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Pre-Budget Submission

Prepared by
the Indian Taxation Advisory Board



**INDIAN
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Table of Contents

Introduction.....	1
Canada’s Productivity Challenge and First Nations	2
<i>Market Failure on First Nation Lands.....</i>	<i>2</i>
<i>Inability to Respond to Market Opportunities.....</i>	<i>6</i>
<i>The Good News.....</i>	<i>7</i>
ITAB Proposals	9
<i>Establish the FNTC as a Special Delivery Agency</i>	<i>9</i>
<i>Sales Tax.....</i>	<i>10</i>
<i>Infrastructure Program.....</i>	<i>10</i>
<i>Land Registry.....</i>	<i>12</i>
<i>Open Market Housing.....</i>	<i>12</i>
<i>First Nations School of Taxation</i>	<i>13</i>
Appendix –	
Reducing Investment Facilitation Costs is the Key to other First Nation Goals	I
<i>Accountability and Governance.....</i>	<i>I</i>
<i>Inter-governmental Cooperation</i>	<i>II</i>
<i>International Stature and Improved Federalism</i>	<i>III</i>
<i>Summary of ITAB Proposals</i>	<i>III</i>





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Introduction

The passage of the First Nations Fiscal and Statistical Management Act (FSMA) in 2005 was a significant step in the development of First Nation economies. First Nations themselves have taken the lead in advancing policies to develop their economies. The FSMA will create job and business opportunities for First Nations people, and also create investment opportunities for Canadians from all over the country.

However, more important than the FSMA itself is the philosophy underlying it. It is based on the premise that the investment market in Canada should work on First Nation lands as easily as other lands. This philosophy, if adopted, would enhance many other First Nation initiatives such as good governance and accountability. It would help ensure that taxpayers get the most out of public investments in child welfare, training and infrastructure.

Socio-economic disparities on First Nation lands are well documented. What is less well understood is that these disparities are more a result of the market not working than of inadequate public funding. Increased funding must be part of the solution but unless the costs of facilitating investment on First Nation lands are reduced, socio-economic disparities will remain and the taxpayer will be shortchanged on public investments.

The 2005 ITAB Pre-Budget Submission outlines initiatives that will reduce the costs of investment facilitation. These initiatives will create a powerful incentive structure for improving governance and accountability regimes. These initiatives are not an alternative to program spending. First Nation conditions clearly warrant increased program spending in education, social assistance, infrastructure, training, housing, and health. However, these initiatives will ensure that new program spending treats causes and not just symptoms.



Canada's Productivity Challenge and First Nations

Canada's society is aging. In the future we will have relatively fewer workers to support higher pension and health care costs. If we are to maintain or improve our quality of life we must improve productivity.

For the most part, improving productivity means facilitating market adjustment. The huge populations of China and India are emerging as competitors and also as markets. We cannot compete with their low cost of labour, nor should we try. Canada's challenge is to facilitate the movement of labour and capital to higher valued aspects of production where we will be able to compete. If we meet this challenge, we will improve our productivity and also safeguard our standard of living and our social infrastructure. The Budget decisions of the next few years will determine whether we meet this challenge. Getting public investments and regulations right is an important part of facilitating market adjustment.

Adjusting to the new global realities is important. However, there is another aspect of improving productivity that we cannot ignore. First Nations people are both the fastest growing and most underemployed component of our labour force. If these facts continue to prevail, not only will First Nation people suffer, but the living standards of the entire country will also be compromised. Creating opportunity for First Nations must be an integral part of our strategy for improving productivity.

However, the productivity challenge for First Nations is not one of "*market adjustment*" as it is in the rest of the country. It is one of "*allowing the market to work*". The stark truth is that private investment is not happening on First Nation lands. That is why socio-economic disparities have emerged and federal programs have not been able to remove them. Until private investment can happen on First Nation lands, these disparities will prevail and public investments will be relatively ineffective.

Market Failure on First Nation Lands

The future of First Nations is bleak if market failure continues. An aging society will put large and growing demands on the public purse which will slowly but surely, crowd out programs for First Nations. Canada's future will also be compromised. With shrinking public investment in First Nation economies, First Nation persons will increasingly have to look to urban centers for new employment opportunities, access to adequate social programs which in turn will create significant stress on Canada's social safety net.



