of the problem of creating a successful modern capitalist economy.

Capitalism is the economic system that drives the thriving economies of the West. The ‘market system’ contains millions of decision makers, producers, employees, employers, investors, suppliers and customers all engaged in an astonishing myriad of economic, commercial and industrial activities. Despite inevitable occasional failures ‘The Market’ does work. It does ‘deliver the goods’ through the almost mysterious working of what Adam Smith, the founder of the discipline of Economics over two centuries ago, called ‘The Invisible Hand’.

The job of public policy makers is to facilitate the operation of the market within their jurisdictions and then to attract investment within them. Sectoral initiatives such as the *First Nations Land Management Act* and the *First Nations Fiscal and Statistical Management Act*, while very important, do not individually address all the deficiencies in the current reserve system and a more comprehensive legislative approach to developing markets on-reserve is probably required.

As this Paper had discussed, the free flow of capital is the means by which economic growth, and thereby the resulting prosperity of the community and the individuals in it, is achieved. Much of the success is deep-rooted in the well-documented and secure property rights of individuals and institutions in Western countries. These are among the main reasons Canada regularly scores so high as one of the world’s major economies in the so-called Group of 8 Industrialised Nations.

However, in stark contrast, the essential ingredient for economic success, the ability to turn assets into capital, is frequently missing for First Nations’ on-reserve just as Hernando de Soto has shown it is missing in Third World countries.

At its core, the Paper therefore concludes that the solutions to rectify this imbalance in economic underdevelopment on-reserve must be found largely in political cooperation

between First Nation leaders and federal policy makers, particularly as the goal of self-government is being achieved and outstanding land claims are settled.

The main conclusions of the Paper are therefore that three basic steps ought to be followed:

Firstly - codify assets, such as property rights, to create the legal structure to release 'locked in' capital on-reserve.

Secondly – develop local policies and laws that promote the use of the new capital, as well as to attract additional capital from the investment community in the private sector, to compliment funding from the federal government.

Thirdly- with all due diligence possible, invest wisely the returns on the First Nations' collective or individual capital as the case may be, in order to build sustainable, healthy and wealthy First Nation communities across the country, which we all hope for.

Economic growth, wealth accumulation and its preservation, as well as increasing Aboriginal prosperity, should be the norm, not the exception. There is no realistically acceptable alternative.

Notes

¹ See for instance Chapter 5 in Volume 2 “Restructuring the Relationship” in the *Report of the Royal Commission on Aboriginal Peoples* (Canada 1996). See also *Sharing the Harvest: the Road to Self-reliance*, Royal Commission on Aboriginal Peoples (Canada 1993). For an account of the US tribal experience, see generally the work of the Harvard Project on American Indian Economic Development and specifically Stephen Cornell & Joseph P Kalt, eds., *What Can Tribes Do? Strategies and Institutions in American Indian Economic Development* (Los Angeles: University of California 1992). For a discussion on economic development in the context of treaty negotiations see Roslyn Kunin, ed. *Prospering Together: the Economic Impact of the Aboriginal Title Settlements in BC* (Vancouver: The Laurier Institution 1998). See also David Newhouse “The Development of the Aboriginal Economy Over the Next 20 Years,” *The Journal of Aboriginal Economic Development*, Vol. 1 Issue 1, CANDO (1999) 68-77.

² United Nations, Geneva, April 2005 in the report of Rodolfo Stavenhagan, UN Special Rapporteur on Indigenous Peoples, following his mission to Canada in 2004.

³ George Manuel & Michael Posluns, *The Fourth World: An Indian Reality* (Toronto: Collier – Macmillan 1974).

⁴ Despite the obstacles to development, there are now a number of reserves across Canada with successful initiatives, some community owned and others using outside capital. Listed are a few with some of their projects: Sechelt Indian Band, BC (Construction Aggregates, Sechelt Shopping Centre); Tsleil-Waututh Nation, BC (Ravens Wood) Squamish Nation, BC (Park Royal Shopping Centre); Kamloops Indian Band, BC (Sun Rivers and the Mount Paul Industrial Park); Westbank First Nation BC (Westbank Shopping Centre, The Hub Centre, Lakeridge Park, Bayview, Sun Village and Vintage Hills); Osoyoos Indian Band, BC (NK'MIP Canyon Desert Golf Course, NK'MIP Cellars and NK'MIP Vineyards) St. Mary's, BC (St. Eugene Mission Casino and Resort); Mnjikaning, Ontario (Rama Casino); Millbrook First Nation, Nova Scotia (Truro Power Centre, Cole Harbour Developments).