The market failure on First Nation economies has happened because the **Indian Act** effectively legislated us out of the Canadian economic union. The **Indian Act** effectively made it impossible for people on reserve to leverage their assets and to invest with confidence. This Act made it very difficult for a First Nation government to take measures that created business opportunities.

While the **Indian Act** created the problem, just changing the Act will not alone bring First Nation people back into the economic mainstream. First Nations have not participated in the economy for many years and so many of the systems that supported the market have broken down. These systems are taken for granted in other contexts but must be re-established in First Nations. Only then will the investment market operate properly. Moreover, reestablishing the investment market is not enough. Measures which allow First Nation people to take advantage of the business and job opportunities this creates are also needed.

There are three types of problems therefore three types of initiatives are required. The first would reverse the original sources of market failure. The second would restore systems that have atrophied as a result of market failure. The third would give First Nations people the ability to take advantage of the opportunities created by re-establishing the market.

Structural Causes of Market Failure

1. Poor Infrastructure

Most First Nations must undertake infrastructure improvements before they can even begin to attract business investment. Existing infrastructure is generally not of a standard that will meet the insurance requirements of business. The problem is that government policy has been to generally not fund infrastructure to the standard required by business and most First Nations have been unable to access the capital required to make improvements themselves.

2. Uncertainty about Land Tenure

The existing system of First Nation land tenure has made it difficult to provide investors with the certainty they require. They cannot be certain about their rights over the land they are using.

3. Land Use Uncertainty

There is considerable uncertainty about land use. Investors have difficulty getting assurance that they will be able to use the land as they wish. They also need assurance that land use on adjacent lands will also be consistent with their interests.

4. Poor Access to Capital

Most First Nation governments have poor access to capital. They are subject to higher rates, higher collateral requirements and shorter pay back periods, if they can access capital at all. They face considerably higher administrative resources required to secure a loan. The result is that financial requirements for project viability are significantly higher.

5. Lack of Local Decision Making

Investors report that there are significant lags in decision making time in a First Nation context. Approvals and decisions are often slow because input is required from the Department of Indian and Northern Development (DIAND). The result is an inability to respond in an appropriate and timely fashion.

6. Stove Piping of Programs

Program restrictions have inhibited the ability of First Nations to design programs that best meet local circumstances and respond to local opportunities. In the case of infrastructure, this has often prevented funds from different sources being combined for maximum effect.

7. Jurisdictional Uncertainty

Jurisdictional disputes between governments continue to create uncertainty for investors in a First Nation context.

8. Balkanization of Policies and Procedures

There are over 600 First Nations in Canada. Many of these have developed unique policies and administrative procedures. This has made it difficult to develop a First Nations public service with transferable skills. It has also made it difficult for investors to specialize in First Nation investments because knowledge is not readily applicable.

Derivative Causes of Market Failure

1. Limited administrative expertise

First Nation administrations have not developed significant investment facilitation administrative expertise. They generally do not have enough resources to maintain this in house. Also, there is little quality training, and there is a lack of opportunity.

2. Absence of supportive policies and procedures

Most First Nation administrations have not developed the supportive policies, procedures and regulations that are needed to support business and investment proposals. There is a danger of substantially different policies emerging in different First Nations. This would inhibit the development of specialized invest expertise

3. Insufficient tools

Many of the financing tools used to support infrastructure developments in other contexts have not been developed for use in a First Nation context.

4. Reputation

Many investors are reluctant to do business on First Nation lands. Most First Nations have little or no record in doing business which creates a perception of risk. Investors often attribute events in one First Nation to all First Nations and as a result, they often inflate their estimation of the risk.

5. Lack of investment specialists

There are few investors who have developed the specialized knowledge required to identify opportunities and close deals in a First Nation context. The lack of harmonized rules and administrative procedures contributes to this problem.

6. Poor Quality Information

Most investors have a difficult time acquiring the basic information they need to support an investment decision concerning First Nation investments. Information about land status, public finances and basic business data is hard to acquire and investors often lack confidence in it.

7. Diminished Expectations

Many First Nation children grow up without exposure to job opportunities, business opportunities or even people who work. The absence of positive experiences leaves them permanently handicapped in taking advantage of opportunities later in life.

Inability to Respond to Market Opportunities

1. Limited Business Capital

Investment brings business opportunities. However, in order to take advantage of these opportunities, people need access to capital. Potential First Nation entrepreneurs do not have equitable access to capital. Even if problems regarding security and collateral on reserve are resolved, this issue will remain. A principal source of the problem is the lack of home equity and of a lending history.

2. Ineffective Training

In the past training was often touted as the answer to First Nation unemployment. It was however less effective because employment opportunities were scarce. Investment will bring job opportunities. However, in order to take advantage of these opportunities, training must be coordinated with local opportunities. Training requirements have grown more specialized over time and can best be understood from the local perspective.

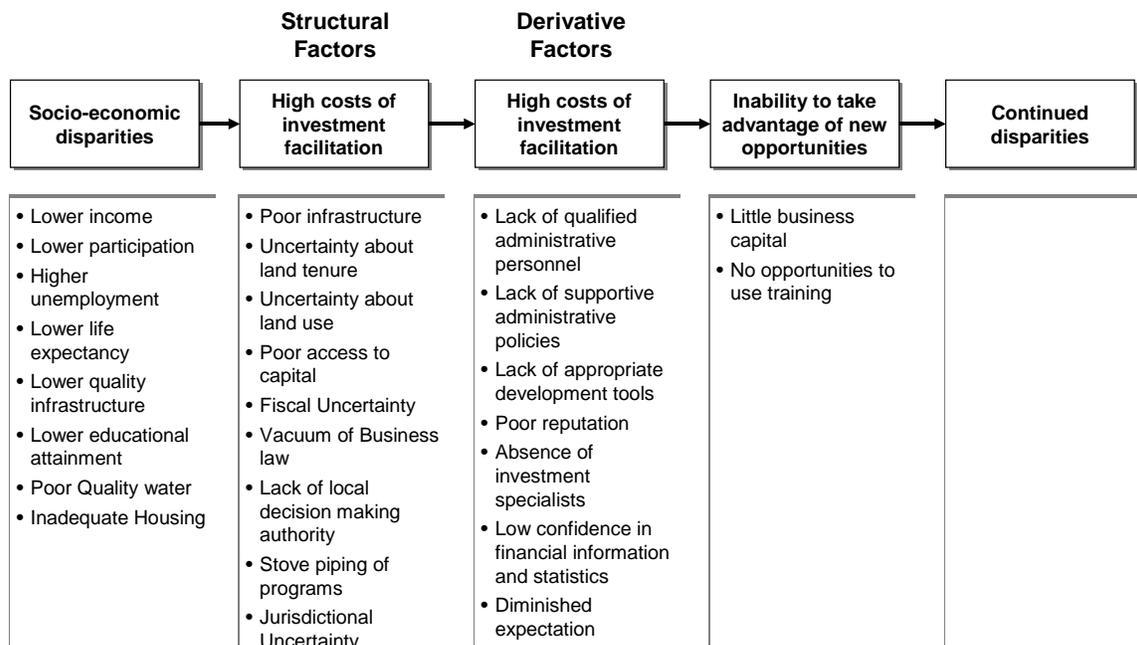


Figure 1: Three types of barriers preventing First Nations from participating in the Canadian economy

The Good News

The failure of the investment market on First Nation lands has been a social and economic disaster for First Nations. It has been a fiscally expensive problem for the federal government with implications for federal-provincial relations and the sustainability of the social infrastructure. However, recent developments suggest that governments have now begun to come to grips with this issue.

- The recent passage of the FSMA will address some of the principal sources of market failure: (a) Poor access to capital; (b) investor uncertainty regarding tax treatment on First Nation lands; (c) investor uncertainty regarding service provision on First Nation lands; (d) the lack of administrative personnel with an understanding of economic development; (e) the lack of policies that support economic growth; (f) the lack of appropriate tools; and, (g) a lack of confidence in statistics and financial information coming from First Nation lands.
- The **First Nations Land Management Act** has created the power to begin addressing some investment uncertainty concerning land use on First Nations. It will allow First Nations to significantly shorten land use approval processes and provide investors with more certainty about land use.

- The potential passage of the **First Nations Commercial and Industrial Development Act** will provide one way to begin addressing the vacuum over business law, which is currently inhibiting investment.