⁵ For instance, see W.W. Rostow, *The Stages of Economic Growth: a Non-Communist Manifesto* (London: Cambridge University Press 1963).

⁶ Backgrounder – “Federal Aboriginal Economic Development Programming,” Government of Canada, Privy Council Office, www.pco-bcp.gc.ca, November 24th 2005.

⁷ Auditor General of Canada, “Economic Development of First Nations Communities – Institutional Arrangements,” Auditor General's Report, Chapter 9, November 2003.

⁸ See for example Marshall Sahlins, *Stone Age Economics* (London: Tavistock Publications 1972).

⁹ See for instance Hugh Brody, *Maps and Dream* (Vancouver/Toronto: Douglas & McIntyre 1981) and Richard F.A. Salisbury, *Homeland for the Cree: Regional Development in James Bay 1971 -1981* (Kingston and Montreal: McGill-Queens University Press 1986).

¹⁰ Hernando de Soto, *The Mystery of Capital; Why Capitalism Triumphs in the West and Fails Everywhere Else* (New York: Basic Books 2000).

¹¹ De Soto is not without his critics. Some argue that it is too simplistic to assume that all cultures are inclined to emulate the west. Others argue that he fails to account for the continued exploitation of the Third World by the West where raw products are exported cheaply and expensive manufactured product sold back to them. It has been said De Soto has overstated the size of the informal economy and also that he places too much emphasis on the amount of wealth created by land titling. See for example: Robert J. Samuelsson, “The Spirit of Capitalism”, *Foreign Affairs*, January/February 2001; Alan Gilbert, “On the Mystery of Capital and the Myths of Hernando de Soto,” *International Development Planning Review*, Vol. 24 (February), pp. 1–1, 2002; R.G. Rossini, and J.J. Thomas, “The Size of the Informal Sector in Peru: A Critical Comment on Hernando de Soto's El Otro Sendero,” *World Development*, Vol. 18 (January), pp. 125–35 1990, and; Christopher Woodruff, “Review of de Soto's The Mystery of Capital,” *Journal of Economic Literature*, Vol. 39 (December), pp. 1215–23, 2001.

¹² There were originally 13 communities that entered into the Framework Agreement on Land Management with Canada to take over land management powers; an initiative led by Westbank First Nation. Other communities have subsequently been added to the Framework Agreement and will continue to be added. For a list of the current communities coming under the Act see the First Nations Land Management Board Website, www.fafnlm.com.

¹³ See the First Nations Land Management Board Website, www.fafnlm.com, for a selection of land codes that have been developed by First Nations.

¹⁴ See, *Building a Better Future through Investment and Economic Growth*, First Nations Fiscal Institutions Initiative, 2004.

¹⁵ For the text and a discussion on recent legislation see Brian A. Crane, Robert Mainville & Martin W. Mason, *First Nations Governance Law*, (Markham: Butterworths 2006) and Paul Salembier, Al Broughton and & Jeffery Hutchinson, *2006 Modern Annotated First Nations Legislation*, (Markham: Butterworths 2006).

¹⁶ For a discussion of the place of property in modern policy making see *The Idea of Property in History and Modern Times*, Kolbert, Colin ed. (London: Churchill Press 1997) and, with respect to First Nations property rights, see specifically herein Tim Raybould, “Native Property Rights: Negotiating Modern Treaties in British Columbia, Canada,” 131-151.

¹⁷ Indian Taxation Advisory Board, *Five Times Harder: Why First Nation Communities Must Engage the Private Sector*, leaflet, 2005.

¹⁸ See the series of background paper prepared by Fiscal Realities for the Indian Taxation Advisory Board (ITAB) and The Research and Analysis Directorate, Policy and Strategic Direction Branch of the

Department of Indian Affairs and Northern Development: *First Nations Taxation and New Fiscal Relationships* (1997); *The Indigenous Peoples and Fiscal Relationships - The International Experience* (1999); *Expanding Commercial Activity on First Nations Land; Lowering the Costs of Doing Business on Reserve* (1999); *Building Bridges: Towards A First Nation Development Cost Charge Program* (2001). These can be found on the ITAB website, www.itab.ca.