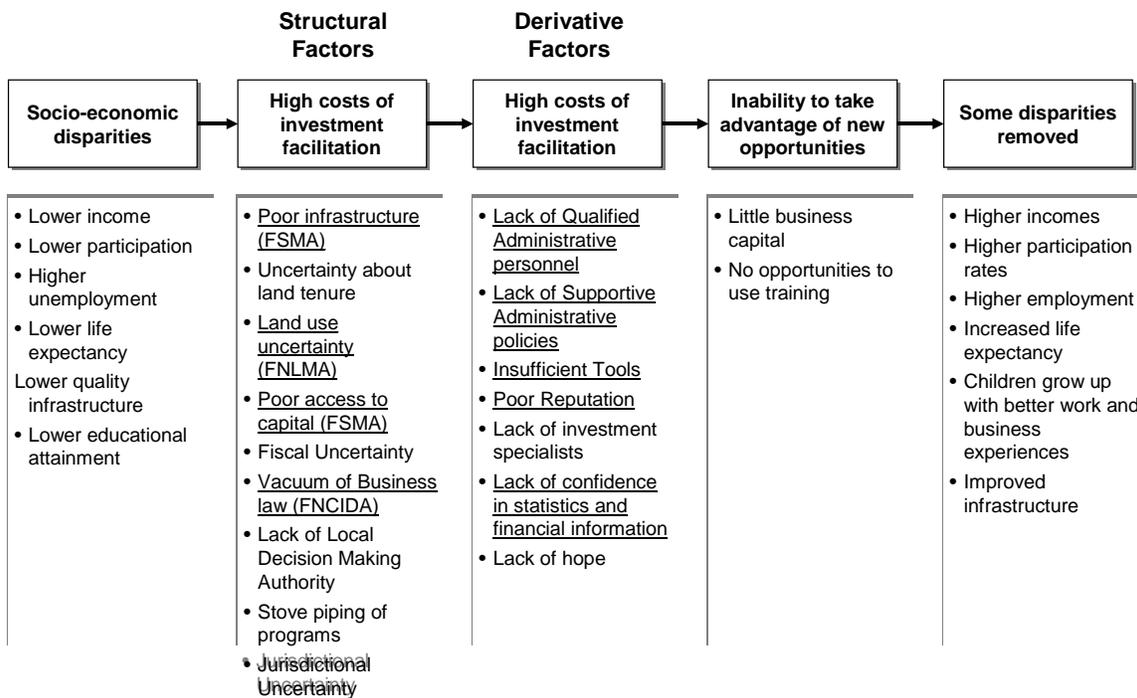


Figure 2: Figure 2 underlines aspects of the investment market failure that could be addressed by the FSMA, FNLMA and proposed FNCIDA.



ITAB Proposals

The accountability goes further in terms of creating transparency and promoting the rights of member and non-member taxpayers than any First Nation initiative. A large part of the reason it was created is that ITAB has developed credibility within First Nations.

ITAB has developed this credibility through a long history of assisting First Nations. It has developed tax systems, provided support in bylaw development to promote the reputation of these tax systems. It has brokered important service agreements between First Nations and adjacent jurisdictions. It has worked with First Nations and represented their interests in order to resolve disputes with the railways and other governments. It has consistently offered quality training to enhance administrations. The proposals listed below can work. However they must draw upon the credibility and trust that ITAB has developed with First Nations. They must draw upon the knowledge and awareness that has developed within these same First Nations.

These proposals would address all three problems that prevent First Nations from sharing in the benefits of private investment.

Establish the FNTC as a Special Delivery Agency

The FNTC will replace ITAB when the FSMA comes into force. If needed policy change is to be embraced by First Nation Administrators, it is essential that the FNTC retain the legacy of ITAB and *continue* to be seen as a First Nation institution. The FNTC will need to draw upon its legacy to help First Nations develop policies and administrations that support private investment. In order to do this, the FNTC must be perceived as a credible and independent First Nation institution.

We are therefore recommending that ITAB, and the other FSMA institutions, be established as special agencies. These institutions should be placed outside the normal Departmental hierarchy. As special agencies, the FSMA institutions would be bound by a mandate and subject to review with respect to important performance measures. However, they would also be free to divert resources from their relationship with the DIAND towards their relationship with First Nations.



The establishment of First Nation special agencies would provide a clear signal to First Nations that it is not business as usual and that the FSMA institutions must be viewed not simply as creatures of DIAND advancing an agenda of transfer control. The FSMA institutions are vehicles for economic development and forums within which First Nations can confidently explore their collective interests in improving their investment climates.

Sales Tax

Many First Nations with economic potential are unable to tap into it. They have insufficient revenues to participate in a debenture issue and have no other means of improving their infrastructure. Some of these First Nations would be able to finance infrastructure if sales tax revenues were brought within the regime established by the FSMA. A sales tax account could be administered much like a property tax account.

Bringing First Nations with sales tax revenues into the FSMA regime would also mean that expenditures made using these revenues would be subject to the same requirements for financial administration laws as property tax. Obligations against sales tax would be deducted from any calculation of borrowing room available from sales tax revenues. This would not only accelerate the development of infrastructure, would also extend the accountability regime of the FSMA. The extension of this accountability regime would serve the goals of good government and also encourage First Nations to develop sales tax collection agreements. It would provide reassurance to members that sales tax revenues would be used to the benefit of all the membership.

Infrastructure Program

First Nations face several disadvantages compared to non-First Nation communities when developing economic infrastructure:

- Economic Infrastructure Planning – First Nation physical development plans, unlike other communities, do not include economic infrastructure requirements. This lack of planning can result in economic infrastructure that is inadequate or overbuilt on First Nation lands.

- ❑ Coordinating Financing – Non-First Nation communities can coordinate their sources of infrastructure financing so that different streams can be combined. This is more difficult for First Nation owing to infrastructure financing program restrictions and requirements.
- ❑ Assistance for Small Communities – Small non-First Nation communities have generally received assistance from larger governments in order to meet the thresholds for undertaking those initial infrastructure improvements that were needed to attract business investment. First Nations have not had the same benefit. As a result, many First Nations with significant economic potential are unable to realize their potential.

A dedicated infrastructure program would help solve these problems. If properly designed it would provide the following benefits:

- ❑ It would increase the number of First Nations able to utilize the services of the FSMA.
- ❑ It would provide a means for ensuring that economic infrastructure is included in community plans.
- ❑ It would make it easier for First Nations to coordinate different types of funding and realize maximum efficiencies.
- ❑ It would allow the federal government to receive a higher rate of return from its own investments into First Nation lands.
- ❑ It would bring more First Nations under the FSMA accountability regime.
- ❑ It would help put underemployed First Nation resources to work.

A program should be designed to work with the borrowing regime created under the FSMA. For example, a program could require First Nations to commit their existing or potential property tax room, net of service obligations, to cost share the infrastructure. In this way, it would allow First Nations with significant potential to begin utilizing that potential. ITAB and its successor the FNFC would be able to calculate First Nation contributions. This would ensure that only quality proposals are received. ITAB and the FNFC would also be able to provide assistance to ensure that any infrastructure constructed is the best match for the economic and community needs of the First Nation.



Provincial governments have established precedent for such programs. Many small communities were locked in the same infrastructure trap that presently afflicts First Nations. Provincial governments helped them out of this trap by providing program funds for initial infrastructure improvements.

The participation of ITAB would ensure high rates of return are earned from infrastructure investments. The FNTC could help direct these investments to their highest use. It can ensure that funding does not simply subsidize what would have taken place in any case, and it can direct investments towards areas with the highest potential.

Land Registry

First Nations need their own land registry system. A land registry system would create greater certainty over land title. Currently, investors are deterred by the length of time required in title searches and the scope the existing system creates for disputes.

A First Nations land registry would be a natural complement to ITAB. It would allow it to more easily support First Nations in investment facilitation. It would also allow it to register property tax liens against land. This would help prevent and resolve disputes.

Open Market Housing

The development of First Nation lands under the FSMA will create job and business opportunities. However, many First Nation persons are unable to take advantage of these opportunities because they have been unable to access the capital needed to start a business. Home equity is a traditional source of funding for private businesses and a big part of the problem is that First Nation persons have not been able to develop equity in their homes.

ITAB is proposing that it work with the federal government in developing open market housing on First Nation lands. If open market housing was supported by a proper land registry, it would allow First Nation persons to profit personally as well as communally from investments made through the local tax system. We estimate that open market housing would create up to 600 per cent more personal equity than is possible under the existing system. This would give First Nation persons a powerful leg up from which to pursue business opportunities created by the FSMA.





This type of housing program would be the most cost effective means of addressing the shortage of housing on reserve lands. We estimate the federal government could develop four times as much housing for each dollar of expenditure by using an open market system over the existing system.

Finally, an open market housing program would create four direct and indirect jobs for each house built.

First Nations School of Taxation

Private investment requires supportive government policies and administrations. Non-First Nation jurisdictions have benefited from a long history of investment facilitation and a supportive educational infrastructure. As a result, they have developed a sound pool of investment facilitation expertise.

First Nation administrations face a different situation. First, the art of investment facilitation requires a different skill set in a First Nation context. Second, there is a much more limited body of people with the requisite experiences and skills. Third, the education system does not train First Nation administrators the skills they need to develop a good investment climate and facilitate investment.

ITAB wants to fix this problem. We have developed a training curriculum that stresses some of the skills needed for investment promotion and facilitation. When the FSMA comes into force there will be a need to significantly expand these offerings, particularly in the area of capital management. The development of the First Nations School of Taxation will allow the FNTC, the successor to ITAB, to work with other agencies and make this training available to First Nations all across the country.



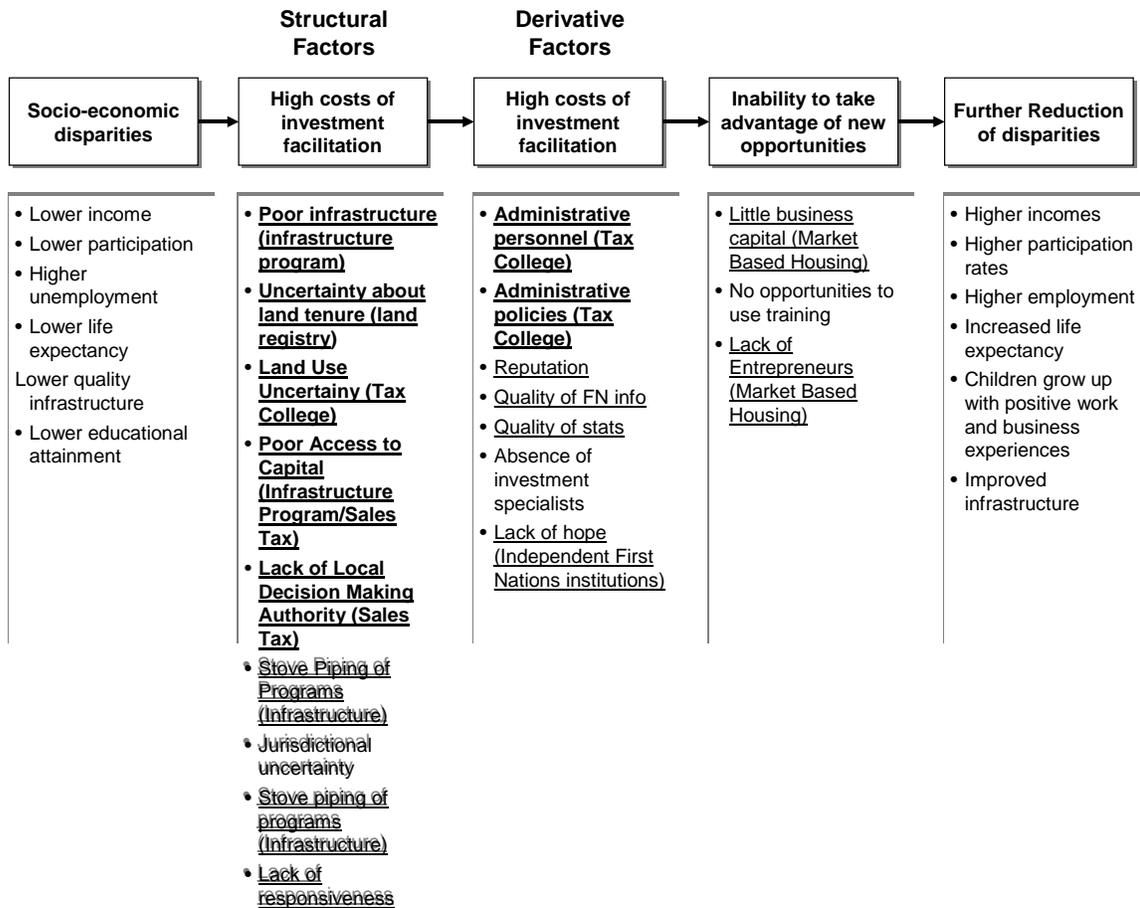


Figure 3: Figure 3 underlines or bolds additional improvements to the investment market on First Nation lands that the ITAB proposals would create.

Appendix – Reducing Investment Facilitation Costs is the Key to other First Nation Goals

The ITAB proposals will increase the number of First Nations that can participate in the debenture process under the FSMA. They will accelerate the development of infrastructure under this program. They will enhance the ability of First Nations to attract investment. They will improve the ability of First Nations to take advantage of the business and job opportunities that private investment provides. In short, these proposals will put the most powerful force for economic growth, private investment, to work on reducing First Nation socio-economic disparities.

However, removing impediments to private investment will serve other goals besides reducing socio-economic disparities. Their reduction will: (a) help improve First Nation administrations; (b) help improve First Nation statistical information; (c) help guide policy development; (d) improve accountability regimes; (e) create the basis for better relations among governments; and, (f) enhance Canada's international stature and provide a model for improving federalism throughout the world.

The role of the FSMA in supporting these goals is outlined below.

Accountability and Governance

The role of the FSMA in improving access to capital appears to be well understood. However, there is another aspect of the FSMA that is less well appreciated. The First Nations that participate in the FSMA initiative have developed a comprehensive system of accountability that will go well beyond that which was envisioned in the failed First Nation Governance Act. The accountability regime includes mechanisms to ensure that all interests are heard in policy development and have access to recourse and dispute resolution. It includes a requirement for sound financial management and reporting. It includes monitoring and enforcement by institutions that are independent of First Nation administrations.



The accountability regime created under the FSMA is a significant achievement. It is significant because it is probably the most comprehensive system developed in a First Nation context. It was developed to meet bureaucratic requirements but to meet First Nation interests. It was developed in response to the opportunities that the FSMA creates; the opportunity to access capital, and the opportunity to attract investment.

The logic of the accountability regime is as follows: first, the FSMA has created the ability for First Nations to collectively pool their property tax revenues and issue debentures based upon these. Second, the ability to issue debentures has created a powerful incentive to develop the institutional backstop that credit rating agencies want to see. Third, the ability to collectively issue debentures creates a joint liability and this will create a culture of compliance and cooperation within participating First Nations. They will expect one another to live up to all the provisions of their accountability regime. This is quite a different environment from that which results from attempts to impose an accountability regime. Fourth, the FSMA creates a connection between the extent of the accountability regime and quality of life on the reserve. This connection has been historically lacking. However, under the FSMA, improved accountability provides better access to capital and more economic development. Economic development in turn provides a better quality of life for First Nation members. The enhancement of the connection between accountability and quality of life will, in time, create some realignment of political priorities within participating First Nations.

Inter-governmental Cooperation

Improving investment facilitation will create incentives for improved cooperation between First Nations and other governments and also between First Nations and third parties. The ITAB proposals will make it easier to ensure First Nations share in the downstream investment that results from investment projects on their traditional territories. This creates a greater stake in concluding accommodation agreements.



International Stature and Improved Federalism

The development of self-government within an institutional framework is the key to meeting the unique aspirations of Canada’s First Nations without compromising the goals of the federation itself. Institutions provide a means for developing economies of scale, administrative harmony and a logical interface with the federal government. This model is an important model for democracy in the 21st Century because so many of the world’s problems are rooted in the aspirations of minorities, particularly indigenous communities for some degree of self-determination.

Summary of ITAB Proposals

Proposal	Benefits	Cost
FNTC as Special Delivery Agency	<ul style="list-style-type: none"> Greater regulatory efficiency Clear signal of transformative change 	No Cost
FNTC mandate to include sales tax	<ul style="list-style-type: none"> More First Nations collecting sales tax Regulatory structure for First Nation sales tax systems Use of sales tax for debentures 	No Cost
Infrastructure Program for FSMA First Nations	<ul style="list-style-type: none"> More First Nation economic infrastructure More investment on First Nation lands More First Nation independent revenues More First Nations using FSMA institutions 	\$125 million over 5 years
Land Registry	<ul style="list-style-type: none"> Higher First Nation land values Fewer disputes relating to land title 	\$10 million over 3 years
Open Market Housing	<ul style="list-style-type: none"> Home equity and wealth transfer Opportunity to finance businesses Four times as many homes built compared to social housing No on-going maintenance costs 	\$250 million over 5 years
First Nations School of Taxation	<ul style="list-style-type: none"> Transfer investment facilitation technology, models and administrative practices Certify First Nation tax administrations Accredited through universities 	\$2 million over 5 years